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THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

cc: Baird
McCarthy
Singh
Schmidt-Hebbel

DATE: January 10, 1994

TO: DISTRIBUTION

FROM: Zafer Ecevit, Acting Director, EA2 Z.H.E.

EXTENSION: 84072

SUBJECT: CHINA CSP - Minutes of the President's Review Meeting

1. Attached please find the minutes of the President's Review Meeting, chaired by Mr. Sandstrom on December 3, 1993.

Attachment

DISTRIBUTION:

Messrs./Mmes. Preston, E. Stern, Sandstrom, Kalantzopoulos (EXC); Shihata (LEGVP); Linn (FPRVP); Eccles (CTRVP); Jaycox (AFRVP); Kaji (EAPVP); Wood (SASVP); Thalwitz (ECAVP); Husain (LACVP); Koch-Weser (MNAVP); Bruno (DECVP); Kashiwaya (CFSVP); Rajagopalan (OSPVP); Messenger (PAAVP); Ryrie (CEX); Iida (MIGEX); Ray (DPG), Thahane (SECGE); Rischard (FPDVP); Serageldin (ESDUP)

EA2 Management Team:

Messrs./Mmes. Kimura, Cardoso (EA2DR); Goldberg (EA2AG); Newfarmer (EA2IE); Stott (EA2TP); Bhargava (EA2HR); Sierra (EA2EU); Bottelier (EA2CH)

SJBurki: eca

CHINA COUNTRY STRATEGY NOTE:
Minutes of Meeting, December 3, 1993

China country strategy note was discussed in a meeting chaired by Mr. Sven Sandstrom. The meeting was held on December 3, 1993 and was attended by Messrs Kaji, Burki and Bottelier.

The meeting opened with three statements by the region. Mr. Kaji said that China had been successful in pursuing the gradualist approach to reform. The country had covered some significant distance in moving toward market, including the reform of the state owned enterprises. In view of the experience of East Europe and countries of the former Soviet Union, Mr. Kaji thought that the Chinese paradigm was the only one that had established a record of success.

Mr. Kaji reminded the meeting that the question of World Bank lending to state owned enterprises was discussed at length in June 1992, at a meeting chaired by Mr. Preston to discuss the Country Strategy Paper. The 1992 CSP discussion had led to the preparation of a strategy paper on World Bank lending for enterprise reform. The region's approach was approved by the President.

The region was now proposing to adopt a somewhat different approach toward SOE lending. The focus will be on creating a supporting environment within which enterprises could be restructured and reformed.

Mr. Bottelier spoke about the problem created by the rapid urbanization of China's cities, particularly those along the coast. The rapid development of the industrial sector, increased government support of the service sector, and the easing of controls on rural-urban immigration had brought about an explosive growth of cities. Mr. Bottelier thought that China's rapid urbanization offered an opportunity for the Bank to undertake both analytical and lending work.

Mr. Burki provided an update on the economic situation in China indicating that the 16 point program of stabilization and structural reform adopted by the authorities in July had checked the rate of increase in inflation and reduced the rate of growth in investment. He also summarized that main features of the comprehensive economic reform program adopted by the Communist Party in a meeting held in mid-November. The program aimed at bringing about a profound structural change in the Chinese economy by addressing the problems posed by non-performing state owned enterprises, a financial sector that had not developed to keep pace with the real sectors of economy, a fiscal system that had resulted in reducing the share of central government in public revenue, and a monetary system over which the central bank had only a weak control. While the program was comprehensive in scope it was by no means clear that political will had developed for implementing it fully. It was probably to win political support for the program that Beijing had allowed some relaxation in monetary controls. That was a worrying development, one toward which Mr. Kaji had drawn the attention of a number of senior leaders during his recent visit to China.

A number of comments were made on both the CSN and the evolving economic situation in China. A speaker indicated that while it was not difficult to be impressed with China's economic performance in recent years, the region should develop a "low case" based on its assessment of downside risks. A number of speakers wondered whether it was an appropriate strategy for the region to commit a sizeable proportion of Bank's lending to assisting state-owned enterprises. One speaker, taking a different view was of this opinion that the Bank cannot afford to ignore the state sector but should be closely involved in clearing an enabling environment for the reform of SOEs. The objective of these reforms should be to commercialize these enterprises, to eliminate efficiency loss caused by them. Another speaker emphasized the need for developing the legal structure in China without which it would not be possible to successfully move toward market.

There was a brief discussion of the size of the lending program proposed by the region. It was indicated that on the basis of current projections of overall IBRD lending envisaged over the next decade or so, the region's program for China would exceed exposure limits in the first dace of the 21st century. The chairman indicated that, in the medium term, more attention should be given to ensuring that exposure limits not be exceeded. It was agreed that this can be handled in a low key and pragmatic manner over time. This would also help ensure that "headroom" is preserved to assist China if other sources of finance fall away. It was also noted that the scaling down of IDA lending planned by the region was appropriate.

In summary, the meeting concluded that:

- while the region's analysis of the Chinese economic situation was appropriate, the CSP, to be prepared in 1994, should examine down-side risks and factor them in lending program projections;

- the lending program proposed by the region, including the allocation for IBRD and IDA was appropriate; and

- it was correct for the region to shift emphasis from direct lending to SOEs to the creation of an enabling environment for the reform and restructuring of state enterprises.

c:\wp51\Burki\China.CSP

8396

The World Bank
Washington, D.C. 20433
U.S.A.

SVEN SANDSTRÖM
Managing Director

93 DEC 20 AM 4:58

File

December 17, 1993

Mr. Gautam Kaji

China: Country Strategy Note

As we discussed, the overall strategy set out in the CSN is appropriate. Close attention will be paid to the implementation of our assistance strategy for reform of state-owned enterprises, which was prepared earlier this year, to ensure that our assistance does not unintentionally perpetuate or introduce distortions that work against the private sector.

The proposed FY94-96 lending program, including the phase-down of IDA, is endorsed. Beyond this period, attention must be given to the program to ensure that exposure limits not are exceeded around the turn of the century.

As we also discussed, there are certainly grounds for optimism with regard to China's economic performance. However, macro-economic developments must be followed closely and we should continue to provide intensive analytical support to Chinese officials in their efforts to avoid a "hard landing".

cc: Messrs. Preston, Karaosmanoglu, Stern, Bruno, Choksi, Husain, Jaycox, Kashiwaya, Koch-Weser, Linn, Rischard, Serageldin, Shihata, Thalwitz, Wood, Ryrie, Iida, McHugh, Burki,
Mmes. Fox, Kalantzopoulos

=) China CSP

The World Bank/IFC/MIGA
O F F I C E   M E M O R A N D U M

DATE: December 6, 1993 08:46am

TO: See Distribution Below

FROM: Mark Baird, DECVP (MARK BAIRD)

EXT.: 31666

SUBJECT: China CSP Updating Memorandum

The review of the China CSP Updating Memorandum, chaired by Sven Sandstrom, was held on Friday. The discussion focussed on the following issues:

- Enterprise reform. The Region reported that there had been progress on the legal basis for privatization and bankruptcy. The Government was considering liquidating some public enterprises.

- Macro policy. The Region took the view that inflation was under control and the prospects were good for a soft landing.

- Downside scenario. The Region noted that a downside scenario had been presented in last year's CSP and this would be done again next year. The base case was described as "guarded optimism". The major downside risks were political, including the risks to national unity.

- Bank lending. The Region confirmed that they would not lend for projects (eg in the infrastructure sector) when private financing was available.

DISTRIBUTION:

TO: F. Desmond McCarthy (F. DESMOND MCCARTHY)
TO: I.J. Singh (I.J. SINGH)
TO: Klaus Schmidt-Hebbel (KLAUS SCHMIDT-HEBBEL
TO: Shahid Yusuf (SHAHID YUSUF)
CC: Michael Bruno (MICHAEL BRUNO)
CC: Phi Anh Plesch (PHI ANH PLESCH)

THE WORLD BANK/IFC/MIGA
OFFICE MEMORANDUM

Mr.
pl. file
with CSP.

DATE: December 3, 1993

TO: Mr. Ernest Stern

FROM: Michael Bruno MB

EXTENSION: 33774

SUBJECT: China: ECO for Yangzhou Thermal Project

We have no objection to the proposed ECO guarantee, to facilitate commercial financing of the Yangzhou Thermal Power Project.

We have not seen any documents on the proposed Bank loan of $350 million. At today's meeting on the China CSP, the Region indicated that it did not intend to lend for projects where private financing was available. Why is that not the case for this project?

cc: Messrs. Sandstrom
Baird
McCarthy

- 5 -

CHINA CSP MTG NOTES 12/3/93

Gradual approach has paid
multiple firm
non-state sector

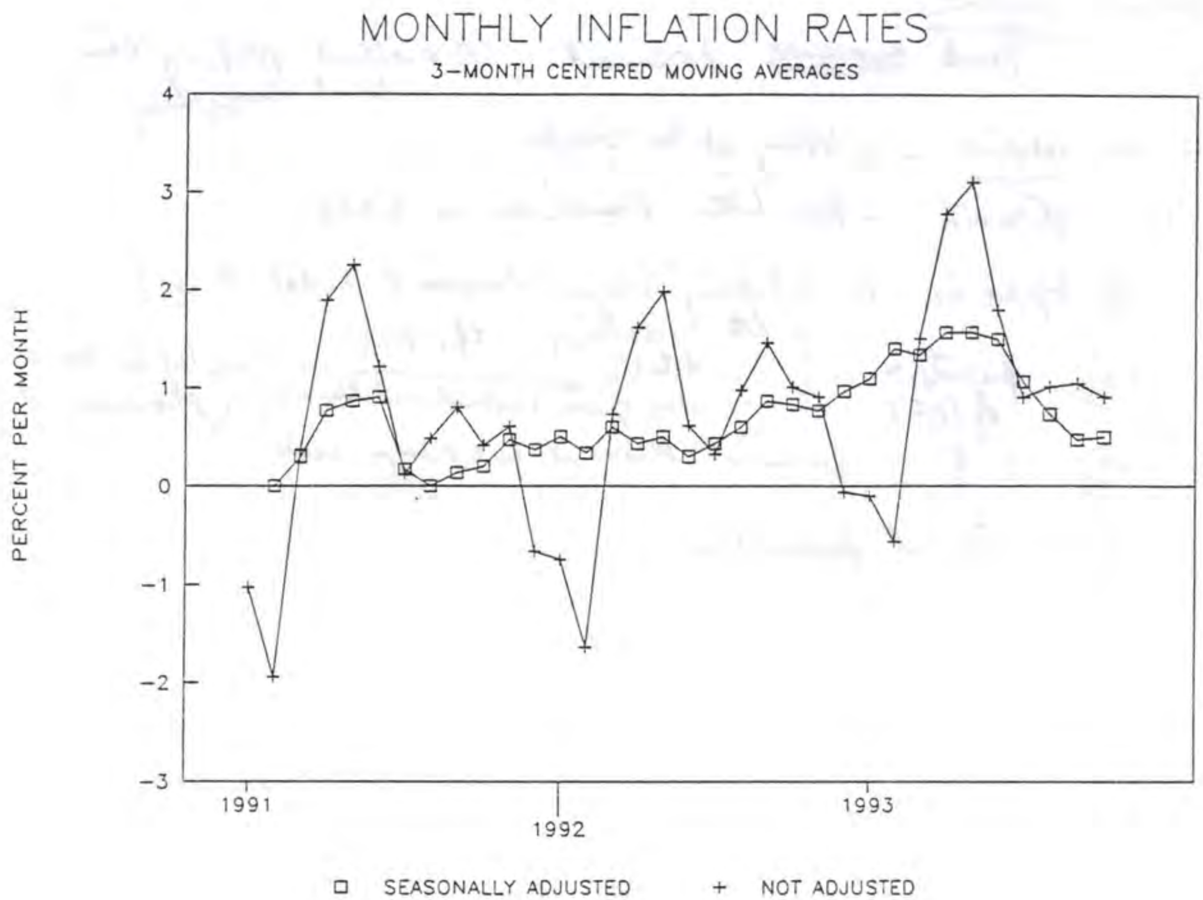
~~not~~ an/ ideological issue.

Jane Burki: They will have a soft landing - learnt the experience from the past - Enlarge instruments, cool off speculative sector.
Recent congress cannot be overestimated. As important as 1970.
Fundamental important change in market sector:

① SOE at the heart of the economy - heart of reform -
?.| large scale corporatization - dilution of shares
② Distance between Govt + management -
having social sec. for enterprise
③ limited privatization.
must clean much from ~~[illegible]~~ enterprises. restructure
+ then offer them for privatization - giving these but
will not say so openly
④ Commercialize housing by 2000
⑤ FDI - encourage into transport + power sectors
- also to inland
⑥ Financial sector (main Bank there) - taken fundamental decision.
Policy lending to banks. Devt Bank
genuine Central Bank
⑦ Fiscal reform (FT yesterday) - mind boggling
Jan. 1. uniform tax base, level-playing field + central tax service
Not yet expenditure assignment reform.
⑧ Trade - reduction in tariffs
+ unification of ex. rate (6-12 months?)
Also oil, coal, etc...

Answer to ..

- labour reform
- separation of social services.
- financing
- provision for exit



	GDP Growth		Industrial Output	Urban Cost of Living
First quarter	14.0%	May	27.3%	19.5%
Second quarter	14.2%	June	30.2%	21.6%
Third quarter	13.3%	July	25.1%	23.3%
Fourth quarter	12.0%	August	23.4%	22.2%
1994	13.2%	September	19.1%	20.7%
		October	16.3%	

General reaction.
Good ~~comment~~ document, excellent synth. of many mind-boggling

Comments are relative - nibbling at the fringes.

Too optimistic - too little shade across fields

(1) Agree to π not being a/major danger (a rel. to g)

(2) privatization of SOE's { - elite ideology - cf. mult. - dilution - why give indument lending } no legal basis / shedding of labour.

(3) C.B. + financial sector + f. exchange contr.

(4) Final: Fiscal federalism

China

- SOE Reform
- Fiscal decentralization
- C.B. & financial sector
- fragility
Excess M expansion
- overheating
- IDA ↓ & poverty / social
- Infrastructure bottlenecks

piece on enterprise reform pp. 9-10
is not clear. likewise pp 13-15

Terms corporatization & marketization
not clear in China context.

What is the ?? of 10% p.20?
(Also) whether need to ?? less one to IMF?
MACRO? SOE?

SS/LP

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

Office of the President

December 2, 1993

To: Distribution

Attached for your information are the Issues for Discussion of the China Country Strategy Paper. The review meeting will be held on Wednesday, December 3 at 2:30 p.m. in the Conference Room in E-1227.

Orsalia Kalantzopoulos

Orsalia Kalantzopoulos

Attachment

Messrs.	Preston, Sandstrom, Karaosmanoglu, Stern, Bruno, Choksi, Linn, Kaji, Rischard, Serageldin, Shihata, Ryrie, Iida, McHugh, Burki
Ms.	Fox

CHINA -- COUNTRY STRATEGY PAPER

President's Review Meeting Agenda

Friday, December 3, at 2:30 p.m.

The Macroeconomic Framework

1. Reforms underway in the monetary and fiscal areas have brought about some improvement in macroeconomic demand management. However, fiscal accounts remain weak, and the quasi-fiscal deficit persists, as macroeconomic management continues to rely on administrative measures rather than indirect instruments and austerity measures are frustrated by opposition from the public enterprise sector.

- Is the pace of reform appropriate to avoid macro instability and a hard landing in the near term? What are the principal macroeconomic risks at this stage?

- Can the proposed reform of center-local fiscal relations, which are the core of long term fiscal reform, be carried through?

The Structural Reforms

2. Examples from around the world demonstrate that ownership does matter. Yet, the China strategy implies that public enterprise reform could be achieved through corporatization and marketization.

- Will corporatization measures, without fundamental change in ownership, be sufficient to achieve financial discipline and increase efficiency in the public enterprise sector?

- How will the slow progress in privatization affect the viability of China's long term macroeconomic performance and structural reforms?

3. Labor reform is a crucial corollary of public enterprise reform.

- What are the principles guiding fixed-term labor contracts for enterprise workers?

- What practical progress is being made in housing and pension reform and how does this affect the pace of enterprise reform?

4. Trade and exchange reform are parts of the reform agenda.

- What is the status of the dialogue in trade reform and exchange parity unification?

The Composition of Bank Lending

5. China has received good commercial risk ratings and as a result has become a major recipient of private capital inflows in the past few years.

- How can the Bank complement and support rather than crowd out private investment in infrastructure, oil etc. where the Bank is expected to be an active lender?

- Would it be more appropriate to limit Bank investment lending to projects with long gestation periods that may not easily attract funds from other sources, and/or in areas of regulatory policy reform?

6. The CSP advocates a continued strategy of minimizing the role of public enterprises. Yet, Bank lending data seem broadly inconsistent with the stated strategy, with the Bank in part financing the government's expansion of public enterprises while an adjacent private sector develops on its own, largely without Bank support.

- Is this a correct interpretation of the data? Is the Bank's program consistent with the stated strategy of containing the public enterprise sector?

7. China currently has a very low rate of private automobile ownership. Nonetheless, congestion is high in the cities and major arterial highways.

- How should the Bank advise the government in dealing with the difficult choice on whether to promote or constrain the potentially rapid growth in private automobile ownership?

Access to IDA and IBRD Exposure

8. The IDA lending volume for FY95-96 is proposed under the current LAR at 780 million SDR. Even though China's inflows of private capital has continued to swell, IDA financing plays an important role in human resource and rural development in China's poorest regions and localities.

- Is the proposed phase-out of IDA lending appropriate?

9. While China's IBRD exposure will not be significantly affected by the decision on IDA, the lending program outlined by the CSP implies that IBRD's exposure to China would rise from 4% in 1993 to about 10% in the year 2000, and would continue to increase after the year 2000.

- Is this an appropriate lending strategy?

CSP HB

A L L - I N - 1 N O T E

DATE: 01-Dec-1993 10:26am

TO: Orsalia Kalantzopoulos (ORSALIA KALANTZOPOULOS)

FROM: F. Desmond McCarthy, DECVP (F. DESMOND MCCARTHY)

EXT.: 31362

SUBJECT: China - CSP Updating Memorandum

1. The Country Strategy Updating memorandum for China raises a number of issues that might be usefully discussed at the President's Review. Following discussion with Michael Bruno, our revised suggestions for the agenda.

SOE Reform

2. We feel that we would like an update by the Region on progress with the SOEs. In view of the discussion at the President's Review of the CSP last year (June 12, 1992) to what extent has the Region been instrumental in contributing to SOE reform through its operations and what progress can be reported.

Macro Situation

3. Presently there is some concern about the overall approach to transition adopted by the Chinese. There are a number of reforms underway in the monetary and fiscal areas as well as in the SOEs. However, fiscal accounts remain weak in part because of the inelasticity of the tax base, in part because of continuing outlays on SOE deficits. In addition to the SOE deficit financed through budget allocation there is also the invisible (quasi-fiscal) deficit which is financed from Central Bank operations. Inflation is now expected to reach 15% this year and the authorities must still largely depend on administrative measures while the SOEs continue to absorb more than their proportionate share of investment funds.

4. Is the pace of reform fast enough to avoid macro instability, and especially the prospect of a hard landing in the near term, and indeed is the overall approach in fact sustainable? What are the main risks the Region envisages at this stage?

Bank Lending

5. Presently China is the main borrower from the Bank. On what basis is it reasonable to continue lending to a relatively successful country at such a level, especially the IDA component? While it is always preferable to see funds being used in a generally effective way would it be more appropriate to channel our lending to: (a) projects with long gestation periods that

may not easily attract funds from other sources--education, health; (b) areas where we can be reasonably effective in improving the policy climate--possibly infrastructure pricing. Is it perhaps less appropriate to lend in such areas as telecommunications, energy and oil sectors?

ESW

6. Would it be possible to have ESW better integrated with the lending program and more forward-looking? In particular could it try to analyze areas for prospective operations? Work is needed to help suggest what type of reforms for the SOEs, for instance may be best in the Chinese context. Similarly the civil service reforms that were tried in Africa are unlikely to be any more successful in China.

7. Would it also be desirable to have some work done on the regional/global implications of further Chinese economic expansion? The effect of Hong Kong integration, expansion of Pacific trade ties, the role of some of the FSU states bordering China (especially in the energy sector), and the implications of Chinese membership in GATT.

CC:	Michael Bruno	(MICHAEL BRUNO)
CC:	Mark Baird	(MARK BAIRD)
CC:	Shahid Yusuf	(SHAHID YUSUF)
CC:	I.J. Singh	(I.J. SINGH)
CC:	Klaus Schmidt-Hebbel	(KLAUS SCHMIDT-HEBBEL)

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DATE: November 30, 1993

TO: Mr. Singh

FAX NO.: ~~60439~~ 60083

FROM: F. Desmond McCarthy

SUBJECT: CHINA CSP

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DATE: November 30, 1993

TO: Mr. Schmidt-Hebbel

FAX NO.: ~~60439~~ 60083

FROM: F. Desmond McCarthy

SUBJECT: CHINA CSP

TRANSMISSION RESULT REPORT (NOV 30 '93 03:12PM)

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DATE: November 30, 1993

TO: Mr. Singh

FAX NO.: 60439

FROM: F. Desmond McCarthy

SUBJECT: CHINA CSP

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SUBJECT: CHINA CSP

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DATE: November 30, 1993

TO: Mr. Singh

FAX NO.: ~~60439~~ 60083

FROM: F. Desmond McCarthy

SUBJECT: CHINA CSP

See attached.

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: November 24, 1993

TO: Mr. Michael Bruno

THROUGH: Michael Baird

FROM: F. Desmond McCarthy

EXTENSION: 31362

SUBJECT: CHINA - CSP Updating Memorandum

1. The President's review of the China CSP is scheduled for Friday, December 3, at 2:30 pm in E-1227. This briefing discusses the current situation in China, the last CSP done in April 1992, and the proposed CSP Updating Memorandum.

2. Further details are provided in: (a) Shahid Yusuf's November 23 memo to Mark Baird; (b) Klaus Schmidt-Hebbel's memo to Lyn Squire of November 12; and (c) I.J. Singh's memo of November 22 to F. Desmond McCarthy. Selected tables from Shahid Yusuf's back-to-office report of November 19, 1993 are attached.

Current Situation

3. **GNP**. GNP grew by 13% in 1992 and even though it seemed to accelerate further in early 1993 it is now projected to result in around 13% for 1993 due to a modest slowdown in recent months. For 1994 a growth rate of 10% is projected. This growth is driven by strong investment demand especially by State-Owned Enterprises (SOEs) but more recently by consumption. Around half of investment is going to real estate.

4. **Public Finance**. Public finances in 1993 on the revenue side continue to have to deal with a relatively inelastic tax base while on the expenditure side the authorities face overruns in administrative spending and large losses of SOEs. The 16-point program calls for cuts in administrative spending, strengthening tax administration, reducing wage bonuses of SOEs and review of capital expenditure.

5. **Monetary**. This is an area of major concern. Inflation is showing signs of increasing to 15% in 1993. Here the authorities continue to be faced by structural weaknesses so that typically they have to resort to administrative measures. In the past this has resulted in a "bang-bang" form of control. Now the intention is to move to more indirect measures so that open market operations might be used to affect interest rates, for example. Presently both the IMF and the Bank are providing technical assistance in these areas. However this needs to be complemented by

market-based measures to control aggregate demand. On the institutional side this would be accompanied by a streamlining of the Central Bank (peoples Bank). Some recent measures to increase interest rates and stricter control of loans for more speculative purposes may preclude a hard landing.

6. **Exchange Rate**. Presently there are two principal rates: (a) the administrative rate; and (b) the swap rate (there is also a blackmarket rate). The differential has decreased from 70% earlier in the year to around 50% at present due to a combination of administrative measures and official intervention. It is now expected that rates will be unified during the coming year.

7. **Investment/Savings/FDI.** In recent years gross national savings rates have been over 35% of GDP so that there has been little difficulty in financing gross domestic investment levels of a similar magnitude. While the high level of investment is commendable there are some concerns about its composition. Much of it is not driven by market forces and the SOEs in particular have been one of the fastest growing users of investment. In recent times real estate has accounted for about 50% of total investment but the authorities are presently adopting some measures to tighten lending in this area. China has been particularly successful in attracting FDI estimated at about US$13 billion for 1993. This is a significant share of total global flows to developing countries. It reflects confidence among international investors and is strengthened by traditional ties among Chinese communities in other countries.

8. **Current Account**. Following surpluses from 1990 to 1992 the current account turned negative in 1993 (US$10 billion). It is also expected to continue to be negative in 1994. This is perhaps a little surprising as the external environment continues to be favorable. The trade account deteriorated as import demand remained strong while export growth slowed. The latter may be due in part to some diversion of goods to the booming domestic market.

Previous CSP (1992)

9. A principal concern was the reform effort and whether the proposed Bank lending would bring us to a ceiling on exposure but where only partial and ultimately unsustainable reforms were achieved. DEC, in particular, felt that there was a need for a clearer linkage between SOE reforms and the Bank lending program. The Region agreed to prepare an Enterprise Reform Strategy Paper. It was agreed that four areas of reform would be emphasized: (a) housing and social security; (b) financial sector; (c) SOEs; and (d) commodity pricing and marketing.

Present CS Updating Memorandum

10. The present CSN is a relatively short document that proposes to continue the strategy outlined in the previous CSP with Bank lending at essentially the 1992 base case. While this may be appropriate in most instances there is a problem of

emphasis. More recently the question of overheating of the economy and the associated possibility of a hard/soft landing has come to the fore. This, in turn, has moved the issues of monetary policy to center stage. The question of reform and *a fortiori* the pace of reform of the SOE's needs closer examination. How critical is the need to curtail losses or low productivity levels here. In view of the relative success of the Chinese authorities there is also the question of what the financing needs are and also how much and what form future bank lending should take. The concessionary component is particularly important.

Macro Situation

11. It would be useful to provide more detail here. In particular, is the gradualist approach still considered adequate, sustainable, or can some macro instability be expected? What are the risks envisaged and how might they be weighted? To what extent is it dependent on continuing supplies of labor from the agriculture sector? Will this supply continue? What are the concomitant needs, e.g. for education, health, social security?

12. The SOEs are generally viewed as not too efficient. However there is no attempt to indicate just how much they affect the overall macro situation and whether the present pace of reform will be sufficient to contain any major repercussions. Is their privileged access to investment funds (which continues to grow above average investment growth levels) reaching critical proportions? What are the political implications of major change here?

13. Monetary control had been primarily by administrative controls. There are ongoing efforts to move to market-based instruments, open-market operations. Is this being moved forward quickly enough? What are the critical factors at present that will determine the possibility of a hard/soft landing?

Bank Lending

14. The document does not indicate what the total external financing needs are for China for the next few years. The debt-service ratio has been rising over the last few years but in 1993 is estimated at only 12 percent. While this ratio is low it may not be appropriate for the overall total to grow much higher than its present level of around US$73 billion.

15. Loan commitments by the Bank in FY93 were US$3.17 billion making China our largest borrower. As it now approaches the portfolio limit of 10% a few questions arise. Should we continue lending at such a high level to a country that seemingly has adequate access to other sources of finance? If we do then should we offer so much concessionary funds (about US$1 billion) in 1993.

16. One may argue that on the one hand China does seem to make very effective use of our lending and is indeed steadily addressing its poverty problem:

about 80 million people are estimated below the poverty level. On the other hand if China can fund its projects from other sources then why not use our funds in other needy countries.

17. It would seem that we should continue funding in areas where it may not be easy for the authorities to obtain funds elsewhere: projects with long gestation periods, education, health. We might also invest in areas where we see a need for policy reform and where our input may be able to impact the situation; pricing in various infrastructure ventures. There is probably a weaker case for investments in telecommunications, power and oil sectors.

ESW and Projections

18. The document could benefit from some projections indicating perhaps a base and high case scenario. This could be used to give some indication of the likely impact of reforms in the SOEs, fiscal and monetary. It would also be desirable to have some estimate of the likely impact of the unification of exchange rates expected next year.

19. The overall ESW seems rather general and, at this stage, does not seem to be fully integrated with either the country or the Bank's needs. I feel the comments by Shahid Yusuf would be useful here (see para 4 of his memo).

China: Main Economic Indicators (1)

(In growth rate, over a year ago, %)

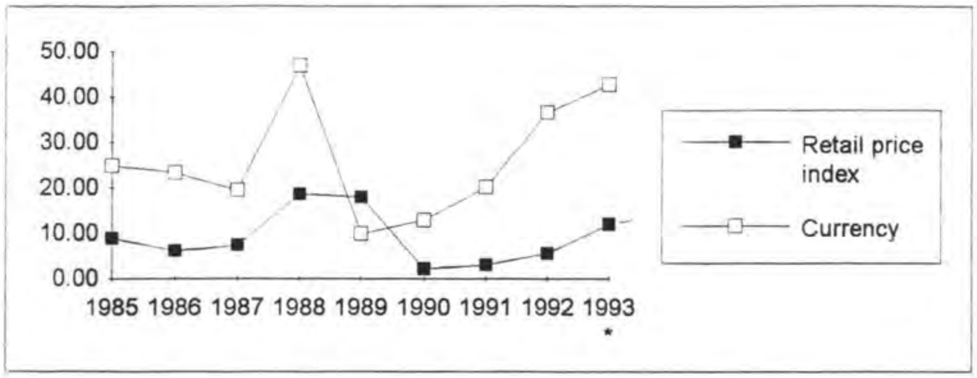
	1992	1993 (1st Q)	1993 (1st H)	1993 (1–Sep.)	1993 (June)	1993 (July)	1993 (Aug.)	1993 (Sept.)	
GDP(real)	12.8	14.1	14.1	13.3					
of which:									
Agriculture	3.7	5.4	4.8	4.5					
Industry	20.5	19.7	21.7	20.7					
tertiary	9.2	8.6	10.5	9.6					
Industrial Output(GVIO)(nominal)	20.8	22.4	25.1	24.1	30.2	25.1	23.4	19.1	
State Sector			10.0	9.3	12.7	8.7	9.6	6.8	
Collectives			45	41.7	50.6	43.4	36.9	30.6	
TVEs			69.4	62.0	67.7	60.7	50.7	45.3	
Others			68.7	67.2	71.5	70.3	65.8	58.2	
Investment(nominal)									
State Sector	40.7	70.7	70.7	66.4	73.7	71.3	58.1	56.5	
Retail Sale of Consumer Goods(n.)	15.7	16.2	21.6	25.2	28.4	26.5	27.8	23.3	
Urban				30.8			30.9	25.6	
Rural				17.9			22.6	20.2	
Income per Capita(nominal)									
Urban	18.2	27.7	28.0	29.0					
Rural	10.6	14.0	18.0	17.0					
Foreign Trade(nominal)									
Export	18.2	7.4	4.4	6.6		6.5	−0.1	25.2	
(value, fob, $bn)	(62.5)	(16.1)	(37.1)	(61.2)		(7.62)	(7.64)	(8.8)	
Import	26.4	25.4	23.2	29.9		39.6	37.3	46.4	
(value, cif, $bn)	(53.4)	(17.2)	(40.7)	(68.2)		(8.76)	(8.75)	(10.1)	
Trade Balance(value, $bn)	−9.1	−1.1	−3.6	−7.0		−1.14	−1.11	−1.15	
Foreign Direct Investment($bn)									
Committent			58.8	83					
Realisation			9.4	15					
Foreign Exchange Reserves($bn)									
PBC	19.4		18.9	19.4					
BOC	20.2		20.0						
Fiscal Expenditure	16.7	21.6	12.6	7.4	1.0	−0.8	5.8	−0.4	
Fiscal Revenue			1.4	11.6	17.8	20.6	30.4	32.9	
Tax Revenue	5.1	6.1	11.6	15.2	24.2	−2.1	29.2	39.7	

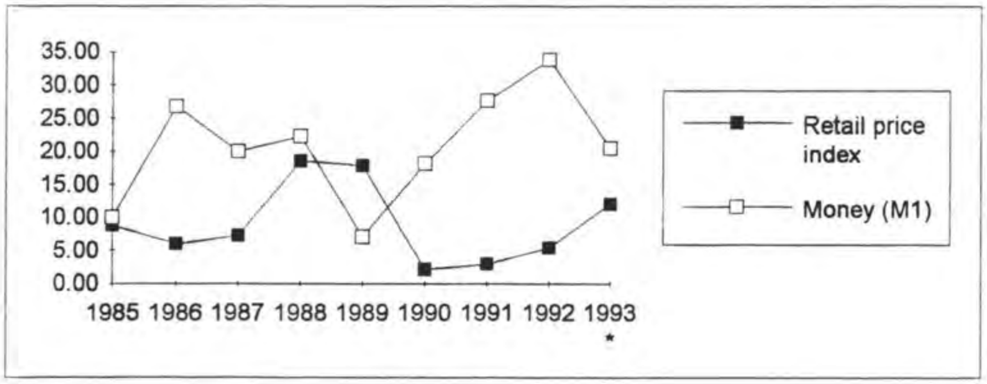
China: Main Economic Indicators (2)

(In growth rate, over a year ago, %)

	1992 (Dec.)	1993 (Mar.)	1993 (Apr.)	1993 (May)	1993 (June)	1993 (July)	1993 (Aug.)	1993 (Sept.)
Loan to household and enterprises	21.1	20.4	18.8	19.4	18.2	17.2	17.9	18.6
Money Supply(M1)	33.8	41.0			34.2	25.3	19.7	20.4
Currency	36.4	46.2	50.7	52.6	54.1	49.7	44.9	42.6
Sight Deposits	31.3	30.3			33.0			
Quasi-Money	28.0	29.7			26.1	23.0	20.6	22.1
Household Savings Deposit		22.9			22.5	24.8	26.9	27.8
Inflation Rate								
Retail Price Index	6.7	10.2	10.9	12.5	13.9	14.9	15.1	14.4
Cost of Living Index	8.8	12.2	12.6	14.0	15.1	16.2	16.4	15.7
(Urban)	10.0	13.3	12.7	14.6	16.6	17.7	17.7	
(Rural)	7.8	11.4	12.5	13.5	14.0	15.0	15.0	
(35 Cities)	13.4	17.0	17.0	19.5	21.6	23.3	22.2	20.7
Production Materials	27.7	41.9	48.2	51.3	52.9	45.0	42.3	
Fixed Investment Deflator								
Exchange Rate(RMB/$)								
Official Rate	5.8	5.7	5.7	5.7	5.8	5.8	5.8	5.8
Swap Market Rate	7.5	8.1	8.1	8.1	10.1	8.9	8.8	8.7
Interest rate								
Household Deposit(3 years)	8.3	8.3	8.3	10.1	10.1	12.2	12.2	12.2
Loan(working cap)(1 year)	8.6	8.6	8.6	9.5				
Government bond yield(3 years)								

Monetary Growth and Inflation





	1985	1986	1987	1988	1989	1990	1991	1992	1993*
Retail price index	8.80	6.00	7.30	18.50	17.80	2.10	2.90	5.40	12.00
Money (M1)	10.00	26.76	19.91	22.25	7.08	18.15	27.60	33.77	20.40
Currency	24.75	23.28	19.38	46.70	9.80	12.77	20.18	36.39	42.60

* September, 1993

A L L - I N - 1   N O T E

DATE: 01-Dec-1993 10:26am

TO: Orsalia Kalantzopoulos (ORSALIA KALANTZOPOULOS)

FROM: F. Desmond McCarthy, DECVP (F. DESMOND MCCARTHY)

EXT.: 31362

SUBJECT: China - CSP Updating Memorandum

1. The Country Strategy Updating memorandum for China raises a number of issues that might be usefully discussed at the President's Review. Following discussion with Michael Bruno, our revised suggestions for the agenda.

SOE Reform

2. We feel that we would like an update by the Region on progress with the SOEs. In view of the discussion at the President's Review of the CSP last year (June 12, 1992) to what extent has the Region been instrumental in contributing to SOE reform through its operations and what progress can be reported.

Macro Situation

3. Presently there is some concern about the overall approach to transition adopted by the Chinese. There are a number of reforms underway in the monetary and fiscal areas as well as in the SOEs. However, fiscal accounts remain weak in part because of the inelasticity of the tax base, in part because of continuing outlays on SOE deficits. In addition to the SOE deficit financed through budget allocation there is also the invisible (quasi-fiscal) deficit which is financed from Central Bank operations. Inflation is now expected to reach 15% this year and the authorities must still largely depend on administrative measures while the SOEs continue to absorb more than their proportionate share of investment funds.

4. Is the pace of reform fast enough to avoid macro instability, and especially the prospect of a hard landing in the near term, and indeed is the overall approach in fact sustainable? What are the main risks the Region envisages at this stage?

Bank Lending

5. Presently China is the main borrower from the Bank. On what basis is it reasonable to continue lending to a relatively successful country at such a level, especially the IDA component? While it is always preferable to see funds being used in a generally effective way would it be more appropriate to channel our lending to: (a) projects with long gestation periods that

may not easily attract funds from other sources--education, health; (b) areas where we can be reasonably effective in improving the policy climate--possibly infrastructure pricing. Is it perhaps less appropriate to lend in such areas as telecommunications, energy and oil sectors?

ESW

6. Would it be possible to have ESW better integrated with the lending program and more forward-looking? In particular could it try to analyze areas for prospective operations? Work is needed to help suggest what type of reforms for the SOEs, for instance may be best in the Chinese context. Similarly the civil service reforms that were tried in Africa are unlikely to be any more successful in China.

7. Would it also be desirable to have some work done on the regional/global implications of further Chinese economic expansion? The effect of Hong Kong integration, expansion of Pacific trade ties, the role of some of the FSU states bordering China (especially in the energy sector), and the implications of Chinese membership in GATT.

CC:	Michael Bruno	(MICHAEL BRUNO)
CC:	Mark Baird	(MARK BAIRD)
CC:	Shahid Yusuf	(SHAHID YUSUF)
CC:	I.J. Singh	(I.J. SINGH)
CC:	Klaus Schmidt-Hebbel	(KLAUS SCHMIDT-HEBBEL)

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: November 24, 1993 **DRAFT**

TO: Ms. Orsalia Kalantzopoulos

FROM: F. Desmond McCarthy, DPG

EXTENSION: 31362

SUBJECT: **CHINA - CSP Updating Memorandum**

1. The Country Strategy Updating memorandum for China raises a number of issues that might be usefully discussed at the President's Review.

Macro Situation

2. Presently there is some concern about the overall approach to transition adopted by the Chinese. There are a number of reforms under way in the monetary and fiscal areas as well as in the SOEs. However, there is some deterioration in fiscal accounts due to the relative inelasticity of the tax base on the revenue side and overexpansion on the expenditure side; inflation is now expected to reach 15% this year and the authorities must still largely depend on administrative measures, the SOEs continue to absorb more than their proportionate share of investment funds.

3. The question is whether the pace of reform is fast enough to avoid macro instability and especially the prospect of a hard landing in the near term and whether the overall approach is in fact sustainable. What are the main risks the Region envisages at this stage?

Bank Lending

4. Presently China is the main borrower from the Bank. On what basis is it reasonable to continue lending to a relatively successful country at such a level, especially the IDA component. While it is always preferable to see funds being used in a generally effective way would it be more appropriate to channel our lending to: (a) projects with long gestation periods that may not easily attract funds from other sources--education, health; (b) areas where we can be reasonably effective in improving the policy climate--possibly infrastructure pricing. Is it perhaps less appropriate to lend in such areas as telecommunications, energy and oil sectors.

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The World Bank/IFC/MIGA
O F F I C E   M E M O R A N D U M

DATE: November 24, 1993 08:52am

TO: See Distribution Below

FROM: Mark Baird, DPG (MARK BAIRD)

EXT.: 31666

SUBJECT: China CSP

Many thanks for your comments on the China CSP. We will send you the brief for Michael which is due out today. You are also invited to the briefing with Michael on Tuesday, November 30 at 5.00pm. I hope you will be able to attend.

DISTRIBUTION:

TO: I.J. Singh (I.J. SINGH)
TO: Klaus Schmidt-Hebbel (KLAUS SCHMIDT-HEBBEL
TO: Shahid Yusuf (SHAHID YUSUF)
CC: F. Desmond McCarthy (F. DESMOND MCCARTHY)
CC: Phi Anh Plesch (PHI ANH PLESCH)

A L L - I N - 1   N O T E

DATE: 23-Nov-1993 05:46pm

TO: Mark Baird (MARK BAIRD)

FROM: Shahid Yusuf, RAD (SHAHID YUSUF)

EXT.: 82339

SUBJECT: Comments on China CSP

A short updating memo cannot go beyond a few brushstrokes so I am being a little unfair in wanting a fuller picture. My principal concern is with the direction and depth of the China Department's ESW. I worry that unless the Region devotes more resources to finer grained analysis, we will be less effective in guiding the Chinese as they move into deeper waters.

The China Program

It bears repeating that lending to China is not only the Bank's largest single program, but it is also important for several other reasons: the money is quickly disbursed and efficiently spent in developing the world's most populous country; the government trusts the Bank's advice and relations are very close; among the Bank's clients, China is near the blue chip end of the spectrum and this helps our portfolio; and lastly, the China program is a valuable source of learning for the Bank.

This is a competent CSP updating memorandum but it makes little attempt at fresh thinking and is a trifle heavy on self-congratulation. Let me touch briefly on several items where the Region may need to reconsider its position or provide more of an explanation.

The Macro Story

(1) Is China headed for a "hard landing" if it does not heed our advice fully? I have three points. First, there has been only one hard landing -- in 1989-90 -- and the tough deflationary action which brought it about was triggered by very unusual circumstances. There is a tiny likelihood of a repeat, as has become amply obvious since late October, when Deng Xiao Ping intervened to moderate Zhu Rongji's policies. The center simply does not have the political wherewithal to do it. Second, the small doses of correction administered in June-July of 1993 worked very quickly and the economy is slowing after a spell of overshooting (this is not brought out fully in pages 6-7). It would take very little trying to bring growth down to a "sustainable" 9-10 percent. Third, hard landings in China are

not especially troubling because the economy continues to grow at 6-7 percent.

I found the macro story to be rather thin and incomplete.

Reforms

(2) There is a tendency to claim that all manner of reforms support growth with stability (SOE reform is mentioned). This may often be the case but the development of the real estate market in 1992-93 has been particularly destabilizing. It has stimulated credit expansion, massively increased investment (thereby pushing up prices of building materials) and encouraged speculation. Some of this was anticipated, but China is simply unequipped to conduct the regulation required.

(3) The CSP makes much of corporatization but it is unclear how the process described of issuing shares and appointing BODs, is going to make SOEs into efficient, competitive entities. China still has not instituted a company law and the ownership reforms that would define "rights," which BODs and managers would enforce, are still far from clear. Further, it is difficult to believe, given international experience, that BODs are likely to be a solution in the next five years at least.

We have tended to draw comfort from the supposed TFP gains registered by SOEs in the latter half of the 1980s. But always shied away from explaining the continuing weak profitability of the sector as a whole in spite of accounting biases that exaggerate the share of profits. No one is expecting a rapid improvement even after price reforms that should help many of the lossmakers (30 percent of all SOEs) in the energy sector.

This lack of understanding is worrisome and the Region should give priority to its work on SOEs.

ESW

(4) In identifying reform priorities and associated sector work, the CSP skates over some key areas.

> (i) The desired degree of macrostability is likely to hinge on fiscal reform, which contains or reduces the budget deficit. Although limited progress has been made with the VAT, other aspects of tax reform and reform of center-local fiscal relations are again bogged down. Until a way can be found out of the current impasse, macropolicy will remain hamstrung. Fiscal weakness will affect initiatives on other fronts as well.
>
> (ii) SOE reform depends on the ability of more autonomous managers to lay-off workers. Well over a year ago, the

government launched a major experiment aimed at shedding redundant employees from a sizable number of large SOEs after a year's breathing spell. The success of this experiment will be a litmus test of how reform is proceeding. Aside from referring to the increasing use of fixed-term labor contracts (p. 10) which has been ongoing since 1986, the CSP neither comments on this issue nor identifies sector work on the urban labor market.

(iii) The importance of administrative reform has been long recognized. But such reform entails much more than "reducing the overall size of the bureaucracy and reorienting its activities" (p. 9). Cutting the central government's bureaucracy won't diminish interventionism because much of its is by provincial bureaucracies. Further, China has done rather well in spite of such intervening. In fact, bureaucratic capitalism has been fundamental to coastal development.

If we believe that bureaucrats are getting in the way of reform, that the quality of central and provincial bureaucracies is declining and that government agencies need to acquire a different set of skills, the case ought to be presented and the matter studied through ESW.

(iv) The CSP seems to imply that identifying the desirability of central bank autonomy and putting Zhu Rongji in charge is sufficient to achieve the goal. That is unlikely and what we should be doing through our ESW is to show the Chinese in some detail what it takes to become autonomous. There is a lot of international experience and what it shows convincingly is that effective autonomy is the outcome of a many-pronged effort.

(v) I have some minor points on why deposit rates but not lending rates are raised (p. 5) (fiscal implications through SOE deficits); and issuing IOUs to farmers (p. 6). They are still doing so on a reduced scale and paying 3 percent interest.

(vi) My final point is on the content of the ESW, which is critical to the supply of "innovative products" (p. 13) and contributing to the new generation of reforms. Several of the proposals are difficult to relate to the major issues highlighted in the CSP, e.g.

Municipal Finance
Quasi Fiscal Deficit
GNP/National Accounts
Regional Patterns of Development
Higher Education Efficiency
Agricultural Marketing (which is about fruits
and vegetables)

Likewise, the region has to consider whether it and the Chinese derive much mileage from short strategy papers that do not break new ground, offer general and well-known recommendations and are of limited, if any, help in charting the sectoral lending program.

In my view, ESW should go more deeply into the problems of

Labor Markets (linked to work on retraining)
Commercial Banks
Fiscal Reform
Corporate Governance in China
Central Bank Autonomy
Administrative Reform

(5) The CSP talks about a new generation of reforms and about the need to provide "nuts and bolts" advice which I take to mean detailed guidance on how to design and implement reforms. Under the circumstances, it is not obvious that the "quick response" capability being created in the Resident Mission is appropriate. The short order cooks, some of whom are generalists, may have difficulty providing a suitably well considered response to some very complex questions. China's reforms have advanced beyond the stage where brief notes garnished with back-of-the-envelope calculations can be deemed acceptable. In order to sustain a relationship based on the government's respect for our expertise, we need to enlarge the analytical capability at headquarters. Transferring resources to the field depletes this critical mass.

Infrastructure

(6) When an economy, where the growth targets are in the 6-8 percent range, grows at higher rates for fifteen years, it is difficult to claim that infrastructure bottlenecks are choking expansion. Over the past year, when growth has averaged 13 percent as against a planned 6-7 percent, port and railway capacity has been under great strain. This is to be expected because such demand is totally unexpected and transport capacity takes years to expand.

If the region sees China growing at 8-9 percent over the medium run then:

(i) Bottlenecks will ease and anticipated levels of spending on infrastructure should accommodate demand.

(ii) In the coastal areas, growth of transport and energy infrastructure is much higher than elsewhere so national averages overstate the degree of scarcity and the slowness with which capacity is increasing.

(iii) No matter what we do, railway capacity will expand quite gradually because of constraints on building new lines, electrification and double tracking.

(iv) If the reform of transport/electricity tariffs lives up to expectations, not only will it lead to more efficient usage, but more importantly, it should provide these sectors with resources to finance much of their capital spending.

(v) China's telecommunications sector is expanding at terrific speed (18 million lines currently and 75 million projected for the year 2000). There is little evidence that funds cannot be found.

In short, the infrastructure bottleneck argument for Bank lending is somewhat overdrawn, although I would not deny that such investment yields high returns, which are becoming apparent to provincial authorities and foreign investors alike.

CC: F. Desmond McCarthy (F. DESMOND MCCARTHY)

File -
CSP BB

The World Bank/IFC/MIGA
O F F I C E   M E M O R A N D U M

DATE: November 22, 1993 07:15pm

TO: F. Desmond McCarthy (F. DESMOND MCCARTHY)

FROM: I.J. Singh, PRDTM (I.J. SINGH)

EXT.: 37473

SUBJECT: RE: CHINA CSP UPDATING MEMORANDUM.

Desmond,

I just returned from mission last Thursday to find a copy of the Chin on my desk with your note asking for my comments "as the PRD person o China". I have not had time to give it a very careful reading having only looked it over very quickly during the weekend. My comments per reflect this.

This is a well written CSP and covers many of the issues that are relevant and important. It deals with a country that has had a great of success with reforming a socialist system and in its own way at th The CSP focuses correctly on many of the central issues facing the economy, though it is somewhat over optimist in its assessment and understates the structural problems of a half reformed system.

I intend to comment only on selected issues given the time constraint

1) Macroeconomic instability : The overheating-austerity, boom-brake cycles of macroeconomic instability in China are not just short term as stated in the CSP, but a major recurring issue, that is the natura outcome of a half reformed system. This link between partial reform the macro instability is not spelt out in the CSP. I believe it is crucial.

China is currently trying to cool down an extremely overheated econom but this is not the first time this has happened. The problem lies in un-reformed financial, fiscal and enterprise systems among others. Although recent measures have been announced on reforming both the ba sector and the tax system, it remains to be seen if the announced mea will be actually implemented. Banks are neither independent nor are t run on a commercial basis. A very large share of the loans go to the sector. Loans are given on the basis of guanxi (connections) and not basis of economic criteria. The banking sector remains in the hands o provincial interests and is not subject to direct control from the ce Tax systems are negotiated all down the line and everywhere.

Reforms have been announced. The Central Bank is to be made truly independent and banks are to be allowed to be banks and not check wri agencies for provincial and local authorities. Major tax reforms have been announced, but it remains to be seen how far they will be implemented. There are already press reports indicating that some of investment and credit curbs may not be implemented. Thus a hard landi or renewed inflationary pressures are still a likely outcome.

China's macroeconomic instability will be a recurring problem as long the system remains only partially reformed. The CSP shpould spell th out more fully and also argue for more complete reforms as the remedy

2) SOE Reform: This is a large subject that merits further debate th will no doubt be part of CSPs for years to come. The current approac SOE reform remains, in my opinion, problematic at best, because it av the central issues.

The reform of state-owned enterprises (SOE) is a key issue on which t Chinese have been dragging their feet for a long time - and so has th Bank. We have said our lending would be conditional on satisfactory approach to this issue. Not withstanding the fair performance of the the fact is that they take a very large share of the investment funds the economy, while they are being out performed by a factor of two or three by the non-state industrial firms, whihc could use more of thes scarce funds. There is thus a massive mis-allocation of scarce - investment and working- capital resources in the economy.

SOEs suffer from other problems that the CSP spells out.

However the current approach to SOE reforms spelled out in the CSP (actually in the SOE reform paper) is minimalist at best. It suggest only partial and ameliorative measures - corporatization of SOEs wit Board of Directors, creation of share-holding companies, separation o taxes from profits, diversification of share holding by allowing cross-ownership by other, again state-owned (not private) funds or agencies etc. These are useful measures and may even improve the performance of SOEs somewhat at the margin; but they deny the main pr - the lack of clear property rights and the incentives for performanc the possibility for exit for failing and unproductive firms that such rights would create.

Comparative experience from East Europe suggests that many of the remaining incentive and principal/agent problems that restrict the performance of the SOEs- and in fact of the non-state sector also, th to a lesser degree - cannot be finessed by such marginal reforms. Th is a now a need to bite the bullet and develop clear property rights undertake ownership reforms in the industrial sector. Indeed no clea property rights exist even for the non-state sector, which too suffer this account.

As an alternative, a more comprehensive and bolder reform agenda for enterprise sector could include like the following items (I have mark these bolder items not included so far in the current approach to SOE reforms in the CSP with an (*) at the end:

a) move rapidly as possible on corporatization of all SOEs and its completion;

b) clarify property rights and ownership for both SOEs and the non-st sector, even if these are to be held by state or public agencies at various levels; (*)

c) set up a clear legal framework for a system of property rights and corporate governance including bankruptcy and contract law and make S subject to the same laws as the non-state sector firms (*);

d) privatize most small manufacturing firms - the tail end accounting 50% of the firms and some 20 % of the output, and do this through a distribution of shares locally to workers, managers and local governm (*);

e) keep only very large SOEs (top 5 % in size accounting for say 30 % output) and carefully limited key "strategic" sectors under direct st ownership, but regularize their ownership and governance and provide autonomy and accountability and incentives for performance, with clea penalties for failure and rewards for success (*); encourage entry by private investors even in key sectors (*);

(This would not require mass privatization as being done in Eastern E - that is the entire state-owned sector is being privatized in some countries. Indeed, in many key sectors - utilities, infrastructure, defense etc. - the state owned firms could continue to play a major, dominant, though not monopoly role. But even in these key sectors ent private firms would be permitted and even encouraged (*);)

f) for the rest of the SOEs - the middle 40-50% of the size distribut and half the output - consider clarifying ownership under central or provincially owned funds, value assets, set up shares and distribute shares widely to banks, holding companies, enterprise groups, current local or provincial owners, workers and managers - to diversify owner later allow secondary private markets for these shares and allow thei public purchase (*);

g) de-link all loans from state ownership; instead back "strategic" industries if needed by direct budgetary allocations for investments; other SOEs compete with the rest of industry for loanable funds on a competitive capital market at market rates (*);

h) phase out all subsidies and material supplies to SOEs in 2-3 years force firms to operate on a hard budget and profit-loss basis;(*)

i) allow firing from and even closure of loss making SOEs in a phased manner;(*)

j) reform the delivery of services and welfare to workers - housing, welfare, social security - by de-linking them from SOEs and placing t in the hands of local governments; pay employees the equivalent costs tax equivalent to local governments to provide these services.

Though some of these measures are included, a more comprehensive appr to industrial sector and SOE reforms, including the issue of ownershi property rights needs to be addresssed. Unless they are, the inefficiencies and problems associated with the SOEs will remain a ma issue.

The CSP also is also silent on a number of other issues that one woul
expect in such a document devoted to a discussion of strategic issues

3) Pace of Reforms: This CSP - and others prior to this - say littl
about the pace reforms and the costs of delayed or set aside reforms.
general thrust of the CSP is that the Chinese are undertaking reforms
successfully, their reforms are generally in the right direction and
further they are being carried out at the right pace.

But is this in fact so ? Were all the reforms past CSPs said would b
carried out,actually carried out ? And in the time frame we said they
would be in previous CSPs ? Were there any deviations and were there
costs associated with these deviations and delays ?

Most of the problems which have been the subject of many past CSPs -
liberalization, exchange rate unification, financial reforms, fiscal
reforms, banking reforms, infrastructural bottlenecks and their
alleviation - seem to appear all over again in this CSP, despite repe
assurances that the Chinese are pursuing reforms vigorously and solvi
these problems. After over a decade and half of reforms, and "dialo
many of the same issues remain; and each year one is told that furthe
reforms are under consideration in each of these areas. Is there no c
to delay ? or does it not matter ?

What is missing is any sense of correlation between what was expected
what was anticipated say last year or the year before and what was
actually done and not done or delayed, and for how long. The slow pa
reforms and the fact that many reforms have been inordinately delayed
nullified or set even aside and at what cost if any is never even
mentioned! The CSP is silent on all these issues.

4) Rationale for Bank Lending and IDA: It is hard to see what, if an
the rationale for Bank lending and for IDA allocations for China. Th
does not make a convincing case in my opinion.

a) Let us start with IDA. Here is my problem, one that has plagued m
ever since I started work on China. How can a country that started
the same place as India in per capita GDP terms around 1960's (around
$200-250 in the sixties) with a GDP growth of around 9 % in real ter
for the past 15 years (compared to India's 3 %) and a population rate
lower than India's, end up at about the same level of per capita GDP
the 1990's ? (The WDR shows GNP/capita of $330 for India and $370 for
China in 1991) !

The answer everyone says is the error due to the Atlas method. We can
agree with that.

But what an error ! We have looked at some figures on the ratio of
PPP/Atlas figures for India, some East Asian countries and also some
socialist comparators. While the ratio for east Asian countries is a
2.7 and for India around 2.7-3.0 all through the '60s, '70s and '80s,
ratio for China is around 9.0 ! Thus the error in using the Atlas in

of the PPP figure is three times for China than for all other countri looked at. (See Gelb, Jefferson, Singh, " Can Communist Economies Transform Incrementally ? ", WPS 1189, October, 1993)

So while the Atlas figure understates the per capita GDP levels for a countries it does so for China by a factor of three !! Even if we adj and use PPP figures, China would not fall in the same category as oth IDA countries.

Is IDA then justified due to poverty ? The CSP says that China has 10 million poor (actually around 90 million) and so is a poor country. surely it is not the absolute number of poor but the incidence of pov (less than 10 % by all counts in China compared to say 30 % + in Indi even as high as 50 - 60 % for some sub-Saharan IDA countries) that ma more sense as a justification for IDA. Further rapid growth in China lower this incidence even further and faster.

The real issue is not whether China does or does not qualify for IDA real per capita terms it probably does not fall in the same category other IDA countries), but whether we should be giving these scarce gr funds to the really poor and desperate countries that have little prospects for improved growth performance and which cannot get any ot source of development funds from international capital markets, nor c they repay their loans. If economic justification are to be used, we not give IDA to China. May be there are political imperatives.

b) Again regarding IBRD funds, China is hardly a "needy" country. Gr at 12-13 % per annum, it also has $ 100 billion of foreign direct investments committed this year of which $ 40 b. will probably be use has a healthy surplus of trade with many major trading partners ($ 10 with the US alone) and reserves that are growing in the medium term.

It can also easily get plenty of funds from the global capital market several China based mutual funds are in the offing. In terms of tota foreign flows, Bank lending is very small - say no more than 4 % this - while in terms of its total investments our funds are miniscule.

So what is the economic justifications for Bank lending to China, whe China can get whatever funds it needs, although at a slightly higher and which it can afford ?

There can be only two reasons in my opinion:

a) We do innovative, catalytic or unfundable projects:

We are doing projects that either cannot be financed otherwise (no pr in my opinion falls in this category), or we are doing projects in an innovative way. That is Bank projects, via Bank involvement, help C do projects in ways that projects would not otherwise be done.

May be this is the case, but the CSP has to make this case. I do not believe it does this. It does not tell us how Bank involvement change projects such that they are either innovative, different or even catalytic. If there is a case is to be made that our projects are innovative, catalytic or cannot be otherwise funded, the CSP has not it.

b) We are lending for policy dialogue and so encouraging innovative reforms that would not occur without this lending :

We lend because our policy dialogue through our project lending and o high quality ESW assists China to make policy changes that it would n have made otherwise, or not have made at least at a faster pace.

This is also a case that the CSP does not make, for it would suggest the Chinese follow, and we lead and are the cutting edge on reforms a reform issues. Experience suggests that we can only get the Chinese what they have already decided to do on their own; indeed we seldom t up any reform issue that may seem controversial to them and which we suspect they would rebuff us on. (Ownership reforms, more rapid pric reforms and an independent banking sector are just few of the cases i point).

As a point of fact it could be argued, that most of our so called pol dialogue and our project related conditionalities are either restatement of measures and reforms that the Chinese have already car out before the loans are even approved or they are often ignored in t implementation once loans are approved. (Energy price reforms on whic have been having a "dialogue" for nearly a decade and whose reforms w condition in some of our loans and loan discussions, still remain distorted and un-reformed, for example).

It would be hard to make a case that the Bank, through its lending an dialogue, has made the Chinese carry out reforms that they would not otherwise have carried out. Nor can it be argued that our ESW is at t cuttting edge of dialogue on reforms. A case could be made, but the C does not make it.

If it is dialogue, policy or more innovative and radical reforms, are really getting our money's worth in terms of these goals ? Would it n make more sense to push the Chinese to consider a faster and perhaps radical pace of reforms ?

Thus what remains of the rationale for Bank lending to China ? If it political, then the argument ends; but then these considerations shou stated clearly and up front.

There are other points, but some of these can be taken up later if PR to be included in any follow up discussions on this CSP and other Chi work that DEC has to comment on.

I apologize for this delay in getting this note to you.

I hope that in the future we will have more lead time to read and ref before commenting on documents sent to us for review. My feeling is if it is worth doing, it is worth doing well. For this one needs time follow up discussions.

I am sure that as the new review process is set in place by PRD and D
this will not be a problem.

Regards,

I.J.

CC:	Lyn Squire	(LYN SQUIRE)
CC:	Alan Gelb	(ALAN GELB)
CC:	Mark Baird	(MARK BAIRD)
CC:	Klaus Schmidt-Hebbel	(KLAUS SCHMIDT-HEBBEL
CC:	Institutional ISC Files	(INSTITUTIONAL ISC FIL

TRANSMISSION RESULT REPORT (NOV 24 '93 07:37PM)

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THE WORLD BANK

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FAX NO.: 202 477-1569
PHONE NO: 202 473-5100

NO. OF PAGES: 10
(including this page)

DATE: November 24, 1993

TO: Klaus Schmidt-Hebbel

FAX NO.:

FROM: Mark Baird

SUBJECT: China CSP - For Bruno Briefing Tuesday, 11/30, 5 p.m.

Please see attached

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: November 12, 1993

TO: Mr. Lyn Squire, Director, PRDTM

FROM: Klaus Schmidt-Hebbel, PRDTM KSH

EXTENSION: 37453

SUBJECT: China CSP Updating Memorandum: Review

1. The China CSPUM is a well-reasoned, well-written, and concise document. It could be strengthened in two ways: by emphasizing more strongly the downside risks of macroeconomic management and overall reform slippage and by better justifying, in the light of the downside risks, the Bank's medium-term lending program.

2. China's macroeconomic management is going through a critical phase, which requires taking restrictive fiscal and monetary measures in order to reduce excessive growth in monetary aggregates and aggregate demand observed in 1992-93. The downside risks of inadequate macro management are substantial and are derived from institutional features of policy making in China. First, the size of the initial public sector imbalance is huge -- the 1992 CEM estimates public sector borrowing needs at 9% of GNP. Second, the share of quasi-fiscal deficits -- which are typically harder to control than central government deficits -- in the total public sector deficit is rising. Third, due to weak macroeconomic monitoring capabilities and the current fear of stopping market reforms (as observed during the preceding clamp-down in 1989), restrictive policies could come too late, putting into serious jeopardy monetary and external stability and, when finally implemented, could lead to a strong reduction in growth. The CSPUM could gain by emphasizing more strongly these downside risks.

3. The approach followed in Eastern Europe and the FSU in dealing with the Gordian knot of SOE losses, fiscal deficits, and insolvent state banks has been by resorting to swords of varying sharpness, implementing fast reforms at the cost of significant output losses. China has followed hitherto a very different approach, postponing public sector and enterprise reform while relying on spectacular growth of the non-state sector. At this juncture of China's required reforms it seems difficult to postpone further SOE reform/privatization, macroeconomic stabilization (including elimination of quasi-fiscal deficits), and state bank recapitalization and restructuring. While this should not lead to negative output growth as observed in EE and the FSU, it could lead to a temporary but significant decline in overall growth. The CSP could also gain by assessing this scenario.

3. Given these downside risks, the projection of the Bank's medium-term lending program for China seems bold. In particular the projected doubling of China's DOD share from 4.9% in 1995 to 9.9% in 2000 warrants a stronger justification.

Enclosures

cc. A. Gelb, W. Easterly (PRDTM).

The World Bank/IFC/MIGA
O F F I C E   M E M O R A N D U M

DATE: October 22, 1993 10:26am

TO: See Distribution Below

FROM: Orsalia Kalantzopoulos, EXC (ORSALIA KALANTZOPOULOS)

EXT.: 82636

SUBJECT: China: Country Strategy Paper

You are invited to a meeting chaired by Mr. Preston to review the China Country Strategy Paper on Friday, December 3, 1993, at 2:30 p.m. in the Conference Room in E-1227.

DISTRIBUTION:

TO:	Michael Bruno	(MICHAEL BRUNO)
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2 File CSP BB

A L L - I N - 1   N O T E

DATE: 22-Oct-1993 12:14pm

TO: See Distribution Below

FROM: Orsalia Kalantzopoulos, EXC (ORSALIA KALANTZOPOULOS)

EXT.: 82636

SUBJECT: **China: CSP - Agenda Suggestions**

There will be a President's review meeting of the China CSP on December 3, 1993. We would appreciate your suggestions for the agenda by Monday, November 29.

DISTRIBUTION:

TO:	Michael Bruno	(MICHAEL BRUNO)
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CC:	Mieko Nishimizu	(MIEKO NISHIMIZU)
CC:	James W. Adams	(JAMES W. ADAMS)

THE WORLD BANK/IFC/MIGA
OFFICE MEMORANDUM

c/ file China CSP

DATE: October 14, 1993

TO: Mr. Lyn Squire, Acting DECVP

FROM: Anandarup Ray, Acting Director, DPG

EXTENSION: 35100

SUBJECT: CSPs on China and Venezuela

We have received two CSPs for the President's review: on China and Venzuela. The one on China is probably going to be reviewed by the President at the end of November. The Venezuela one will be reviewed in December, if at all. Kindly have your staff review the China CSP and send comments to Mark and me by November 18. No action on the Venezuela CSP is required at this point.

Attachments

cc: Messrs. Baird
McCarthy

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DM

To Mr Roy 8989

SEP 20 93 11:19

DATE: September 20, 1993

TO: Mr. Sven Sandstrom, Managing Director, EXC

FROM: Gautam Kaji, Vice President, EAPVP

EXTENSION: 81384

SUBJECT: China: CSP Updating Memorandum

Attached, for appropriate review, please find a Country Strategy Paper Updating Memorandum for China. The Updating Memorandum reviews political and economic developments since the last CSP was issued in April 1992, principally focussing on the acceleration of reforms on the one hand, and the emergence in recent months of economic overheating, and the Government's stabilization program, on the other. Taking account of the hardening IBRD/IDA blend that will result from the decisions made during the Tenth IDA replenishment, the Updating Memorandum recommends that the Bank's lending program continue at essentially the 1992 CSP 'Base Case' level, as authorized by the senior management at last year's CSP review.

Attachment

cc: Messrs./Ms. Sandstrom (5 copies), Rajagopalan (EXCPM), Shihata (LEGVP), Thahane (SECGE), Linn ((FPRVP), Einhorn (TREVP), Eccles (CTRVP), Jaycox (AFRVP), Wood (SASVP), Thalwitz (ECAVP), Koch-Weser (MNAVP), Husain (LACVP), Kashiwaya (CFSVP), Bruno (DECVP), Choksi (HROVP), Rischard (FPDVP), Serageldin (ESDVP), Alisbah (PAAVP), Picciotto (DGO), Ryrie (CEXVP), Iida (MIGEX), Neiss, Horiguchi (IMF), Thomas, El Maaroufi (EAPVP), Burki, Cardoso o/a (EA2DR), Ecevit, Goldberg, Newfarmer, Stott, Sierra, Mukherjee (EA2), Harrold, Ody (EA2CO)

AOdy:em

STRICTLY CONFIDENTIAL

CHINA

COUNTRY STRATEGY PAPER UPDATING MEMORANDUM

September 1993

Country Operations Division
China and Mongolia Department
East Asia and Pacific Region

CHINA: 1993 CSP UPDATING MEMORANDUM

EXECUTIVE SUMMARY

i. The past year has witnessed key meetings of China's party congress and national legislature, which gave their approval to the collective leadership succession proposed by veteran leader Deng Xiaoping. In many ways even more importantly, the Congresses authoritatively changed the official definition of China's basic economic ideology, removing references to planning and public ownership and substituting a "socialist market" creed. With this clearing of the ideological air, recent months have witnessed a near-ferment of new market-oriented reform proposals in many key areas of public policy, including those targeted by last year's CSP [reform of state-owned enterprises (SOEs); housing and social security reform; financial sector reform; and reform of prices and markets]. In the latter area, indeed, the liberalization of product pricing and the adjustment of the most distorted prices (energy, rail tariffs, raw materials and grain) have come so far over the past two years that the remaining steps are starting to look significantly less challenging than before.

ii. Beyond the speeding-up of market-oriented reforms in these and other areas (see paras. v, vi), the news in recent months has been dominated by macroeconomic developments. The further acceleration of the boom during 1992 brought real GDP growth from around 7 percent in 1991 to almost 13 percent, well above the 8-9 percent which we and the Government see as the safe trend rate. Much of the fuel came from monetary expansion, running at over 30 percent. Results for the first quarter of 1993 confirmed the costs of this pace of growth, including a swift turnaround in the trade balance and escalating inflation, and the Government was quick to accept our advice on the need for immediate action to avoid further deterioration and try to achieve a "soft landing." The first measures announced, though pointing in the right direction, were in our view clearly insufficient to achieve the desired result, and Bank representatives delivered this message in unambiguous language to senior leaders at a high-level seminar on macroeconomic management held in June.

iii. Many elements of the Bank's recommendations were rapidly picked up by the Senior Vice-Premier, Mr. Zhu Rongji, who has emerged, de facto, as in charge of overall economic policy (including assuming the functions of the Governor of the Central Bank), and incorporated into a "16 point program" designed to stabilize the economy. As yet it is too early for solid data to confirm the effectiveness of the measures adopted, but the boldness of the economic leadership being provided is definitely encouraging. Beyond this, while we do not expect the external accounts to be allowed to get out of hand, we are emphasizing the benefits of extending more market-oriented (rather than administrative) approaches in this area as well, and have recently completed a major ESW report advocating a combination of further trade liberalization with exchange rate reform. Helping to avoid another bout of chronic overheating, with the potential for reform setbacks this has brought in the past, has thus become our highest priority for the immediate future.

iv. At this stage, it is still too early to rule out the risk that, as has happened before, the Chinese authorities will miss the chance to achieve a relatively soft landing for their overheated economy. In favor of an *optimistic* view are the heightened sensitivity of central leaders, following the lessons of 1988-90, to the dangers of delaying an effective response and being subsequently forced into an abrupt deceleration (interruption of reform momentum, sociopolitical stresses, loss of domestic and international confidence), the increasing economic sophistication of their own domestic policy analysts and the fact that a substantially larger share of the economy is now more highly marketized and hence susceptible to management through indirect policy levers. There is also, as noted above, the boldness of Vice-Premier Zhu's attack on the problem. The sources of *concern*, by contrast, are that much of the investment pressure still comes from the least reformed sectors of the economy—local authorities and locally-controlled state enterprises—which have their own powerful political patrons among provincial leaders. The latter have, in the past, too often put parochial development interests above the national need for stability until forced to give ground by an obvious crisis. We cannot yet rule out the danger that this will happen again, and thus China *may* again experience a hard landing.

v. On the reform front, the Government has announced new measures to increase further the role of private sector investment in the economy [including Foreign Direct Investment (FDI), currently running at record levels of around $10 billion a year.] These include opening-up inland areas, the service sectors and—in a recent initiative whose implications have yet to be fully assessed—even the provision of physical infrastructure to private FDI. In a more general sense, private sector development continues to move largely *in parallel* with SOE reform rather than being seen, as in some other economies attempting transition, as an immediate or large-scale component of the solution to the SOE's problems. The key features in the next phase of China's assault on SOE reform will thus, in general, involve not so much privatization as "corporatization" and "marketization." Consistent with our Strategy Paper on SOE Reform, approved earlier this year, these measures will be designed to convert the SOEs from miniature welfare-states, subject to extensive bureaucratic interference and protected from market discipline by a range of distortions in pricing, taxation and financial markets, into market-oriented commercial corporations, whose workers look outside the factory-gates for social security or housing provision, and whose managers are responsible for their performance to well-defined owners' representatives. The past year has seen further advances in defining and protecting managers' autonomy and promoting the adoption of more transparent mechanisms of corporate governance: we expect active innovation in this area to continue. In parallel, the Government has explicitly committed itself to cutting and restructuring the public bureaucracy so as to reorient it away from the micro-interventionist tendencies of the past.

vi. Recent months have also seen a new intensification of interest in the previously slow-moving area of financial sector reform. Sector reform is projected to include separating remaining directed "policy lending" from a newly commercialized mainstream banking sector, accompanied by the restructuring and further strengthening of China's Central Bank. These are changes the Bank has long been urging. They will also be ambitious and far-reaching changes and, when they start to be introduced in earnest, we can expect to be called on to supplement our largely advisory role of recent years with substantially expanded hands-on operational involvement.

vii. In addition to providing advice and practical implementation support for the new phase of economic reforms, Bank objectives also include other priority goals set out and approved in last year's CSP: helping to break the recurrent infrastructure bottlenecks which have repeatedly constrained China's growth; promoting the expansion of income-generating opportunities and improved provision of basic social services for the country's 100 million hardcore rural poor; and supporting policymakers and local administrations confronting the formidable challenges posed by air and water pollution. Broadly speaking, our strategies in these three areas will continue to follow the lines set out in the 1992 CSP. Some shifts of emphasis will, however, be warranted. In the infrastructure sectors, in particular, recent progress with tariff reform means that attention can increasingly shift to the corporatization of service provision along more commercial lines, accompanied by the development of more transparent regulatory frameworks. It also, however, leaves the inadequacy of China's highway network, starved for dependable sources of investment financing, all the more apparent—and we propose a further increase in the emphasis given to highways development in our own operational program.

viii. An additional challenge which has emerged since the approval of the 1992 CSP concerns the management of the decline in IDA availability resulting from decisions taken on "blend" countries during the tenth replenishment. Domestic onlending arrangements create a danger that the hardening of China's IBRD/IDA blend could lead to reduced willingness to borrow in the areas of poverty alleviation, the social sectors and the environment. We have communicated our view that such an outcome would be unacceptable. The early response has been encouraging, but we can expect this issue to resurface as the cuts start to become effective.

ix. The accelerated pace of reform is being accompanied by a heightened appetite for Bank advice and assistance, not only with broad policy issues but also, very crucially, with the details of reform implementation, often delegated by the central decisionmakers to sectoral agencies or, more often, local authorities. With the major philosophical barriers now mostly crossed, these "nuts and bolts" questions will increasingly determine China's success in translating its bold reform intentions into working reality. In turn, with no other outside agency able to match the Bank's experience or credibility within China, we ourselves face difficult challenges in trying to leverage our own limited resources in innovative ways so as to maintain our responsiveness to the country's requirements and demands, including the related priority of strengthening our presence in China's less-advanced inland regions. Economic and sector work will need to become more flexible to meet calls for immediate advice on specific reform implementation choices, and we are restaffing our Resident Mission to help meet this need. Sector-specific technical assistance operations may offer another promising new model. In addition, our lending operations are rapidly acquiring more of a "reform implementation support" element, precisely to help meet the "nuts and bolts" needs of putting reform into practice.

x. The quickening of the reform impulse outlined above may be considered to meet, in substantive terms, the basic conditions set out in last year's CSP for moving from the CSP's *Base Case* lending scenario (about 45 operations over FY94-96, with combined IBRD/IDA lending of close to $9 billion) up to the *High Case* scenario (about 51 operations, with combined lending of about $11 billion). In *not* making such a recommendation at this time, we have been guided by three considerations:

(a) The decline in China's expected IDA allocation under IDA 10, compared to the assumptions made in the CSP, together with assurances given to the Chinese at the time of the IDA 10 discussions, create an imperative to substitute IBRD lending for previously anticipated IDA credits;

(b) This, in turn, brings forward the date at which attention needs to be given to issues of IBRD exposure limits; and

(c) The internal budgetary implications of seeking to process a larger number of projects.

xi. Accordingly, we propose to continue working at a level approximately equivalent to last year's *Base Case* (44-45 operations over FY94-96, with combined lending of an estimated $9.1 billion). On this basis, China's share of IBRD debt outstanding and disbursed is forecast to remain within the 10 percent guideline through at least the turn of the decade.

CHINA: 1993 CSP UPDATING MEMORANDUM

1. The 1992 Country Strategy Paper (CSP) was reviewed and approved by the President's Office on June 12, 1993. The present "Country Strategy Note" (CSN) updates our analysis of the reform climate and macroeconomic situation and proposes appropriate modifications in our country assistance strategy in keeping with the rapidly evolving situation in China. An Updating Economic Memorandum (UEM), based on a mission to China in April 1993, was issued in Gray Cover on June 30, 1993 (Report 11932-CHA).

A. BACKGROUND: KEY CHALLENGES

2. Last year's CSP and a number of other Bank documents have extensively documented the key achievements of China's reforms to date—the marketization of agriculture, the rapid growth of nonstate activity in industry and services, the "open door" to trade and foreign direct investment (FDI)—and the ensuing growth in GDP (averaging 9 percent) and productivity. Rather than repeating this discussion, we concentrate here on the areas where we still see major challenges remaining. Many of the priority areas from last year's CSP remain (e.g., the key nexus of SOE reform, connected social reforms and financial sector reform), though the recent impetus seen behind price reforms (paras. 4, 5) means that this area has now dropped somewhat down the scale of our priorities. By contrast, the short-term macroeconomic situation has emphatically increased in visibility since June of last year. We therefore list the following key challenges:

(a) Intensifying the marketization of those domestic producers of tradable goods still significantly shielded from market forces, i.e., *China's state-owned enterprises (SOEs)*: a process that needs to move in parallel with the further development of domestic *factor* markets (including *financial and labor market reforms*);

(b) Continuing to address perennial constraints to growth in the domestic nontradable sectors: principally energy, transport and communications *infrastructure bottlenecks*;

(c) Developing effective responses to the plight of the 100 million Chinese poor still largely bypassed by reform-induced development; and

(d) Further strengthening indirect instruments of *macroeconomic demand management* consistent with an increasingly marketized economy and, as the *highest and most urgent priority of short-term policy*, making effective use of them to achieve a "soft landing" from the pressures of overheating that have recently emerged.

3. **State-Owned Enterprises and Related Reforms.** As in the CSP, this continues to be seen as the key longer-term challenge. To summarize our basic analysis, China's 100,000 SOEs have continued to operate in an environment characterized by

significant administrative involvement in economic decision-making and to be sheltered from the ultimate discipline of "hard budget constraints." The relatively cautious pace of SOE marketization hitherto can be largely attributed to concerns over the potential social impact of fundamental restructuring on the SOEs' workforce, over 70 million strong and, together with dependents, covering the bulk of the population in the main cities. The SOE workers' vulnerability, in turn, has reflected patterns of social security provision designed in the context of traditional lifetime employment, including dependence on the employing enterprise for subsidized housing, unfunded and nontransferable pension rights and medical insurance, together with the absence, until very recently, of formal systems of unemployment compensation or meaningful urban labor markets. A variety of mechanisms has served, in practice, to soften SOE budget constraints so as to avoid redundancies or bankruptcy, including—in addition to explicit budgetary subsidies—concessional pricing on Plan allocations of energy and raw materials; ad hoc local negotiation of corporate income tax bills; and preferential access to directed credit, often on favorable terms, from the state banking system. Beyond this, SOE managers have continued to be subject to extensive involvement in business decisions by government agencies: the organization of these bureaus, both centrally and locally, along narrow, subsector-specific lines has served, inter alia, to inhibit diversification strategies and, to a considerable degree, to "freeze" the pattern of SOE investment and output.

4. A certain amount of progress has already been made in the marketization of the SOE sector. Final output markets are far less subject to state control (90 percent of retail prices are now uncontrolled) and have also been increasingly influenced by competitive pressure from nonstate entrants; the financing of industrial investment has been largely shifted from the budget to the banks and retained earnings; and energy supplies and raw materials are now subject to multiple-tier pricing, with at least out-of-Plan supplies at the margin at generally realistic market prices. In addition, "contract management system" reforms from the mid-1980s, which converted SOEs' formal objectives from gross output to profit maximization, provided managers substantially enhanced autonomy over the allocation of resources (including labor) *within* the individual enterprise: Bank-supported studies have identified a resulting upward trend in SOE productivity. At the same time, the earlier phase of reforms fell short of a more fundamental restructuring involving cross-enterprise or cross-sectoral resource reallocation; the SOEs continue to show slower growth in productivity or output than nonstate enterprises; SOEs still absorb a disproportionate share of formal credit (approximately four fifths) and of the best-qualified entrants to the workforce; and visible SOE losses (generally considered understated as a result of weak accounting standards) are equivalent to 4-5 percent of GDP, or close to double the total budget deficit. Broader ramifications of the SOEs' protected status include obstacles to relaxing continued government dominance over the allocation of bank lending (as well as to placing the taxation system on a more transparent basis). As such, SOE reform is needed not merely as an end in itself, but also as a means toward freeing-up markets (including the capital market) in order to permit greater responsiveness to demand from the *nonstate* sector. The Chinese authorities' recently reinforced commitment to more fundamental marketization of the SOEs is discussed in greater detail in Section C below.

5. **Infrastructure**. Basic infrastructure bottlenecks, as also noted by the CSP, have played a part in choking off growth in each of the recent episodes of overheating, including 1985 and 1988/89, and reports of power shortages and congestion on the railways and at the ports have again surfaced in recent months. Investment in transport and energy has been constrained from two sides—erosion of the budgetary funds that were the traditional sources, and low controlled prices for nontradable services, which inhibited self-financing (while also stimulating wasteful consumption). Bank-supported price reforms, which have accelerated over the past two years, have gone a long way toward removing past distortions: recently increased rail tariffs are expected to permit the self-financing of about 80 percent of planned sectoral investments, while average consumer electricity tariffs are now estimated to be in excess of 90 percent of long-run marginal cost. Even in these sectors, however, backlogs and unevenness in regional coverage remain. Meanwhile, efforts to develop a more balanced transport system, in particular a modern highway network, continue to be hampered by the absence of robust road financing mechanisms, while telecommunications coverage remains at low levels, in part reflecting quasi-monopolistic traditions and past resistance to competitive entry. Recent policy initiatives in the infrastructure area are also reviewed in Section C.

6. **Poverty**. A major Bank report finalized during the last year (No. 10409-CHA) has broadly confirmed the view of this issue taken in the 1992 CSP. It shows that, while the first five years of reform lifted some 170 million Chinese out of absolute poverty, the population remaining in poverty (close to 100 million) has shown no discernible reduction over the last decade. Absolute poverty in China today is almost exclusively *rural*; it affects *whole communities* rather than individuals; and it is heavily concentrated on a *regional* basis—affecting villages in remote, resource-poor (and often environmentally degraded) areas, primarily in the northwestern and southwestern interior. The challenge of alleviating this remaining hardcore poverty is a multidimensional one. In at least some of the poorest regions, technological packages now exist that are capable, with the necessary investment support, of yielding substantially improved agricultural incomes, on an environmentally sustainable basis, for at least part of the current population. Other sources of employment, however, such as small-scale industry, are widely constrained by infrastructure deficiencies and poor market access (although some border areas, in particular, should benefit from the recent expansion of the open-door policies). For some of the poor, outward migration may be the most promising option: this, though, is a field where earlier policy restrictions are only gradually yielding to pressures from below.

7. Low incomes in these regions are compounded by marked weaknesses in the provision of social services, and resulting indicators of health and education status strikingly below national averages. Women's health and girls' education are frequently the most severely affected. Central policy has traditionally stressed self-sufficiency by rural communities in social service financing and, although fiscal arrangements have long redistributed revenues to the poorest *provinces* (and, since the mid-1980s, also to the poorest *counties*), there is little indication that effective mechanisms yet exist to achieve sustained social improvements at the level of the poorest *villages* where the worst conditions are found. With no easy solutions, the plight of China's poor continues to

challenge the best efforts both of the Chinese authorities and of the international development community (paras. 42-43).

8. **Macroeconomic Management**. The cyclical nature of Chinese growth since 1978 has been widely discussed. By many international standards, the troughs have been neither particularly deep nor especially prolonged: the most recent cycle, at its lowest point, witnessed real GDP growth of 3.8 percent in 1990, with recovery to 7.2 percent in 1991. There is, nonetheless, legitimate cause for concern over the stresses created by very rapid deceleration,1/ as well as over the extent to which, in past episodes, the pursuit of marketization reforms has become subordinated to the imperative of regaining control of aggregate demand, in turn achieved largely through administrative mechanisms and quantitative controls. The prevalence of such direct levers to date can be traced to several causes. The tax system, based largely on multiple-year contracts negotiated between the different layers of government, has not lent itself to the fine-tuning of demand (though Beijing has shown some inventiveness in introducing *new* taxes), so that deflationary fiscal policy has primarily comprised direct cutbacks in public investment (imposed administratively by the center). On the monetary side, although interest rate changes played a more important role in the most recent (1988/89) period, direct quantitative credit controls remained the principal instrument, reflecting partly the limited capability and experience of the central bank (People's Bank of China, PBC) in the use of indirect policy tools (and relatively thin, undiversified domestic money markets), but also reservations over the likely responsiveness of SOE credit demand to the interest rate changes then considered feasible.

9. The 1988/89 episode had specific features not likely to be repeated, including an abortive preannounced "big bang" attempt at price reform, which sparked a rapid upswing in consumer demand and complicated the design of an effective policy response. Beyond this, the earlier experience has itself served to increase the sensitivity of policymakers to the disruptive potential of overheating, and thus to improve the likelihood of a more timely response on subsequent occasions. Signs of the need for concern built over a period of time. Real GDP growth during 1992 proved close to 13 percent, significantly above the 8-9 percent level judged consistent, on a sustained

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1/ Economic factors, including rapidly rising prices, curbs on wages and bonuses, and general economic insecurity (possibly including concern over longer-term job security) undoubtedly played a part in the *urban* protests that preceded the Tiananmen events of June 1989. This experience helps explain the caution shown by the leadership over the pace of urban reform (particularly in the labor market area), and the promptness with which Beijing has responded to the latest signs of overheating. Beyond this, the Western press reported cases of *rural* protest earlier this year (mostly concerning delayed payment for grain purchases and/or excessive local taxes), and some commentators have suggested that such protests could now be a serious source of instability for the Government. We disagree. Careful readers of the Chinese press know that scattered, small-scale incidents of this kind are nothing new: the purchase of the harvest is traditionally a time of tension. But experience in China and elsewhere suggests that only under historically exceptional and extreme circumstances do the peasants coalesce into a larger movement able to threaten the government politically. One of the key aspects of 1989 is that—despite similar discontent over grain purchases, etc.—the rural areas lent no support whatever to the urban protests. All this is not, of course, intended to deny the case, *on equity and efficiency grounds*, for continued reforms to gain marketing and the tax system, and continued attention to regional differentials—all areas in which the Bank is working actively.

basis, with noninflationary growth by the 1992 CEM (and subsequently adopted as the official target). At the same time, however, the trade and inflation results for 1992 were, in overall terms, still relatively comforting, with export growth at 18.2 percent (though imports grew faster, at 26.2 percent), and the retail price index (RPI) up by only 5.4 percent (though here, too, more worrying signals were visible in some of the disaggregated indices, including a rise of 15 percent in the "means of production" measure of raw materials prices).

10. Data for the early months of 1993 eliminated any remaining ambiguity over the danger of overheating. The turnaround in the trade balance was particularly striking. While export growth (first quarter) slowed to a rate of 7.4 percent, import expansion maintained its pace at an unabated 25.4 percent, resulting in the first trade deficit since 1989 ($1.2 billion for the quarter). This was accompanied by substantial further widening of the divergence between the official exchange rate and that in the parallel market. Price data confirmed the trend, with the RPI rate of increase up to 8.6 percent and the "means of production" index rising at a rate of 38 percent by the end of March. Industrial output growth had reached an annual 27.3 percent by May, but the single most dramatic statistic, which said much about the nature of the boom, was the growth in state enterprise investment, which reached 70.1 percent in the year ending May 1993. With the official budget deficit relatively stable (in the internationally unexceptionable range of 2-3 percent of GDP), it was the monetary sector that provided most of the fuel for the rapid expansion in demand, through an expansion in credit focused heavily on state enterprises. Growth in broad money during 1992 reached 31.3 percent and, on top of perennial difficulties in containing lending by local branches of the state banks, a distinctive contribution on this occasion originated from rapidly expanding nonbank financial institutions (NBFIs), effectively covered neither by PBC's traditional quantitative controls nor by the newer style of prudential regulation the central bank is attempting to introduce into the sector.

11. Starting in mid-May, and in line with warnings contained in our draft UEM, the central authorities signaled their recognition of the need for immediate measures to avoid further deterioration in the macroeconomic balance. Preliminary steps announced at this time, consistent with our advice, included increases in officially administered interest rates for bank deposits and loans, as well as on Government bonds; proposals to stiffen enforcement of the authorization process for capital market issues; and directives to curb the erosion of the fiscal revenue base by local governments via the multiplication of "development zones" conveying tax concessions. While these initial actions were welcome and timely, we made very explicit our view that these changes alone would not be sufficient to achieve the desired results. We also expressed concern over the fact that *deposit* rates had been raised significantly more than *lending* rates, with adverse implications predictable for financial sector viability. In addition, we pressed the role which further *trade liberalization and exchange rate reforms* could play, in addition to their longer-term contribution to improved resource allocation, in helping to absorb the more immediate demand pressures.

12. In June, a crucial conference on macroeconomic management was held in Dalian, China, hosted jointly by the Bank and China's Systems Reform Commission. A

statement prepared at this conference, on China's macroeconomic priorities, was presented to the government and received attention at the personal level of the Senior Vice-Premier, Mr. Zhu Rongji. Very shortly after, at the beginning of July, the Central Committee of the Party issued a 16-point program of austerity measures to arrest the macroeconomic deterioration. Close personal involvement with the plan was indicated by the removal of the former governor of the Central Bank, and the assumption of this role by the Senior Vice-Premier himself. There is a close correspondence between this plan and the measures proposed by us to the government, which indicates a very high degree of responsiveness to our message at both the working level and the very top.

13. The 16-point program encompasses, first, measures to address immediately the unsustainable macroeconomic upswing, and second, longer-term structural measures to address the underlying roots of macroeconomic instability. Important in the first category are a squeeze on the money supply, through the compulsory issue of government bonds and deadlines for the recall of loans issued outside earlier ceilings; a proposal to cut government administrative spending by 20 percent; a temporary suspension of further price reforms through the end of the present year; further increases in interest rates for savings deposits; a tax on the appreciation of real estate (to curb speculative investments) and a reduction in the scale of infrastructure projects. The second category of measures addresses more long-term, structural issues. These measures include, importantly, the proposed strengthening of the central bank, and a decision to separate commercial lending from policy loans (see also para. 24). The clamp-down on unauthorized development zones was reiterated, while the government also reemphasized its commitment to resolve bottlenecks in transport and communications. The issue of new IOUs to farmers for the purchase of summer grain was explicitly forbidden. Realizing the need for coordination at provincial and local levels, the government also resolved to send out teams to inspect the implementation of the program at these levels.

14. It is as yet too early to determine the economy's response to these measures with any accuracy or comprehensiveness. However, a few early indicators are available, which provide some positive and other more mixed results. First, the index of industrial production, which had increased by 27.3 percent for the 12-month period ending May 1993, and a similar 30.2 percent up to June 1993, registered rises of only 25.1 percent in July and 23.4 percent in August. The value of retail sales indicates a similar trend: this rose in June by an annual 28.4 percent, but by only 22.2 percent in July. It is reported that the deposit flight from commercial banks has been reversed, and that large sums of money (estimated at Y 72.7 billion) have been recovered from illegal interbank lending. Inflation indices are mixed so far. In May, the urban cost of living index for the 35 largest cities was 19.5 percent above a year before, and continued to rise, in June, to 21.6 percent, but declined in July to 18.2 percent. The increase in the retail price index (RPI), standing in June at 13.9 percent above a year before, had come down to 10.8 percent by July. By contrast, the price index for grain, construction materials and services continued to rise, from 15 percent, at the end of 1992, to over 20 percent in the year ending July 1993. On the external front, while import growth (over a year previously) declined fractionally from 26 percent in May to 25.7 percent in July, export growth declined as well, from 7.7 percent to a low 4.7 percent by the end of July. The exchange rate

differential between the parallel market and the official market has narrowed (with the parallel rate declining from Y 11:$1 in June to Y 8.8:$1 in July and August), though this is likely to have been influenced in part by the reported intervention of the People's Bank of China to support the currency.

15. If this constitutes a mixed picture, such is in fact what should be expected at this stage: allowing for normal lags, the economy's response may well not be entirely clear until the early part of next year. On the side of optimism, it can be said that the technical content of the Government's proposals is broadly in line with the advice we and other independent economists have provided, and that the leadership in Beijing is pressing these measures with considerable vigor and political commitment. It is almost a truism by now that the key test will be the center's ability to secure compliance in the provinces and at lower levels. If the jury is still out on this issue, Beijing is fully aware of the problem and its approach appears to combine both toughness and sophistication.

B. External Environment

16. During recent years, with the relative isolation suffered following Tiananmen now largely dissipated, China has benefited from a generally favorable external environment, which permitted trade growth over 1989-92 of 15-20 percent per annum. In 1992, in particular, FDI (primarily targeted to export-oriented manufacturing) rose to around $10 billion, making China the largest developing country recipient of such investment. China has also continued to enjoy relatively easy access to international financial markets, made easier of late by the opening (albeit on a restricted basis) of China's internal financial markets to overseas portfolio investors. At the same time, however, as noted above (para. 10) and as predicted in last year's CSP, the trade balance has rather rapidly swung into deficit; not in itself necessarily an undesirable development, but one which will require careful monitoring.

17. In *trade*, there are a number of *external* issues. First, China's application to resume its seat at the GATT, which was filed in 1986, is still pending (and subject to difficult negotiations, which may take at least one more year to conclude). If completed satisfactorily, this would add a degree of certainty to China's external economic environment that has for some years been lacking. Second, in May the US administration extended China's MFN status for another year, linking subsequent renewal to progress on human rights, but explicitly excluding bilateral trade and arms export issues (concerns in the latter area were, however, in August to prompt US imposition of *selective* sanctions in high-technology areas). Third, China stands to benefit more than many others from a hoped-for successful conclusion to the Uruguay Round, in view of its dependence on garment and footwear exports, which would be liberalized relatively more than other commodities.

18. China's *investment climate* continues to improve, as reflected in the doubling of FDI in 1992. The country is benefiting in this regard from the growing role of other Asian economies such as Japan, Taiwan (China) and Korea as overseas investors, supplementing China's original investment partners in Hong Kong. If this continues, FDI

can be expected to make a significant and increasing contribution, both in established manufacturing sectors and also in new areas for FDI (such as services and infrastructure). The *financial markets* continue to look favorably on Chinese instruments. Bonds and syndications are issued with ease, especially on Asian financial markets, and at very favorable rates. China's excellent repayment record, and absence of rescheduling requests, combine to make the country a very desirable sovereign borrower. We expect China to continue to enjoy a strong creditworthiness position. As we forecast last year, the balance of payments current account has returned to its normal pre-1989 stance of a moderate deficit. We see no reason to expect this to be allowed to get out of hand (see UEM for more detailed forecasts): the interesting question, rather, is whether its future management will take place primarily through traditional administrative measures or, as advocated in a recent major ESW report on *Trade Reform*, through a combination of liberalization of quantitative restrictions and exchange reform. Total debt outstanding stood at only 16 percent of GDP in 1992 and this is projected to fall gradually over the balance of the decade. The associated debt service level is also expected to remain healthy, declining further from its already modest level of 9.7 percent of export earnings in 1992 to about 7 percent in the second half of the decade. Indicators for IBRD exposure are reviewed in para. 53 below.

19. On the downside, some uncertainties remain. Trading arrangements are ad hoc, as noted, and subject to arbitrary change pending conclusion of ongoing negotiations. China's export growth has been highly concentrated in terms of markets and products (notably in garments, toys and footwear for the US market) and some of these niches may be approaching saturation. Finally, political tensions continue to affect relations with Hong Kong and Taiwan (China), which reduce the achievement of potential synergies from the much-discussed "fourth growth pole." These aspects will therefore continue to demand attention and monitoring.

C. Country Assistance Strategy

Recent Developments and Government Policies

20. **Political Developments**. The past year has witnessed developments of considerable importance at the policy-making and political levels, which have served inter alia to cement the policy consensus around further acceleration of China's marketization reforms. The key events were the meeting, in October 1992, of the fourteenth Party Congress, whose decisions set the overall policy direction for the next five years, and the subsequent inaugural session (March 1993) of the newly elected National People's Congress (NPC), China's legislature. These two bodies, the sources of policy legitimacy within the party and the state, took the critical symbolic steps of writing into party policy and the constitution, respectively, a redefinition of official economic philosophy that replaced the earlier formula of "a planned economy on the basis of socialist public ownership" by "a socialist market economy." In keeping with Chinese tradition, the latter concept does not readily lend itself to a precise or static legalistic definition. It may, however, be read (particularly taken together with an earlier reinterpretation of "socialist public ownership" to include not only SOEs but also local collectives) as an explicit

downgrading of the weight attached to any specific ownership model, as well as a powerful public assertion of the central role further marketization is designed to play in future economic strategy. In summary, we see these steps as symbolizing the authoritative removal of residual ideological constraints to the ongoing marketization process. The *socialist* nature of the Chinese economic model, in turn, is likely in future to be manifested primarily by concern to protect basic social service provision and avoid extreme inequities in economic welfare and, more specifically, a continuing commitment to the eradication of China's remaining absolute poverty.

21. The two Congresses also gave their stamp of approval to the planned collective succession to the elders of the Long March generation. This included the reelection (with a number of dissenting ballots) of Li Peng to his second (and, constitutionally restricted, final) term as Premier; the elevation of Jiang Zemin to be State President as well as Party Secretary and Chairman of the Central Military Commission; and the promotion of the reform-minded Zhu Rongji to the new post of *Senior* Vice-Premier. In designing the new lineup, China's patriarch Deng Xiaoping appears to have succeeded in avoiding several potential political pitfalls. The rumored ambitions of the Yang family (outgoing President Yang Shangkun and his younger half-brother General Yang Baibin) were squashed, and both brothers sidelined, together with a number of potential allies in the military. Equally, several members of the "princelings' party" (the sons and daughters of older leaders whose activities helped fuel popular discontent in 1989), were passed over in the new appointments. The specific names that *were* chosen clearly reflected a good deal of back-room negotiations, and could yet be subject to disruption by unforeseen events (e.g., the currently uncertain health of Premier Li Peng). However, the obvious success of and popular support for the basic policy line ratified by the Congresses is probably of greater ultimate significance for the future than the position of any particular individual among the designated successors. The Congresses' removal of remaining uncertainties over ideology has legitimized the recent and very obvious upsurge in the discussion, proposal and introduction of specific reform measures, at both central and local levels, in many of the most important reform areas. The current policy climate is reviewed in greater detail in the UEM, but key features are outlined below.

22. **SOE Reform**. The central thrust of official policy is now the aggressive promotion of corporatization and marketization reforms in the SOE sector. New regulations (July 1992) seek to improve the definition and protection of *management autonomy* over major business decisions. The center is, in addition, encouraging the conversion of SOEs into *shareholding companies*, with the ownership function exercised by Boards of Directors rather than government bureaus: this step will also help open the door to further *ownership diversification*. In parallel, a *government reorganization* has been announced, designed over several years to reduce the overall size of the bureaucracy and to reorient the work of ministries and bureaus away from their past micro-interventionist traditions. Meanwhile, *bankruptcy provisions and mergers* are being increasingly applied to SOEs. Official sanction has been extended for the *sale or leasing* of at least some of the smaller SOEs to collectives or private enterprises. A cautious approach is currently being taken, however, to the expansion of *stock exchange listings* (not inappropriate at this stage, given the gaps still to be filled in securities market

regulations, as well as the generally weak state of *enterprise accounts*, an area where the Government has recently launched an urgent nationwide upgrading program: as recent stories such as the "Great Wall" bond scam show, weak regulations leave China still vulnerable to financial scandals).

23. **Labor Market (Housing and Social Security) Reform.** As noted earlier, this is a crucial corollary of SOE reform, and one in which the basic lines of official policy have by now been in place for about two years. The scope of fixed-term *labor contracts* for SOE workers (replacing lifetime guarantees) is being expanded. In *housing*, the center has established a timetable for previously nominal rents to increase to cover management, maintenance, depreciation, interest and property taxes by the end of the decade. In parallel, enterprise housing units are to be transferred to commercial housing corporations. As rents rise, the second prong of official policy, encouraging wider owner-occupation, should also come into play. *Pension* rights are starting to be pooled across enterprises: similar reforms for *health insurance* are, however, at a more preliminary stage. Finally, *unemployment insurance* schemes are under development and introduction. It should be stressed, however, that the detailed *implementation* responsibility for the above reforms lies almost entirely at *local* (usually municipality) level, and this is where practical models are having to be worked out.

24. **Financial and Capital Market Reforms.** Following several years without basic policy movement, this area is now receiving reinforced attention. It is symptomatic—and encouraging—that we received a Government request, which has been met, for a strategy paper in this sector earlier this year. Beijing has committed itself in principle to converting the bulk of the existing State banking system into genuinely *commercial banks*, with the autonomy over lending this would imply. Remaining directed "*policy lending*" is to be segregated from commercial banking—initially on an accounting basis, but subsequently through the formation (probably by restructuring existing institutions) of one or more banks dedicated to the provision of policy loans. Banks' *accounting* practices are to be standardized as part of the basis for *more sophisticated methods of monetary control and bank regulation*. Consistent with these changes, gradual deregulation of *interest rates* is projected. On the *capital market* side, meanwhile, new regulatory bodies have been established for the securities exchanges, and foreign investors permitted to purchase certain categories of Chinese equity shares. Finally, there is now active preparation for a *reorganization of PBC*, to strengthen its ability to concentrate exclusively and more effectively on its *central banking* functions. Additional details of the Government's plans are becoming available on almost a daily basis, and the prospects now appear highly encouraging. At a seminar held in mid-September, the authorities indicated their acceptance of our advice to strengthen the autonomy of PBC, and there is reason to expect a corresponding enhancement of the effectiveness of indirect monetary policy instruments.

25. **Fiscal Reform.** This is an area where progress has long been complicated by conflicts of interest between the center and the lower-level administrations that actually carry out the assessment and collection of the great bulk of China's tax revenue. Initiatives under way include efforts to standardize the taxation of *corporate income* (another area

where improved accounting standards are crucial), as well as the gradual diversification of the revenue base, including phased introduction of a *value added tax*. Despite Beijing's desire to regularize its fiscal relationship with lower levels, however, and experiments with "*tax-sharing systems*," there appears no sign of an imminent breakthrough in this politically difficult area: we plan to continue, nonetheless, to press its importance within our own dialogue.

26. **Private Sector Development**. In overall terms, the further development of the private sector is projected to continue to take place *in parallel* with the corporatization and marketization of the SOEs, rather than through efforts at a mass privatization of the existing public sector. The central authorities have undertaken to simplify further the *registration* of new private firms, and to *ease restrictions* over such firms' scope of business. Lower levels, meanwhile, are increasingly active in promoting new *joint venture* subsidiaries between Chinese enterprises (including both SOEs and local collectives) and foreign partners (even if some represent in part a response to advantageous tax treatment of joint ventures). Such activity is likely to increase further following recent announcements *expanding the scope of the open door for FDI* both geographically (to cover *interior regions*) and sectorally (to encompass an increasing range of *tertiary activities*, including retailing, distribution and financial services). The center has also extended its blessing to increased FDI in *infrastructure* sectors. There are already examples of private Hong Kong investment in toll highways, other transport facilities and a 200 MW thermal power station in neighboring Guangdong province, as well as a recent Hong Kong-Chinese joint-venture agreement to develop Shanghai's container port. Assessing the potential for wider replication is now an area of active interest for IFC (paras. 47-48) and the Bank Group as a whole.

27. **Legal Reform**. The authorities recognize that further marketization calls for traditional reliance on administrative mechanisms to give way, across wide areas of the economy, to transparent rules-based systems and a more comprehensive framework of economic law. Given the many areas in which the current legal framework is either clearly deficient or nonexistent, as well as the numerous fields in which, as discussed above, new reform proposals are under active development, something close to a flood of draft legislation is at present circulating in Beijing. The authorities have indicated potential interest in Bank advice and assistance in helping to develop the legal framework in an effective and internally consistent manner: exploring possible modalities for such support will provide a new focus for our proposed assistance strategy (para. 32).

Main Objectives and IBRD/IDA Program of Assistance

28. **Lending and Portfolio.** New Bank commitments to China amounted to just over $2.5 billion in FY92 and $3.2 billion in FY93. Despite modest year-to-year changes in average supervision ratings, to be expected in a growing and maturing program, the overall implementation status of the Bank portfolio in China, currently comprising approximately 100 active investment projects, has continued to be robust (average supervision rating of 1.50), fundamentally reflecting a combination of strong local administrative capability and the powerful sense of borrower ownership that has

consistently characterized the Bank-supported program in China. There are no major implementation problems identified as generic to a significant number of operations, and at any one time there are seldom more than 3-4 specific operations rated as having significant implementation difficulties (while the Government's responsiveness to concerns raised by the Bank is such that projects do not generally remain in this category very long).

29. **Country Dialogue and ESW**. The policy dialogue between China and the Bank is exceptionally strong, reflecting Chinese decisionmakers' trust in the objectivity and relevance of Bank ESW, respect for the quality of the Bank's investment project work across a broad range of sectors and regions, and recognition of the consistency of the institution's support of China's reforms and development throughout the past decade. Formal ESW reports are studied seriously both by the most senior decisionmakers and by officials in the relevant sectors, and studies in recent years have contributed to the evaluation of reform implementation alternatives in areas including the financial and fiscal sectors, housing and social security reform, the development of urban land markets and grain market liberalization, as well as providing comprehensive overviews of issues relating to poverty and the environment. Major reports on China's trade policy and budgetary issues, respectively, are currently being finalized. Planned topics for work over FY94 are summarized in the box below.

CHINA: PROPOSED MAIN AREAS OF ESW FOR FY94

Studies:	Domestic Market Regulation and Development
	State-Owned Enterprise Reform
	Municipal Finance
	Quasi-Fiscal Deficit
	GNP/National Accounts
	Regional Patterns of Development
	Agricultural Marketing
	Water Resources Planning
	Provincial/Municipal Environmental Management
	Higher Education Efficiency
	Health Finance Reform
Strategy Papers:	Financial Sector
	Industrial Policy and Restructuring
	Power Sector
	Transport Sector
	Ports Subsector
	Highways Subsector

30. **Need for Innovation.** Our program in China over much of the past decade largely comprised the two products discussed above: formal ESW reports, prepared after intensive research and providing comprehensive coverage of issues in specific sectors or policy areas; and solid, well-prepared investment projects supporting technological

modernization and institutional development objectives, as well as selected, well-defined sector reform objectives, such as tariff reform in the principal infrastructure sectors. This combination, and the "parallel-track" approach which maintained some distance between the two products, helped to meet specific country needs and demands for technology transfer and institutional modernization during a period when China was still emerging from its earlier international isolation. It was also broadly compatible with the relatively deliberate approach to reform during much of the decade, and the manner in which the leadership then preferred to receive outside advice. What is now apparent, however, is that the earlier product range and the parallel track will no longer serve fully to meet the requirements and demands for assistance being generated by the recently accelerated pace of reform, and the Government's desire to see more intimate Bank involvement in the detailed implementation of the new generation of reforms. We are thus now being challenged to develop new approaches and incorporate additional flexibility into our country assistance program, and this is a challenge the proposed strategy will seek to meet.

31. One clearly identified demand is for the ability to provide *prompt feedback and advice* to decisionmakers on reform implementation alternatives in specific areas through succinct analytical papers, based more upon synthesis than on extensive original research, and produced on a more flexible schedule than formal ESW. During the past year, informal strategy papers of this kind have been provided to the Government in areas including SOE reform, financial sector strategy and short-term macroeconomic management issues: to help reinforce our capacity to respond to additional requests of this type, we are currently restructuring the staffing of the *Resident Mission in China (RMC)*, to put considerably greater emphasis on macro and sector policy analysis skills. Under a second model, we have to date provided intensive assistance, through international workshops and follow-up staff input, to two of China's most important coastal cities (Shanghai and Tianjin) with the design of city-level "*reform action plans*," intended to serve as "living documents" capable of guiding reform implementation on a multi-year basis and underpinning future Bank lending: we plan in the near future to start adapting this model to the needs of selected inland cities (tentatively, Wuhan and Shenyang).

32. In some of the key reform areas, the demand for external assistance with policy analysis and reform implementation issues will clearly go beyond what the Bank can provide from its own resources (in view of the *extent* of the support needed and/or the *specialized skills* involved). We thus expect to make increasing use of *sector-specific TA operations* in future. The first example was provided by the Financial Sector Technical Assistance Project (Credit. 2423-CHA), designed largely to help strengthen the capability of PBC, and approved in September 1992. We are actively discussing with the Government the potential for additional operations of this type, in such areas as economic law reform, further strengthening of financial and capital markets and the development of support services for newly marketized enterprises.

33. A further area where we are introducing innovative products might be described as *reform implementation support operations*. In many areas where reform plans are now active, effective reform implementation will itself call for significant investments in building new or modified institutions, imparting new skills and creating supporting

infrastructure, not only at the center but throughout China's provinces and municipalities. One example concerns the marketization of China's hitherto tightly planned grain distribution system. This reform will not only require development of new institutions and skills (commodities exchanges, commercial trading corporations, etc.), but will also open up new possibilities for more economically rational domestic and international trading patterns that, however, without supporting physical investment, could be frustrated by infrastructure bottlenecks: a grain market reform implementation support operation was recently approved by the Board. A second area is housing and social security reform, where the city-level administrations charged with implementation require assistance with the creation of viable models of commercial housing corporations, housing finance institutions, etc. Here, too, preparation is at an advanced stage. A third example, where we are working actively, relates to labor redeployment issues raised by SOE reform. Existing vocational/technical training models in China focus heavily on *preservice* training: new approaches will be needed to meet the *retraining* requirements of older workers called on to change jobs.

34. **IDA Replenishment**. An additional challenge in the management of the country assistance program, on both the Bank and Government sides, is raised by the decline in availability of IDA resources for China resulting from the decisions, subsequent to last year's CSP, on blend countries in the context of the tenth replenishment (IDA-10). In this connection, we are already discussing with the Chinese authorities our aim of maintaining our existing levels of support for the social sectors, for the development of the poorest regions and for environmental protection and the amelioration of pollution. Internal arrangements for onlending make this a difficult issue for the Chinese to handle and, although the initial response has been encouraging, it will undoubtedly continue to require considerable attention, particularly as the cuts start to bite.

35. **Proposed Operational Program**. As earlier discussion has sought to demonstrate, the central policy stance has by now evolved to provide an enabling environment for rapid further marketization reforms. Certain key policy areas will continue of necessity to be addressed primarily through dialogue at the center—e.g., monetary and financial sector aspects, and fiscal and trade reform—though in these areas too we will explore all possible vehicles for Bank support, including the types of innovative products outlined above. In most other areas, however, reform progress will depend largely on developments at the level of individual sectors, provinces and municipalities, and it is at these levels that we propose to continue to concentrate the bulk of our future lending.

36. Our earliest operations in *industry* focused primarily on supporting the technological modernization of Chinese firms (primarily SOEs) in a selected number of subsectors, itself an important contribution given that prevailing standards were often decades behind international best-practice. Expectations today, however, are pitched much higher, and future involvement in this sector must clearly be designed with the primary objectives of fully supporting and advancing the processes of marketization and transformation now endorsed at the central level. In keeping with the recommendations of our *Enterprise Strategy Paper*, endorsed by Bank Senior Management earlier this year,

understandings have therefore been reached with the Government that future Bank support in the industrial sector (at both the regional and sectoral levels) would need to be provided within specific frameworks fully consistent with marketization and transformation objectives, including:

(a) separation of state firms from government bureaus through restructured corporate forms (including transparent ownership mechanisms);

(b) promotion of ownership diversification;

(c) corporate income tax reform;

(d) accompanying social and labor market reforms (housing, social security, etc.);

(e) competitive market policies, including promoting freedom of entry and exit for both public and private producers; and

(f) satisfactory guarantees of access by nonstate enterprises to Bank support.

37. We are committed to experimenting with the design of industrial investment operations meeting the above objectives at the provincial/municipal level in several regions (including inland as well as more traditional coastal locations), and are also exploring the possibility of applying them in selected subsectors on a cross-provincial basis. One ongoing operation, the Rural Industrial Technology (Spark) Project (Ln. 3274-CHA, Cr. 2186-CHA), seeks to provide support exclusively to the domestic nonstate sector, and we will consider possible further operations with a similar focus. We will also review the possibility to make use of the innovative product models discussed earlier to support industrial enterprise marketization and restructuring.

38. In the *financial* sector, our initial goal was to help introduce modern investment evaluation approaches through the development of a new industrial DFC, the China Investment Bank, CIB (and parallel support, in rural areas, to the Agricultural Bank). Recent years have witnessed a shift in focus to the imperative of strengthening the overall sector policy framework and the institutional capability of PBC, an approach whose operationalization was launched with the recently approved TA project (para. 32). We expect our next financial sector operation to continue and broaden the focus on the sector-wide framework and infrastructure pioneered by the TA project. Given the expected pace of change in this sector, however, attention to the strengthening of PBC and other sector-level agencies will soon need to be supplemented by a focus on the transformation and restructuring of the operating institutions in the sector, including the commercialization of China's state banks. This is thus a sector in which our operational involvement may need to be intensified rather rapidly, and it is a sector in which finding innovative models for reform implementation support will be a central challenge for our assistance strategy.

39. China's *infrastructure* sectors (primarily power and—within transport—rail, roads and ports) have together absorbed over 40 percent of cumulative Bank lending to China. As discussed earlier (para. 5), these have been the key bottleneck sectors, with heavy absolute investment requirements, and the development of effective new mechanisms of *domestic* resource mobilization (fundamentally through tariff reform) has inevitably been a gradual process. As also discussed, however, it is a process now paying off, with the *railways* and the *power sector*, in particular, now better placed for internal resource generation (para. 5) and the *ports* undergoing rapid commercialization, including experiments with the introduction of FDI (para. 26).

40. These changes are now prompting a reevaluation of the future role of the Bank in the infrastructure sectors. We recently submitted a strategy paper on the railways sector to the Board (No. 10592-CHA), and are planning similar papers on ports, highways and electric power, respectively, as well as a strategy document for the transport sector as a whole. With substantial progress already in tariff reform, greater attention is now called for within our policy goals, in the case of the natural monopolies, to promoting *corporatization* accompanied by more transparent systems of *regulation* reflecting the lessons of international best-practice. In subsectors where competitive market structures are a realistic possibility, meanwhile, including ports and—potentially—*telecommunications* (an area where the Bank has yet to lend but where a proposed first operation is due to be negotiated shortly), our priority will be to promote the dual objectives of *commercialization* and subsectoral policy frameworks conducive to *competition* and the introduction of private capital, including FDI.

41. By contrast to the directly revenue-earning subsectors, there has been no comparable breakthrough in the case of China's *highways*. Our analytical work has highlighted the severe modal imbalance of the Chinese transport system (in which almost 60 percent of freight, and close to half the passenger traffic, is still carried by the railways). A modern highway system is urgently needed both to support the further development of marketized production activities and also as a key to greater domestic market integration and more balanced regional development. Within the overall transport system, this is the mode where future capital requirements are likely to be greatest. Our recent intermodal transport study of Guangdong province (Bank Discussion Paper No. 151), for example, recommended that some three quarters of future transport investment in the province should be directed to highway development. It is also, however, the field where domestic resource mobilization is currently least well-developed. We are therefore proposing a major increase in the relative weight given to highway development, and will be taking the study of, and support for, new models of resource mobilization as our leading sector policy objective.

42. In *agriculture* and the *social sectors* last year's CSP explicitly proposed the pursuit of *poverty alleviation* as our highest priority objective. In several of the regions of concentrated absolute poverty, including areas of the northwest as well as the "red soils" areas found in much of the southeast, we consider that farming models already in existence (developed in part through earlier Bank projects) have proven their worth, and we are now preparing successor operations to promote their replication on a larger scale. Rural income

generation in the most resource-poor areas of the southwest, by contrast, has less in the way of proven farm technology packages to build on. As an outgrowth of our recent poverty study (paras. 6-7), we plan very shortly to launch the identification of a poverty alleviation project in the southwest: given the difficult local conditions, innovative approaches (possibly including a multisectoral strategy) are likely to be required.

43. In the social sectors, similarly, operations recently approved or in the active pipeline exemplify the priority now being given to the problems of the poorest areas (para. 7), including basic education for girls and maternal health care priorities. The Education Development in Poor Provinces Project (Cr. 23390-CHA), which seeks to strengthen basic education provision in six of China's poorest provinces, is expected to be followed by a successor operation extending the approach to additional poor regions. Work is also under way on a Maternal and Child Health Project, similarly targeted at poor rural areas. The recently approved Rural Health Workers Development Project includes provisions intended to help develop appropriate and sustainable financing mechanisms for rural health care which, if successful, could provide the basis for wider replication.

44. Beyond the primary goal of poverty alleviation, there are additional areas in agriculture and the social sectors where Bank assistance has an important role to play. Our support for the marketization of China's *grain* sector has already been noted (para. 33), as have our efforts, within the social sectors, in vocational retraining (para. 33) and health finance reform (box attached to para. 29). In addition, strengthened *water resource planning* is a vital priority for China, both for agricultural and other end-uses, and in both the water-scarce north of the country and flood-prone areas further south. Despite well-established domestic capability in irrigation development, particularly at the local level, water-use planning on a regional or cross-regional basis tends to strain both the older generation of planning models currently in use within China and established mechanisms for interprovincial coordination. In addition, while a recent Bank review has confirmed that Chinese mechanisms for planning and implementation of *resettlement* have generally produced very satisfactory results in recent years (and a report on this study has been issued in Gray Cover recently), it is also clear that it is the larger water development projects that are most likely to put pressure on the adequacy of these mechanisms. This sector is therefore proposed to continue as an area of active Bank involvement.

45. Our first comprehensive strategy paper on China's *environment* (No. 9669-CHA) was completed in April 1992 and its recommendations were summarized in last year's CSP. These recommendations provide the basis for what has become the fastest-growing area of concentration in our lending program, and we have recently concluded that a new sector division should be created, to focus exclusively on future environmental activities, while permitting sufficient attention also to be given to our work on education and health. Three investment operations addressing the amelioration of environmental conditions, especially in the field of water pollution, and located in—respectively—Southern Jiangsu, Zhejiang and Changchun, were approved during the course of FY93 (Ln. 3582-CHA; Credits 2475-CHA and 2457-CHA). Work is under way on a pipeline of further investment projects in additional priority cities and provinces: as in the earlier operations, each will include significant TA for the strengthening of local environmental

management agencies and will also promote the corporatization of local public utilities such as water supply, sewage treatment and solid waste management services, to ensure that their operations are placed on a financially sustainable basis. In addition, we propose to follow the earlier overall strategy paper with a new phase of environmental ESW that will focus in greater depth on environmental management issues as seen from the *provincial and municipal* levels. More immediately, the Board recently approved a first Bank-supported Environmental Technical Assistance Project, intended to help strengthen further the institutional capability of China's National Environmental Protection Agency (NEPA) and other key sector agencies, as well as to support focused studies in priority areas of sector policy.

46. **Cooperation with Other Sources of Financing**. There are no major changes to report in our relations with the IMF, ADB, UNDP or with the principal sources of bilateral funding. As pointed out in last year's CSP, Chinese administrative mechanisms for financing development projects have generally not, in the past, been conducive to *cofinancing* on a large scale: although both ADB and Japanese Government agencies have sizable programs within China, the Government has to date in practice preferred to have just one channel of major overseas funding per project. There have, however, been some recent indications of possible interest in experimenting with more extensive use of cofinancing, which we will continue to pursue (including possible ECOs). In the industrial sector, in particular, we are looking to the possibility of encouraging more extensive involvement of joint ventures with foreign investors. In addition, the Government's expressed intention to encourage greater *private* investment in the *infrastructure* sectors (para. 26) should, over time, open new possibilities in this area. We will be exploring the issues involved and potential vehicles over the coming year.

47. **IFC and MIGA**. IFC's country assistance strategy for China focuses on three principal objectives: (i) promotion of a more favorable foreign investment framework, (ii) catalyst to the expansion of private sector investment, and (iii) acceleration and deepening of financial and capital markets. To respond effectively to the rapid development of the Chinese economy in the context of a continued move towards a market economy, IFC opened its first representative office in Beijing in October 1992. IFC's active participation is being sought by the authorities in China, particularly as the economy is moving towards a more market-based system, with an increasing emphasis on private sector led growth.

48. IFC's operations in China have so far concentrated on supporting joint ventures between foreign investors and Chinese enterprises. IFC plays an important advisory role in China in helping to structure these transactions and in arranging finance on a project risk basis without guarantees from government banks. Work in the capital markets area includes the establishment of a joint venture bank, and technical assistance to the new Securities Regulatory Commission, which will focus on the adequacy and regulations for the rapidly expanding stock markets in China. IFC has also encountered lively interest in infrastructure projects, where the scope for private investment is substantial, as China recently announced new policies to encourage foreign participation in infrastructure development. IFC's progress in infrastructure projects in the near future

will depend on stronger efforts by the Chinese government to develop a suitable environment for private investments, including the legal and regulatory framework, as well as the institutional infrastructure, for private business operations. In the Bank's fiscal year 1993, IFC approved financing for four projects in China, in the areas of banking, cement and manufacturing, totaling $42.8 million, which brought IFC's accumulated total investments in China to $103.4 million. As of June 1993, *MIGA* had approved one investment guarantee in China, with a package of additional guarantees expected to be submitted for approval very shortly.

49. **Proposed Bank Lending Program**. As discussed in Section B above, China's external position has been generally strong in recent years, with substantial inflows of FDI, especially into export-oriented manufacturing, and—until the recent deterioration—surpluses on the trade account. With strong private capital inflows into certain sectors of the economy (para. 16), and the current account deficit projected to remain moderate (para. 18), capital transfer is not the primary objective or determining principle of the level of Bank lending which, even at current and proposed levels, accounts for only a relatively minor share of China's total resource requirements. Rather, we see our operational program as a mechanism for helping to provide vital support for the nationwide implementation of the ongoing reforms, as well as the crucial objectives of poverty alleviation and environmental protection, discussed earlier in this paper.

50. The composition of our future lending program is proposed to continue to be broad-based in both geographical and sectoral terms, in view of the extensive agenda outlined in the present paper. In several sectors, as noted earlier (para. 42), social objectives have already prompted an increased emphasis on China's interior provinces, and we also believe a strong case exists for a similar relative shift of geographical focus in several others, including industry and highways. More broadly, we recognize the need for additional flexibility in the development of the lending program, including the ability to bring forward innovative operations on a fairly tight timetable as warranted by reform implementation needs, but equally the freedom to drop earlier proposals no longer seen as responsive to rapidly changing conditions. As such, the composition of any multiyear Lending Program proposed at the present time must be considered more subject to change than in previous years: it may be taken almost as a certainty that new operations, e.g., of the sector-specific TA or reform implementation support variety, will in fact be developed during the period in question, consistent with the reform impetus and support needs in different sectors and policy areas.

51. In terms of *scale* of future lending, a very crucial element that now needs to be allowed for is the change, since the last CSP, in China's status within IDA. We have explained to the Chinese authorities that, in practical terms, they should assume that IDA resources for China will henceforth decline by roughly $200 million a year (from about $850 million in FY94 to $50 million in FY98, assumed to be the pregraduation year), and this scenario has been accepted. We have additionally explained that: (a) future IDA flows will be concentrated on supporting IDA objectives in the areas of poverty alleviation, the environment and the social sectors, and will not be available to finance investment operations in other sectors; and (b) the Bank would expect, despite the IDA

decline, to safeguard its current level of operational involvement in the above sectors. These factors have obvious implications for the substitution of IBRD for IDA lending within the overall portfolio—indeed, on resource transfer grounds, a case could be made for being prepared to offer such substitution on a more than one-to-one basis. As a minimum, the delivery of any given size of total lending program will now imply greater use of IBRD resources than was assumed at the time of the last CSP. This substitution, in turn, has the result of advancing, compared to the situation at the time of the CSP, the date at which IBRD exposure limits must be factored into the equation.

52. The *Base Case* for lending approved following last year's review of the CSP envisaged 45 operation over FY94-96, with an associated IBRD/IDA lending volume of close to $9 billion. With no change in circumstances, the subsequent acceleration in reform discussed in earlier sections of this memorandum may be considered to create a strong case for now recommending a move to the CSP High Case (51 operations; combined lending of $11 billion). We are still convinced that the Bank should now be maximizing its opportunity to provide support for the implementation of the next, crucial phase of China's reforms. We accept, however, that in view of the IDA substitution factor discussed above and the need to respect IBRD exposure guidelines (as well as internal budgetary constraints on the number of operations the Department can feasibly expect to deliver), such an outcome is, in practice, likely to be much closer to last year's Base Case than the original High Case. As such, we are now recommending a lending program for FY94-96 of 44-45 operations, involving total lending of about $9.1 billion (IDA: $1.95 billion, phased as per para. 48 above; IBRD: $7.15 billion, assumed to be phased roughly: FY94, $2.25 billion; FY95, $2.35 billion; FY96, $2.55 billion). *For purposes of projecting exposure, we have assumed the FY96 level of IBRD commitments to be sustained in all subsequent years.*

53. Based on the Region's proposal above, China's DOD is projected by FRS, as shown below, to remain within the 10 percent guideline through the year 2000.

	(%)
FY93 (actual)	4.0
FY95	4.9
FY97	6.9
FY98	8.0
FY99	9.0
FY2000	9.9

The possibility on this basis of exceeding the 10 percent guideline temporarily at some point in the next century is one that cannot be totally precluded. This possibility is not, however, considered by the Region to justify a further compression of the proposed lending program to China over the period now under review. Aside from the high degree of uncertainty surrounding the Bank-wide totals after the year 2000, the lending proposals made above go no further than meeting the assurances provided to the Chinese, at the time of the IDA-10 negotiations, that any loss in IDA resources would be compensated for by access to IBRD funds. If the Bank were now to retreat from this assurance, based on an unusually rigid application of the 10 percent guideline to long-term projections, the institution's hard-earned credibility in China could suffer damage, with (arguably) no obvious compensating real gain in the Bank's own financial soundness.

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

D-42

cc: DM

CSP file

DATE: July 8, 1993

TO: Those Listed Below

FROM: Anthony J. Ody, Principal Country Officer, EA2CO

EXTENSION: 82344

SUBJECT: China: 1993 CSP Updating Memorandum
Minutes of Regional Review

1. A meeting was held under Mr. Kaji's chairmanship on July 7, 1993 to review the above draft "Country Strategy Note" (CSN). Attendants are listed below.

2. Invited by the chairman to summarize key issues for discussion, Mr. Burki (EA2DR) first highlighted the size of the proposed Lending Program. On the basis of country developments alone, the Department would have been prepared to propose a move to the High Case scenario put forward in last year's CSP (51 operations over FY94-96, with combined IBRD/IDA lending of about $11 billion). The actual proposal in the CSN (44-45 operations, combined lending of about $9.1 billion) reflected three constraints: the need for substitution of IBRD resources for recently agreed reductions in China's IDA share; IBRD exposure limits; and internal budgetary constraints. Secondly, Mr. Burki drew attention to the Department's proposal to put greater focus, within its overall ESW program, on a more flexible approach, including expanded use of shorter turnaround strategy papers: three such pieces produced over the last year (on public enterprise reform, the financial sector and macroeconomic management) had already achieved a profound impact within China. Finally, he said, the Department needed to receive management guidance, within the broader context of the Lending Program scale issue, on the order of magnitude of co-financing it should pursue in China. On the latter point, the chairman responded that the CSN's presentation of this issue required further sharpening. In his own view, the Bank could do more in the way of co-financing in China, so as to leverage constrained IBRD resources while still ensuring its "seat at the table". This question should be followed-up, especially with established Bank borrowers.

3. Ms. Nishimizu (FRSDR) pursued the issue of IBRD exposure, and questioned whether it was appropriate to plan on a basis that might result in China's share of IBRD debt outstanding and disbursed (DOD) rising above 10 percent at some point after the turn of the century. Given the expected pattern of disbursements, the level of commitments over FY94-96 would play a key role in determining the outcome over the subsequent few years. The chairman answered that this issue needed to be viewed in the broader context of the Bank's overall country relationship. In convincing the Chinese authorities of the need for early and very substantial reductions in China's access to IDA resources, the senior management had provided assurances on the Bank's readiness to substitute IBRD lending for previously available IDA credits. A credibility issue would thus arise if IBRD exposure guidelines were now to be applied to China in a more rigid manner than was known in practice to prevail for other major borrowers. He

agreed, however, that this was an issue that should be posed more explicitly in the revised version of the CSN.

4. In response to suggestions from Mr. Ritchie (ASTDR) and Mr. Sud (CFSDR) that Japanese channels (official and, possibly, private) might now be showing more serious interest in possible co-financing with the Bank in China, Mr. Burki said that these were sources the Department had been pursuing for the past three years: it was necessary to remain realistic about the prospects. Mr. Kaji added that, in considering the longer-term (post-year 2000) exposure outcomes, levels of commitment after FY94-96 would start to become more relevant, and it was in this period that larger co-financing levels were in practice likely to impact on the IBRD lending volume to a more significant extent.

5. Turning to the draft CSN's proposals on ESW and related activities, Mr. Kaji noted that Chinese demands for more intensive assistance had internal resource implications for the Department. In this regard, he welcomed the intention to make increased use of technical assistance (TA) operations; greater focus should, in addition, be given to fostering the development of indigenous capacity for policy analysis. Continuing with the theme of internal resource constraints, he said that, while he appreciated the CSN's message on China's need for help with the "nuts and bolts" of reform implementation, the Department should in parallel pursue options for resource savings in delivering some of its lending operations, possibly including a regional approach to "repeater" operations in selected cases.

6. Ms. Nishimizu felt that the Department needed to make more explicit its analysis of the socio-political stresses that might be associated with a possible "hard landing" from the current overheating, particularly in the light of recent media attention to incidents of rural discontent. Mr. Burki replied that reports of this kind needed to be placed in a broader context than was generally done by the press: such problems as existed could not, for example, be compared to those seen in parts of South Asia. Recent discussions with Chinese leaders on the macroeconomic situation indicated a high degree of receptiveness to the Bank's policy recommendations. Taking account, in addition, of China's ability during previous cycles to ride out temporary setbacks without lasting damage to its economic progress, he believed that Beijing would demonstrate that the lessons of the past had in fact been absorbed, and would succeed in introducing an effective stabilization program combining both indirect instruments and some necessary direct measures. The provinces might grumble initially, but would in practice fall in line. It was not unreasonable to expect that, by about the spring of next year, visible improvements in the macroeconomic situation would be in evidence.

7. Following up, Ms. Nishimizu asked whether, nonetheless, the CSN should not have presented a "Low Case" scenario for Bank lending. Messrs. Kaji and Burki replied that such a scenario had been prepared in the previous year's CSP but was not really relevant to the present situation, in which the effectiveness of stabilization, rather than the commitment to reform, was the key issue. Mr. Kaji added that, with infrastructure bottlenecks making a major contribution to overheating, a cutback in

lending at this stage would be counterproductive. Mr. Thomas (EAPVP) pointed out that, on the macroeconomic side, the downside risks were explored in greater detail in the recently completed Updating Economic Memorandum (UEM). Mr. Ritchie wondered if, by contrast, the CSN should not be laying out a "High Case" scenario. Mr. Kaji responded that in his view the relatively modest differences between the Base and High Cases of the 1992 CSP were not now the key issue to pursue. What mattered was ensuring that the Bank had a sufficiently solid presence in the provinces to make an effective contribution and, beyond this, avoiding the suggestion of "salami tactics" which would arise if IDA reductions were now to be followed by cuts in the planned IBRD program.

8. Mr. Ray (DPGDR) said one should not disregard the impact media reports could have. It needed to be made more explicit whether the Department was tracking regional inequality and whether this was viewed as a major source of concern. Expanded treatment was also needed of the alternative macroeconomic scenarios, including the "hard landing" possibility. To this, Mr. Dadush (IECAP) added that more information was also needed on the external implications of the different macro scenarios: if a "hard landing" were to damage foreign investors' confidence, foreign direct investment (FDI) might fall and in turn impact the trade balance. Mr. Burki replied that somewhat more detail could be provided on the so-called "hard landing" case in the CSN (it was pointed out that full details of the relevant projections on the external side were also contained in the UEM). On investor confidence, he continued that, in practice, many foreign businesses which had failed to invest in China earlier now regretted this: investors did not, he said, look at China in isolation but in comparison with other possible locations, and they too could appreciate the record of the past. Mr. Harrold (EA2DR) added that a "hard" landing should not be interpreted to mean a crash landing.

9. Ms. Nishimizu asked how the Department would respond if the Chinese authorities declined to accept its proposal for safeguarding the Bank's involvement in poverty alleviation, the social sectors and the environment in the face of IDA cuts. Mr. Burki responded that China now accepted the inevitability of the IDA reductions and he did not believe the Bank's program in these sectors would in fact be affected. Beyond this, the central Ministry of Finance was starting to receive repayment of some earlier IDA credits, which should ease the transition. Mr. Kaji concurred that the Department had been effective in communicating this message.

10. Mr. Khan (IFC) said that serious problems still remained in China's policy environment for attracting foreign investment. Most FDI continued to come from overseas Chinese sources and to be concentrated on small-scale projects, involving relatively low-level technology and oriented overwhelmingly to export markets. IFC saw the larger, more sophisticated, domestically-oriented investments which it considered China needed as held back by continued imperfections in the foreign exchange market. The organization of foreign currency "swap markets" on provincial lines made the availability of foreign exchange (rather than just its price) a risk to FDI intended to serve domestic markets: in addition, it distorted investors' locational and marketing decisions.

IFC's own recent experience - in talking, for example, to the Hong Kong banks - was that they were not prepared to accept this risk and insisted on guarantees from the Bank of China or its affiliates. In this context, he said, IFC's potential partners urgently needed to see a clear timetable for exchange rate unification and convertibility.

11. Mr. Kaji acknowledged the challenges IFC faced in re-entering China. Nonetheless, in overall terms, it was appropriate to present China's achievement in attracting record levels of FDI as a major success story. Mr. Burki added that the changes already seen in foreign exchange markets represented a fundamental transformation of the situation. The leadership fully recognized the need, in China's own interest, for further advances, and he was convinced that these would indeed materialize. His advice for the Corporation at this stage was that doing business successfully in China called for perseverance and commitment. Mr. Harrold added that the recommendations of the Department's recently completed Trade Report highlighted the case for further foreign exchange market reform - the exchange rate per se was an area where the IMF's leadership was respected. While recent months had seen unusual turbulence in the markets, there was a clear understanding on the Chinese side of what needed to be done over the next 2-3 years.

12. In conclusion, Ms. Nishimizu expressed appreciation for the clarity with which the Department had expressed its strategic vision and its proposals for operational innovation. Mr. Kaji closed by observing that the meeting had provided valuable guidance on the areas where further sharpening of the draft CSN was needed.

Cleared with and cc: Mr. Kaji (EAPVP)
Mr. Burki (EA2DR)

<u>Meeting Participants:</u>

Messrs./Mmes. Ody, Harrold, Rix, Lall, Kumar, Manuelyan Atinc, Raparla (EA2CO); T. Hassan (LEGEA); Nishimizu (FRSDR); Thomas, Siraj (EAPVP); Ritchie (ASTDR); Ray (DPGDR); Plant (EA2EU); Dadush, Otsubo (IECAP); Jones-Carroll (EAPCA); Dinh (FRSCR); Khan (CASD1); Wang (CASDR); Gwilliam (TWUTD); Tay (EA2AG); Sud (CRSDR); Rasheed (EA2TP); Farrell (CASCM)

cc: Messrs./Mmes. Agarwala, El Maaroufi (EAPVP); Kimura, Sonmez (EA2DR); Pearce (EA2CO); Goldberg (EA2AG); Newfarmer (EA2IE); Stott (EA2TP); Ecevit (EA2EH); Bottelier (EA2CH); Madavo (EA1DR); Haug (EA3DR); Ikram (EA1CO); Shilling (EA3CO); M. Koch-Weser (ASTEN); Rao (DECVP); McCarthy (DPG); Husain (AFRCE); Nankani (SASVP); Selowsky (ECAVP); Squire (MNAVP); Birdsall

(PRDDR); Golan (EDIDR); M. Ahmed (IECDI); Yusuf (RAD); Amoako (ESPDR); Adams (OPRDR); de Merode (PHNDR); Iida (MIGEX); Long (FSDDR); Iskander (PSDDR); Stern (IENDR); El-Ashry (ENVDR); Petit (AGRDR); Pouliquen (TWUDR); Horiguchi, Otani, Bell, Kochhar, Scott, Khor (IMF); Hassan (LEGEA); Freeman (CASDR); Perkins (CASD1); Bond (CPLD1); Kashiwaya (CFSVP); Linn (FPRVP); Serageldin (ESDVP); Rischard (FPDVP); Choksi (HROVP); Pfeffermann (CEIED); Raghavan (LOADR); Neiss (IMF); Lynn (PBDDR); Weigel (CFAFI); Lay (FODDR)

EA2CO H/L Staff
Asian Information Center

[CSP Reg.min.]
AOdy:ef

File

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: June 30, 1993

TO: Those Listed Below

FROM: Shahid Javed Burki, Director, EA2DR SJB

EXTENSION: 82332

SUBJECT: China: 1993 CSP Updating Memorandum
Draft for Regional Review

1. Attached please find a revised version of the above memorandum, which is scheduled to be reviewed at a meeting under the chairmanship of Mr. Gautam Kaji at 10:00 a.m. on Wednesday, July 7, 1993, Conference E10-048.

Attachment

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CHINA: 1993 CSP UPDATING MEMORANDUM

EXECUTIVE SUMMARY

i. The past year has witnessed key meetings of China's party congress and national legislature, which gave their approval to the collective leadership succession proposed by veteran leader Deng Xiaoping. In many ways even more importantly, the Congresses authoritatively changed the official definition of China's basic economic ideology, removing references to planning and public ownership and substituting a "socialist market" creed. With this clearing of the ideological air, recent months have witnessed a near-ferment of new market-oriented reform proposals in many key areas of public policy, including those targeted by last year's CSP [reform of state-owned enterprises (SOEs); housing and social security reform; financial sector reform; and reform of prices and markets]. In the latter area, indeed, the liberalization of product pricing and the adjustment of the most distorted prices (energy, rail tariffs, raw materials and grain) have come so far over the past two years that the remaining steps are starting to look significantly less challenging than before.

ii. Beyond the speeding-up of market-oriented reforms in these and other areas (see paras. iv, v), the news in recent months has been dominated by macroeconomic developments. The further acceleration of the boom during 1992 brought real GDP growth from around 7 percent in 1991 to almost 13 percent, well above the 8-9 percent which we and the Government see as the safe trend rate. Much of the fuel came from monetary expansion, running at over 30 percent. Results for the first quarter of 1993 confirmed the costs of this pace of growth, including a swift turnaround in the trade balance and escalating inflation, and the Government promptly accepted our advice on the need for immediate action to avoid further deterioration and try to achieve a "soft landing." The specific measures of monetary and fiscal tightening announced since the middle of May deserve to be welcomed for the emphasis they place on the use of indirect policy instruments, consistent with the economy's increasing market-orientation, as opposed to the old administrative armory of the past. At the same time, we are leaving the authorities in no doubt about our view that these measures do not yet go far enough. This message was given in very strong language at a high-level seminar held in June to discuss macroeconomic policy issues. In addition, while we do not expect the external accounts to be allowed to get out of hand, we are emphasizing the benefits of extending more market-oriented (rather than administrative) approaches in this area as well, and have recently completed a major ESW report advocating a combination of further trade liberalization with exchange rate reform. Helping to avoid another bout of chronic overheating, with the potential for reform setbacks this has brought in the past, has thus become our highest priority for the immediate future.

iii. The risk cannot be ruled out that, as has happened before, the Chinese authorities will miss the chance to achieve a relatively soft landing for their overheated economy. In favor of an *optimistic* view are the heightened sensitivity of central leaders, following the lessons of 1988-90, to the *dangers* of delaying an effective response and being subsequently forced into an abrupt deceleration (interruption of reform momentum, sociopolitical stresses, loss of domestic and international confidence), the increasing economic sophistication of their own domestic policy analysts and the fact that a substantially larger share of the economy is now more highly marketized and hence susceptible to management through indirect policy levers. The sources of *concern*, by contrast, are that much of the investment pressure still comes from the least reformed sectors of the economy—local authorities and locally-controlled state enterprises—which have their own powerful political patrons among provincial leaders. The latter have, in the past, too often put parochial development interests above the national need for stability until forced to give ground by an obvious crisis. No one can rule out the danger that this will happen again, and thus China *may* again experience a hard landing.

iv. On the reform front, the Government has announced new measures to increase further the role of private sector investment in the economy [including Foreign Direct Investment (FDI), currently running at record levels of around $10 billion a year.] These include opening-up inland areas, the service sectors and—in a recent initiative whose implications have yet to be fully assessed—even the provision of physical infrastructure to private FDI. In a more general sense, private sector development continues to move largely *in parallel* with SOE reform rather than being seen, as in some other economies attempting transition, as an immediate or large-scale component of the solution to the SOE's problems. The key features in the next phase of China's assault on SOE reform will thus, in general, involve not so much privatization as "corporatization" and "marketization." Consistent with our Strategy Paper on SOE Reform, approved earlier this year, these measures will be designed to convert the SOEs from miniature welfare-states, subject to extensive bureaucratic interference and protected from market discipline by a range of distortions in pricing, taxation and financial markets, into market-oriented commercial corporations, whose workers look outside the factory-gates for social security or housing provision, and whose managers are responsible for their performance to well-defined owners' representatives. The past year has seen further advances in defining and protecting managers' autonomy and promoting the adoption of more transparent mechanisms of corporate governance: we expect active innovation in this area to continue. In parallel, the Government has explicitly committed itself to cutting and restructuring the public bureaucracy so as to reorient it away from the micro-interventionist tendencies of the past.

v. Recent months have also seen a new intensification of interest in the previously slow-moving area of financial sector reform. Sector reform is projected to include separating remaining directed "policy lending" from a newly commercialized mainstream banking sector, accompanied by the restructuring and further strengthening of China's Central Bank. These are changes the Bank has long been urging. They will also be ambitious and far-reaching changes and, when they start to be introduced in earnest, we can expect to be called on to supplement our largely advisory role of recent years with substantially expanded hands-on operational involvement.

vi. In addition to providing advice and practical implementation support for the new phase of economic reforms, Bank objectives also include other priority goals set out and approved in last year's CSP: helping to break the recurrent infrastructure bottlenecks which have repeatedly constrained China's growth; promoting the expansion of income-generating opportunities and improved provision of basic social services for the country's 100 million hardcore rural poor; and supporting policymakers and local administrations confronting the formidable challenges posed by air and water pollution. Broadly speaking, our strategies in these three areas will continue to follow the lines set out in the 1992 CSP. Some shifts of emphasis will, however, be warranted. In the infrastructure sectors, in particular, recent progress with tariff reform means that attention can increasingly shift to the corporatization of service provision along more commercial lines, accompanied by the development of more transparent regulatory frameworks. It also, however, leaves the inadequacy of China's highway network, starved for dependable sources of investment financing, all the more apparent—and we propose a further increase in the emphasis given to highways development in our own operational program.

vii. An additional challenge which has emerged since the approval of the 1992 CSP concerns the management of the decline in IDA availability resulting from decisions taken on "blend" countries during the tenth replenishment. Domestic onlending arrangements create a danger that the hardening of China's IBRD/IDA blend could lead to reduced willingness to borrow in the areas of poverty alleviation, the social sectors and the environment. We have communicated our view that such an outcome would be unacceptable. The early response has been encouraging, but we can expect this issue to resurface as the cuts start to become effective.

viii. The accelerated pace of reform is being accompanied by a heightened appetite for Bank advice and assistance, not only with broad policy issues but also, very crucially, with the details of reform implementation, often delegated by the central decisionmakers to sectoral agencies or, more often, local authorities. With the major philosophical barriers now mostly crossed, these "nuts and bolts" questions will increasingly determine China's success in translating its bold reform intentions into working reality. In turn, with no other outside agency able to match the Bank's experience or credibility within China, we ourselves face difficult challenges in trying to leverage our own limited resources in innovative ways so as to maintain our responsiveness to the country's requirements and demands, including the related priority of strengthening our presence in China's less-advanced inland regions. Economic and sector work will need to become more flexible to meet calls for immediate advice on specific reform implementation choices, and we are restaffing our Resident Mission to help meet this need. Sector-specific technical assistance operations may offer another promising new model. In addition, our lending operations are rapidly acquiring more of a "reform implementation support" element, precisely to help meet the "nuts and bolts" needs of putting reform into practice.

ix. The quickening of the reform impulse outlined above may be considered to meet, in substantive terms, the basic conditions set out in last year's CSP for moving from the CSP's *Base Case* lending scenario (about 45 operations over FY94-96, with combined

IBRD/IDA lending of close to $9 billion) up to the *High Case* scenario (about 51 operations, with combined lending of about $11 billion). In *not* making such a recommendation at this time, we have been guided by three considerations:

(a) The decline in China's expected IDA allocation under IDA 10, compared to the assumptions made in the CSP, creates an imperative to substitute IBRD lending for previously anticipated IDA credits;

(b) This, in turn, brings forward the date at which attention needs to be given to issues of IBRD exposure limits; and

(c) The internal budgetary implications of seeking to process a larger number of projects.

x. Accordingly, we propose to continue working at a level approximately equivalent to last year's *Base Case* (44-45 operations over FY94-96, with combined lending of an estimated $9.1 billion). On this basis, China's share of IBRD debt outstanding and disbursed is forecast to remain within the 10 percent guideline through at least the turn of the decade.

CHINA: 1993 CSP UPDATING MEMORANDUM

1. The 1992 Country Strategy Paper (CSP) was reviewed and approved by the President's Office on June 12, 1993. The present "Country Strategy Note" (CSN) updates our analysis of the reform climate and macroeconomic situation to cover the events of the past twelve months, and proposes appropriate modifications in our country assistance strategy in keeping with the rapidly evolving situation in China. An Updating Economic Memorandum (UEM), based on a mission to China in April 1993, is being finalized in parallel with this CSN.

A. Background: Key Challenges

2. Last year's CSP and a number of other Bank documents have extensively documented the key achievements of China's reforms to date—the marketization of agriculture, the rapid growth of nonstate activity in industry and services, the "open door" to trade and foreign direct investment (FDI)—and the ensuing growth in GDP (averaging 9 percent) and productivity. Rather than repeating this discussion, we concentrate here on the areas where we still see major challenges remaining. Many of the priority areas from last year's CSP remain (e.g., the key nexus of SOE reform, connected social reforms and financial sector reform), though the recent impetus seen behind price reforms (paras. 4, 5) means that this area has now dropped somewhat down the scale of our priorities. By contrast, the short-term macroeconomic situation has emphatically increased in visibility since June of last year. We therefore list the following key challenges:

(a) Intensifying the marketization of those domestic producers of tradable goods still significantly shielded from market forces, i.e., *China's state-owned enterprises (SOEs)*: a process that needs to move in parallel with the further development of domestic *factor* markets (including *financial and labor market reforms*);

(b) Continuing to address perennial constraints to growth in the domestic nontradable sectors: principally energy, transport and communications *infrastructure bottlenecks*;

(c) Developing effective responses to the plight of the 100 million Chinese poor still largely bypassed by reform-induced development; and

(d) Further strengthening indirect instruments of *macroeconomic demand management* consistent with an increasingly marketized economy and, as the *highest and most urgent priority of short-term policy*, making effective use of them to achieve a "soft landing" from the pressures of overheating that have recently emerged.

3. **State-Owned Enterprises and Related Reforms.** As in the CSP, this continues to be seen as the key longer-term challenge. To summarize our basic analysis,

China's 100,000 SOEs have continued to operate in an environment characterized by significant administrative involvement in economic decision-making and to be sheltered from the ultimate discipline of "hard budget constraints." The relatively cautious pace of SOE marketization hitherto can be largely attributed to concerns over the potential social impact of fundamental restructuring on the SOEs' workforce, over 70 million strong and, together with dependents, covering the bulk of the population in the main cities. The SOE workers' vulnerability, in turn, has reflected patterns of social security provision designed in the context of traditional lifetime employment, including dependence on the employing enterprise for subsidized housing, unfunded and nontransferable pension rights and medical insurance, together with the absence, until very recently, of formal systems of unemployment compensation or meaningful urban labor markets. A variety of mechanisms has served, in practice, to soften SOE budget constraints so as to avoid redundancies or bankruptcy, including—in addition to explicit budgetary subsidies—concessional pricing on Plan allocations of energy and raw materials; ad hoc local negotiation of corporate income tax bills; and preferential access to directed credit, often on favorable terms, from the state banking system. Beyond this, SOE managers have continued to be subject to extensive involvement in business decisions by government agencies: the organization of these bureaus, both centrally and locally, along narrow, subsector-specific lines has served, inter alia, to inhibit diversification strategies and, to a considerable degree, to "freeze" the pattern of SOE investment and output.

4. A certain amount of progress has already been made in the marketization of the SOE sector. Final output markets are far less subject to state control (90 percent of retail prices are now uncontrolled) and have also been increasingly influenced by competitive pressure from nonstate entrants; the financing of industrial investment has been largely shifted from the budget to the banks and retained earnings; and energy supplies and raw materials are now subject to multiple-tier pricing, with at least out-of-Plan supplies at the margin at generally realistic market prices. In addition, "contract management system" reforms from the mid-1980s, which converted SOEs' formal objectives from gross output to profit maximization, provided managers substantially enhanced autonomy over the allocation of resources (including labor) *within* the individual enterprise: Bank-supported studies have identified a resulting upward trend in SOE productivity. At the same time, the earlier phase of reforms fell short of a more fundamental restructuring involving cross-enterprise or cross-sectoral resource reallocation; the SOEs continue to show slower growth in productivity or output than nonstate enterprises; SOEs still absorb a disproportionate share of formal credit (approximately four fifths) and of the best-qualified entrants to the workforce; and visible SOE losses (generally considered understated as a result of weak accounting standards) are equivalent to 4-5 percent of GDP, or close to double the total budget deficit. Broader ramifications of the SOEs' protected status include obstacles to relaxing continued government dominance over the allocation of bank lending (as well as to placing the taxation system on a more transparent basis). As such, SOE reform is needed not merely as an end in itself, but also as a means toward freeing-up markets (including the capital market) in order to permit greater responsiveness to demand from the *nonstate* sector. The Chinese authorities' recently reinforced commitment to more fundamental marketization of the SOEs is discussed in greater detail in Section C below.

5. **Infrastructure.** Basic infrastructure bottlenecks, as also noted by the CSP, have played a part in choking off growth in each of the recent episodes of overheating, including 1985 and 1988/89, and reports of power shortages and congestion on the railways and at the ports have again surfaced in recent months. Investment in transport and energy has been constrained from two sides—erosion of the budgetary funds that were the traditional sources, and low controlled prices for nontradable services, which inhibited self-financing (while also stimulating wasteful consumption). Bank-supported price reforms, which have accelerated over the past two years, have gone a long way toward removing past distortions: recently increased rail tariffs are expected to permit the self-financing of about 80 percent of planned sectoral investments, while average consumer electricity tariffs are now estimated to be in excess of 90 percent of long-run marginal cost. Even in these sectors, however, backlogs and unevenness in regional coverage remain. Meanwhile, efforts to develop a more balanced transport system, in particular a modern highway network, continue to be hampered by the absence of robust road financing mechanisms, while telecommunications coverage remains at low levels, in part reflecting quasi-monopolistic traditions and past resistance to competitive entry. Recent policy initiatives in the infrastructure area are also reviewed in Section C.

6. **Poverty.** A major Bank report finalized during the last year (No. 10409-CHA) has broadly confirmed the view of this issue taken in the 1992 CSP. It shows that, while the first five years of reform lifted some 170 million Chinese out of absolute poverty, the population remaining in poverty (close to 100 million) has shown no discernible reduction over the last decade. Absolute poverty in China today is almost exclusively *rural*; it affects *whole communities* rather than individuals; and it is heavily concentrated on a *regional* basis—affecting villages in remote, resource-poor (and often environmentally degraded) areas, primarily in the northwestern and southwestern interior. The challenge of alleviating this remaining hardcore poverty is a multidimensional one. In at least some of the poorest regions, technological packages now exist that are capable, with the necessary investment support, of yielding substantially improved agricultural incomes, on an environmentally sustainable basis, for at least part of the current population. Other sources of employment, however, such as small-scale industry, are widely constrained by infrastructure deficiencies and poor market access (although some border areas, in particular, should benefit from the recent expansion of the open-door policies). For some of the poor, outward migration may be the most promising option: this, though, is a field where earlier policy restrictions are only gradually yielding to pressures from below.

7. Low incomes in these regions are compounded by marked weaknesses in the provision of social services, and resulting indicators of health and education status strikingly below national averages. Women's health and girls' education are frequently the most severely affected. Central policy has traditionally stressed self-sufficiency by rural communities in social service financing and, although fiscal arrangements have long redistributed revenues to the poorest *provinces* (and, since the mid-1980s, also to the poorest *counties*), there is little indication that effective mechanisms yet exist to achieve sustained social improvements at the level of the poorest *villages* where the worst conditions are found. With no easy solutions, the plight of China's poor continues to

challenge the best efforts both of the Chinese authorities and of the international development community (paras. 39-40).

8. **Macroeconomic Management.** The cyclical nature of Chinese growth since 1978 has been widely discussed. By many international standards, the troughs have been neither particularly deep nor especially prolonged: the most recent cycle, at its lowest point, witnessed real GDP growth of 3.8 percent in 1990, with recovery to 7.2 percent in 1991. There is, nonetheless, legitimate cause for concern over the stresses created by very rapid deceleration, as well as over the extent to which, in past episodes, the pursuit of marketization reforms has become subordinated to the imperative of regaining control of aggregate demand, in turn achieved largely through administrative mechanisms and quantitative controls. The prevalence of such direct levers to date can be traced to several causes. The tax system, based largely on multiple-year contracts negotiated between the different layers of government, has not lent itself to demand fine-tuning (though Beijing has shown some inventiveness in introducing *new* taxes), so that deflationary fiscal policy has primarily comprised direct cutbacks in public investment (imposed administratively by the center). On the monetary side, although interest rate changes played a more important role in the most recent (1988/89) period, direct quantitative credit controls remained the principal instrument, reflecting partly the limited capability and experience of the central bank (People's Bank of China, PBC) in the use of indirect policy tools (and relatively thin, undiversified domestic money markets), but also reservations over the likely responsiveness of SOE credit demand to the interest rate changes then considered feasible.

9. The 1988/89 episode had specific features not likely to be repeated, including an abortive preannounced "big bang" attempt at price reform, which sparked a rapid upswing in consumer demand and complicated the design of an effective policy response. Beyond this, the earlier experience has itself served to increase the sensitivity of policymakers to the disruptive potential of overheating, and thus to improve the likelihood of a more timely response on subsequent occasions. Signs of the need for concern at the present time have indeed been building over recent months. Real GDP growth over 1992 proved close to 13 percent, significantly above the 8-9 percent level judged consistent, on a sustained basis, with noninflationary growth by the 1992 CEM (and subsequently adopted as the official target). At the same time, however, the trade and inflation results for 1992 were, in overall terms, still relatively comforting, with export growth at 18.2 percent (though imports grew faster, at 26.2 percent), and the retail price index (RPI) up by only 5.4 percent (though here, too, more worrying signals were visible in some of the disaggregated indices, including a rise of 15 percent in the "means of production" measure of raw materials prices).

10. Data now available for the first quarter of 1993 have eliminated remaining ambiguity over the danger of overheating. The turnaround in the trade balance has been particularly striking, with export growth slowed to 7.4 percent, while import expansion maintained its pace at an unabated 25.4 percent, resulting in the first trade deficit since 1989 ($1.2 billion for the quarter). This has been accompanied by substantial further widening of the divergence between the official exchange rate and that in the parallel market. Price data confirmed the trend, with the RPI rate of increase up to 8.6 percent

and the "means of production" index rising at a rate of 38 percent by the end of March. With the official budget deficit relatively stable in the internationally unexceptionable range of 2-3 percent of GDP, it is the monetary sector that has provided most of the fuel for the rapid expansion in demand (much of it, however, "quasi-fiscal" in nature and absorbed by the SOEs). Growth in broad money during 1992 reached 31.3 percent and, on top of perennial difficulties in containing lending by local branches of the state banks, a distinctive contribution has on this occasion originated from rapidly expanding nonbank financial institutions (NBFIs), to date effectively covered neither by PBC's traditional quantitative controls nor by the newer style of prudential regulation the central bank is attempting to introduce into the sector.

11. Starting in mid-May, and in line with warnings contained in our draft UEM, the central authorities have signaled their recognition of the need for immediate measures to avoid further deterioration in the macroeconomic balance. The steps so far announced are all consistent with our advice. They include increases in officially administered interest rates for bank deposits and loans, as well as on Government bonds; proposals to stiffen enforcement of the authorization process for capital market issues; and measures to curb the erosion of the fiscal revenue base by local governments via the multiplication of "development zones" conveying tax concessions. Earlier restrictions on access to the parallel market for foreign exchange are also reported to have been eased. Further credit tightening is proposed, including more effective regulation of the NBFI sector. While these actions are both welcome and timely, we have made very explicit in the strongest terms our view that the changes so far announced (e.g., in interest rates) are not going to be sufficient to achieve the desired results. We have also expressed concern over the fact that *deposit* rates have been raised significantly more than *lending* rates, with adverse implications predictable for financial sector viability. In addition, we are pressing the role which further *trade liberalization and exchange rate reforms* could play, in addition to their longer-term contribution to improved resource allocation, in helping to absorb the more immediate demand pressures.

12. It is clear that, over coming months, maintaining a very close dialogue on short-term macromanagement issues will need to absorb a considerable proportion of our efforts. On present showing, it is an area in which the central Government is both eager to receive, and responsive to, the Bank's advice. The discussions of the UEM (and those at a timely recent conference in China on macroeconomic management) indicated a very high degree of responsiveness to our message at both the working level and the very top. Given China's experience over recent years, and the increased sophistication of its policy analysts, our message on the potential dangers of a *hard landing* (renewed cycles, possible interruption of reform momentum) is one that has by now been well internalized. Some of our Chinese counterparts were, indeed, at pains to stress that, if indirect policy instruments *should* need to be supplemented by administrative restrictions, these should be concentrated precisely on the least market-oriented sectors (SOEs, local government), rather than being applied in blanket fashion to the economy as a whole. This is itself an indication of how far things have changed since 1988/89. At the same time, it serves to accentuate that the crucial test at this stage is less one of intellectual appreciation than of

political strength and will. As such, there is an element of uncertainty surrounding the outcome that no amount of analysis at this stage can fully remove.

B. External Environment

13. During recent years, with the relative isolation suffered following Tiananmen now largely dissipated, China has benefited from a generally favorable external environment, which permitted trade growth over 1989-92 of 15-20 percent per annum. In 1992, in particular, FDI (primarily targeted to export-oriented manufacturing) rose to around $10 billion, making China the largest developing country recipient of such investment. China has also continued to enjoy relatively easy access to international financial markets, made easier of late by the opening (albeit on a restricted basis) of China's internal financial markets to overseas portfolio investors. At the same time, however, as noted above (para. 10) and as predicted in last year's CSP, the trade balance has rather rapidly swung into deficit; not in itself necessarily an undesirable development, but one which will require careful monitoring.

14. In *trade*, there are three *external* issues. First, China's application to resume its seat at the GATT, which was filed in 1986, is still pending (and subject to difficult negotiations, which may take at least one more year to conclude). If completed satisfactorily, this would add a degree of certainty to China's external economic environment that has for some years been lacking. Second, on May 28, 1993, the US administration extended China's MFN status for another year, linking subsequent renewal to progress on human rights, but explicitly excluding bilateral trade and arms export issues. This approach helps to remove doubts about China's export markets in the most immediate future. Third, China stands to benefit more than many others from a hoped-for successful conclusion to the Uruguay Round, in view of its dependence on garment and footwear exports, which would be liberalized relatively more than other commodities.

15. China's *investment climate* continues to improve, as reflected in the doubling of FDI in 1992. The country is benefiting in this regard from the growing role of other Asian economies such as Japan, Taiwan (China) and Korea as overseas investors, supplementing China's original investment partners in Hong Kong. If this continues, FDI can be expected to make a significant and increasing contribution, both in established manufacturing sectors and also in new areas for FDI (such as services and infrastructure). The *financial markets* continue to look favorably on Chinese instruments. Bonds and syndications are issued with ease, especially on Asian financial markets, and at very favorable rates. China's excellent repayment record, and absence of rescheduling requests, combine to make the country a very desirable sovereign borrower. We expect China to continue to enjoy a strong creditworthiness position. As we forecast last year, the balance of payments current account has returned to its normal (pre-1989) stance of a moderate deficit. We see no reason to expect this to be allowed to get out of hand (see UEM for more detailed forecasts): the interesting question, rather, is whether its future management will take place primarily through traditional administrative measures or, as advocated in a recent major ESW report on *Trade Reform*, through a combination of liberalization of quantitative restrictions and exchange reform. Total debt outstanding stood at only

16 percent of GDP in 1992 and this is projected to fall gradually over the balance of the decade. The associated debt service level is also expected to remain healthy, declining further from its already modest level of 9.7 percent of export earnings in 1992 to about 7 percent in the second half of the decade. Indicators for IBRD exposure are reviewed in para. 50 below.

16. On the downside, some uncertainties remain. Trading arrangements are ad hoc, as noted, and subject to arbitrary change pending conclusion of ongoing negotiations. China's export growth has been highly concentrated in terms of markets and products (notably in garments, toys and footwear for the US market) and some of these niches may be approaching saturation. Finally, political tensions continue to affect relations with Hong Kong and Taiwan (China), which reduce the achievement of potential synergies from the much-discussed "fourth growth pole." These aspects will therefore continue to demand attention and monitoring.

C. Country Assistance Strategy

Recent Developments and Government Policies

17. **Political Developments.** The past year has witnessed developments of considerable importance at the policy-making and political levels, which have served inter alia to cement the policy consensus around further acceleration of China's marketization reforms. The key events were the meeting, in October 1992, of the fourteenth Party Congress, whose decisions set the overall policy direction for the next five years, and the subsequent inaugural session (March 1993) of the newly elected National People's Congress (NPC), China's legislature. These two bodies, the sources of policy legitimacy within the party and the state, took the critical symbolic steps of writing into party policy and the constitution, respectively, a redefinition of official economic philosophy that replaced the earlier formula of "a planned economy on the basis of socialist public ownership" by "a socialist market economy." In keeping with Chinese tradition, the latter concept does not readily lend itself to a precise or static legalistic definition. It may, however, be read (particularly taken together with an earlier reinterpretation of "socialist public ownership" to include not only SOEs but also local collectives) as an explicit downgrading of the weight attached to any specific ownership model, as well as a powerful public assertion of the central role further marketization is designed to play in future economic strategy. In summary, we see these steps as symbolizing the authoritative removal of residual ideological constraints to the ongoing marketization process. The *socialist* nature of the Chinese economic model, in turn, is likely in future to be manifested primarily by concern to protect basic social service provision and avoid extreme inequities in economic welfare and, more specifically, a continuing commitment to the eradication of China's remaining absolute poverty.

18. The two Congresses also gave their stamp of approval to the planned collective succession to the elders of the Long March generation. This included the reelection (with a number of dissenting ballots) of Li Peng to his second (and, constitutionally restricted, final) term as Premier; the elevation of Jiang Zemin to be State

President as well as Party Secretary and Chairman of the Central Military Commission; and the promotion of the reform-minded Zhu Rongji to the new post of *Senior* Vice Premier. In designing the new lineup, China's patriarch Deng Xiaoping appears to have succeeded in avoiding several potential political pitfalls. The rumored ambitions of the Yang family (outgoing President Yang Shangkun and his younger half-brother General Yang Baibin) were squashed, and both brothers sidelined, together with a number of potential allies in the military. Equally, several members of the "princelings' party" (the sons and daughters of older leaders whose activities helped fuel popular discontent in 1989), were passed over in the new appointments. The specific names that *were* chosen clearly reflected a good deal of back-room negotiations, and could yet be subject to disruption by unexpected events (e.g., the health of Premier Li Peng). However, the obvious success of and popular support for the basic policy line ratified by the Congresses is probably of greater ultimate significance for the future than the position of any particular individual among the designated successors. The Congresses' removal of remaining uncertainties over ideology has legitimized the recent and very obvious upsurge in the discussion, proposal and introduction of specific reform measures, at both central and local levels, in many of the most important reform areas. The current policy climate is reviewed in greater detail in the UEM, but key features are outlined below.

19. **SOE Reform**. The central thrust of official policy is now the aggressive promotion of corporatization and marketization reforms in the SOE sector. New regulations (July 1992) seek to improve the definition and protection of *management autonomy* over major business decisions. The center is, in addition, encouraging the conversion of SOEs into *shareholding companies*, with the ownership function exercised by Boards of Directors rather than government bureaus: this step will also help open the door to further *ownership diversification*. In parallel, a *government reorganization* has been announced, designed over several years to reduce the overall size of the bureaucracy and to reorient the work of ministries and bureaus away from their past micro-interventionist traditions. Meanwhile, *bankruptcy provisions and mergers* are being increasingly applied to SOEs. Official sanction has been extended for the *sale or leasing* of at least some of the smaller SOEs to collectives or private enterprises. A cautious approach is currently being taken, however, to the expansion of *stock exchange listings* (not inappropriate at this stage, given the gaps still to be filled in securities market regulations, as well as the generally weak state of *enterprise accounts*, an area where the Government has recently launched an urgent nationwide upgrading program: the last thing China's reforms need now is a series of stock exchange scandals and, without considerable caution, this is a real danger).

20. **Labor Market (Housing and Social Security) Reform**. As noted earlier, this is a crucial corollary of SOE reform, and one in which the basic lines of official policy have by now been in place for about two years. The scope of fixed-term *labor contracts* for SOE workers (replacing lifetime guarantees) is being expanded. In *housing*, the center has established a timetable for previously nominal rents to increase to cover management, maintenance, depreciation, interest and property taxes by the end of the decade. In parallel, enterprise housing units are to be transferred to commercial housing corporations. As rents rise, the second prong of official policy, encouraging wider owner-occupation,

should also come into play. *Pension* rights are starting to be pooled across enterprises: similar reforms for *health insurance* are, however, at a more preliminary stage. Finally, *unemployment insurance* schemes are under development and introduction. It should be stressed, however, that the detailed *implementation* responsibility for the above reforms lies almost entirely at *local* (usually municipality) level, and this is where practical models are having to be worked out.

21. **Financial and Capital Market Reforms**. Following several years without basic policy movement, this area is now receiving reinforced attention. It is symptomatic—and encouraging—that we received a Government request, which has been met, for a strategy paper in this sector earlier this year. Beijing has committed itself in principle to converting the bulk of the existing State banking system into genuinely *commercial banks*, with the autonomy over lending this would imply. Remaining directed "*policy lending*" is to be segregated from commercial banking—initially on an accounting basis, but subsequently through the formation (probably by restructuring existing institutions) of one or more banks dedicated to the provision of policy loans. Banks' *accounting* practices are to be standardized as part of the basis for *more sophisticated methods of monetary control and bank regulation*. Consistent with these changes, gradual deregulation of *interest rates* is projected. On the *capital market* side, meanwhile, new regulatory bodies have been established for the securities exchanges, and foreign investors permitted to purchase certain categories of Chinese equity shares. Finally, there is active discussion of the need for a *reorganization of PBC*, to strengthen its ability to concentrate exclusively and more effectively on its *central banking* functions. Agreement has yet to be reached, however, on all aspects of the new design (including the crucial—and politically difficult—issue of whether to scrap the current system of organizing PBC on a *provincial* branch basis, which has done much to dilute central control in the past).

22. **Fiscal Reform**. This is an area where progress has long been complicated by conflicts of interest between the center and the lower-level administrations that actually carry out the assessment and collection of the great bulk of China's tax revenue. Initiatives under way include efforts to standardize the taxation of *corporate income* (another area where improved accounting standards are crucial), as well as the gradual diversification of the revenue base, including phased introduction of a *value added tax*. Despite Beijing's desire to regularize its fiscal relationship with lower levels, however, and experiments with "*tax-sharing systems*," there appears no sign of an imminent breakthrough in this politically difficult area: we plan to continue, nonetheless, to press its importance within our own dialogue.

23. **Private Sector Development**. In overall terms, the further development of the private sector is projected to continue to take place *in parallel* with the corporatization and marketization of the SOEs, rather than through efforts at a mass privatization of the existing public sector. The central authorities have undertaken to simplify further the *registration* of new private firms, and to *ease restrictions* over such firms' scope of business. Lower levels, meanwhile, are increasingly active in promoting new *joint venture* subsidiaries between Chinese enterprises (including both SOEs and local collectives) and foreign partners (even if some represent in part a response to advantageous tax treatment

of joint ventures). Such activity is likely to increase further following recent announcements *expanding the scope of the open door for FDI* both geographically (to cover *interior regions*) and sectorally (to encompass an increasing range of *tertiary activities*, including retailing, distribution and financial services). The center has also extended its blessing to increased FDI in *infrastructure* sectors. There are already examples of private Hong Kong investment in toll highways, other transport facilities and a 200 MW thermal power station in neighboring Guangdong province, as well as a recent Hong Kong-Chinese joint-venture agreement to develop Shanghai's container port. Assessing the potential for wider replication is now an area of active interest for IFC (paras. 44-45) and the Bank Group as a whole.

24. **Legal Reform.** The authorities recognize that further marketization calls for traditional reliance on administrative mechanisms to give way, across wide areas of the economy, to transparent rules-based systems and a more comprehensive framework of economic law. Given the many areas in which the current legal framework is either clearly deficient or nonexistent, as well as the numerous fields in which, as discussed above, new reform proposals are under active development, something close to a flood of draft legislation is at present circulating in Beijing. The authorities have indicated potential interest in Bank advice and assistance in helping to develop the legal framework in an effective and internally consistent manner: exploring possible modalities for such support will provide a new focus for our proposed assistance strategy (para. 29).

Main Objectives and IBRD/IDA Program of Assistance

25. **Lending and Portfolio.** New Bank commitments to China amounted to just over $2.5 billion in FY92 and $3.2 billion in FY93. Despite modest year-to-year changes in average supervision ratings, to be expected in a growing and maturing program, the overall implementation status of the Bank portfolio in China, currently comprising approximately 100 active investment projects, has continued to be robust (average supervision rating of 1.50), fundamentally reflecting a combination of strong local administrative capability and the powerful sense of borrower ownership that has consistently characterized the Bank-supported program in China. There are no major implementation problems identified as generic to a significant number of operations, and at any one time there are seldom more than 3-4 specific operations rated as having significant implementation difficulties (while the Government's responsiveness to concerns raised by the Bank is such that projects do not generally remain in this category very long).

26. **Country Dialogue and ESW.** The policy dialogue between China and the Bank is exceptionally strong, reflecting Chinese decisionmakers' trust in the objectivity and relevance of Bank ESW, respect for the quality of the Bank's investment project work across a broad range of sectors and regions, and recognition of the consistency of the institution's support of China's reforms and development throughout the past decade. Formal ESW reports are studied seriously both by the most senior decisionmakers and by officials in the relevant sectors, and studies in recent years have contributed to the evaluation of reform implementation alternatives in areas including the financial and fiscal

sectors, housing and social security reform, the development of urban land markets and grain market liberalization, as well as providing comprehensive overviews of issues relating to poverty and the environment. Major reports on China's trade policy and budgetary issues, respectively, are currently being finalized. Planned topics for work over FY94 are summarized in the box below.

CHINA: PROPOSED MAIN AREAS OF ESW FOR FY94

Studies:	Domestic Market Regulation and Development State-Owned Enterprise Reform Municipal Finance Quasi-Fiscal Deficit GNP/National Accounts Regional Patterns of Development Agricultural Marketing Water Resources Planning Provincial/Municipal Environmental Management Higher Education Efficiency Health Finance Reform
Strategy Papers:	Financial Sector Industrial Policy and Restructuring Power Sector Transport Sector Ports Subsector Highways Subsector

27. **Need for Innovation**. Our program in China over much of the past decade largely comprised the two products discussed above: formal ESW reports, prepared after intensive research and providing comprehensive coverage of issues in specific sectors or policy areas; and solid, well-prepared investment projects supporting technological modernization and institutional development objectives, as well as selected, well-defined sector reform objectives, such as tariff reform in the principal infrastructure sectors. This combination, and the "parallel track" approach which maintained some distance between the two products, helped to meet specific country needs and demands for technology transfer and institutional modernization during a period when China was still emerging from its earlier international isolation. It was also broadly compatible with the relatively deliberate approach to reform during much of the decade, and the manner in which the leadership then preferred to receive outside advice. What is now apparent, however, is that the earlier product range and the parallel track will no longer serve fully to meet the requirements and demands for assistance being generated by the recently accelerated pace of reform, and the Government's desire to see more intimate Bank involvement in the detailed implementation of the new generation of reforms. We are thus now being challenged to develop new approaches and incorporate additional flexibility into our country assistance program, and this is a challenge the proposed strategy will seek to meet.

28. One clearly identified demand is for the ability to provide *prompt feedback and advice* to decisionmakers on reform implementation alternatives in specific areas through succinct analytical papers, based more upon synthesis than on extensive original research, and produced on a more flexible schedule than formal ESW. During the past year, informal strategy papers of this kind have been provided to the Government in areas including SOE reform, financial sector strategy and short-term macroeconomic management issues: to help reinforce our capacity to respond to additional requests of this type, we are currently restructuring the staffing of the *Resident Mission in China (RMC)*, to put considerably greater emphasis on macro and sector policy analysis skills. Under a second model, we have to date provided intensive assistance, through international workshops and follow-up staff input, to two of China's most important coastal cities (Shanghai and Tianjin) with the design of city-level "*reform action plans*," intended to serve as "living documents" capable of guiding reform implementation on a multi-year basis and underpinning future Bank lending: we plan in the near future to start adapting this model to the needs of selected inland cities (tentatively, Wuhan and Shenyang).

29. In some of the key reform areas, the demand for external assistance with policy analysis and reform implementation issues will clearly go beyond what the Bank can provide from its own resources (in view of the *extent* of the support needed and/or the *specialized skills* involved). We thus expect to make increasing use of *sector-specific TA operations* in future. The first example was provided by the Financial Sector Technical Assistance Project (Credit. 2423-CHA), designed largely to help strengthen the capability of PBC, and approved in September 1992. We are actively discussing with the Government the potential for additional operations of this type, in such areas as economic law reform, further strengthening of financial and capital markets and the development of support services for newly marketized enterprises.

30. A further area where we are introducing innovative products might be described as *reform implementation support operations*. In many areas where reform plans are now active, effective reform implementation will itself call for significant investments in building new or modified institutions, imparting new skills and creating supporting infrastructure, not only at the center but throughout China's provinces and municipalities. One example concerns the marketization of China's hitherto tightly planned grain distribution system. This reform will not only require development of new institutions and skills (commodities exchanges, commercial trading corporations, etc.), but will also open up new possibilities for more economically rational domestic and international trading patterns that, however, without supporting physical investment, could be frustrated by infrastructure bottlenecks: a grain market reform implementation support operation was recently approved by the Board. A second area is housing and social security reform, where the city-level administrations charged with implementation require assistance with the creation of viable models of commercial housing corporations, housing finance institutions, etc. Here, too, preparation is at an advanced stage. A third example, where we are working actively, relates to labor redeployment issues raised by SOE reform. Existing vocational/technical training models in China focus heavily on *preservice* training: new approaches will be needed to meet the *retraining* requirements of older workers called on to change jobs.

31. **IDA Replenishment**. An additional challenge in the management of the country assistance program, on both the Bank and Government sides, is raised by the decline in availability of IDA resources for China resulting from the decisions, subsequent to last year's CSP, on blend countries in the context of the tenth replenishment (IDA-10). In this connection, we are already discussing with the Chinese authorities our aim of maintaining our existing levels of support for the social sectors, for the development of the poorest regions and for environmental protection and the amelioration of pollution. Internal arrangements for onlending make this a difficult issue for the Chinese to handle and, although the initial response has been encouraging, it will undoubtedly continue to require considerable attention, particularly as the cuts start to bite.

32. **Proposed Operational Program**. As earlier discussion has sought to demonstrate, the central policy stance has by now evolved to provide an enabling environment for rapid further marketization reforms. Certain key policy areas will continue of necessity to be addressed primarily through dialogue at the center—e.g., monetary and financial sector aspects, and fiscal and trade reform—though in these areas too we will explore all possible vehicles for Bank support, including the types of innovative products outlined above. In most other areas, however, reform progress will depend largely on developments at the level of individual sectors, provinces and municipalities, and it is at these levels that we propose to continue to concentrate the bulk of our future lending.

33. Our earliest operations in *industry* focused primarily on supporting the technological modernization of Chinese firms (primarily SOEs) in a selected number of subsectors, itself an important contribution given that prevailing standards were often decades behind international best-practice. Expectations today, however, are pitched much higher, and future involvement in this sector must clearly be designed with the primary objectives of fully supporting and advancing the processes of marketization and transformation now endorsed at the central level. In keeping with the recommendations of our *Enterprise Strategy Paper*, endorsed by Bank Senior Management earlier this year, understandings have therefore been reached with the Government that future Bank support in the industrial sector (at both the regional and sectoral levels) would need to be provided within specific frameworks fully consistent with marketization and transformation objectives, including:

(a) separation of state firms from government bureaus through restructured corporate forms (including transparent ownership mechanisms);

(b) promotion of ownership diversification;

(c) corporate income tax reform;

(d) accompanying social and labor market reforms (housing, social security, etc.);

(e) competitive market policies, including promoting freedom of entry and exit for both public and private producers; and

(f) satisfactory guarantees of access by nonstate enterprises to Bank support.

34. We are committed to experimenting with the design of industrial investment operations meeting the above objectives at the provincial/municipal level in several regions (including inland as well as more traditional coastal locations), and are also exploring the possibility of applying them in selected subsectors on a cross-provincial basis. One ongoing operation, the Rural Industrial Technology (Spark) Project (Ln. 3274-CHA, Cr. 2186-CHA) seeks to provide support exclusively to the domestic nonstate sector, and we will consider possible further operations with a similar focus. We will also review the possibility to make use of the innovative product models discussed earlier to support industrial enterprise marketization and restructuring.

35. In the *financial* sector, our initial goal was to help introduce modern investment evaluation approaches through the development of a new industrial DFC, the China Investment Bank, CIB (and parallel support, in rural areas, to the Agricultural Bank). Recent years have witnessed a shift in focus to the imperative of strengthening the overall sector policy framework and the institutional capability of PBC, an approach whose operationalization was launched with the recently approved TA project (para. 29). We expect our next financial sector operation to continue and broaden the focus on the sector-wide framework and infrastructure pioneered by the TA project. Given the expected pace of change in this sector, however, attention to the strengthening of PBC and other sector-level agencies will soon need to be supplemented by a focus on the transformation and restructuring of the operating institutions in the sector, including the commercialization of China's state banks. This is thus a sector in which our operational involvement may need to be intensified rather rapidly, and it is a sector in which finding innovative models for reform implementation support will be a central challenge for our assistance strategy.

36. China's *infrastructure* sectors (primarily power and—within transport—rail, roads and ports) have together absorbed over 40 percent of cumulative Bank lending to China. As discussed earlier (para. 5), these have been the key bottleneck sectors, with heavy absolute investment requirements, and the development of effective new mechanisms of *domestic* resource mobilization (fundamentally through tariff reform) has inevitably been a gradual process. As also discussed, however, it is a process now paying off, with the *railways* and the *power sector*, in particular, now far better placed for internal resource generation (para. 5) and the *ports* undergoing rapid commercialization, including experiments with the introduction of FDI (para. 23).

37. These changes are now prompting a reevaluation of the future role of the Bank in the infrastructure sectors. We recently submitted a strategy paper on the railways sector to the Board (No. 10592-CHA), and are planning similar papers on ports, highways and electric power, respectively, as well as a strategy document for the transport sector as a whole. With substantial progress already in tariff reform, greater attention is now called for within our policy goals, in the case of the natural monopolies, to promoting

corporatization accompanied by more transparent systems of *regulation* reflecting the lessons of international best-practice. In subsectors where competitive market structures are a realistic possibility, meanwhile, including ports and—potentially—*telecommunications* (an area where the Bank has yet to lend but where a possible first operation will shortly be appraised), our priority will be to promote the dual objectives of *commercialization* and subsectoral policy frameworks conducive to *competition* and the introduction of private capital, including FDI.

38. By contrast to the directly revenue-earning subsectors, there has been no comparable breakthrough in the case of China's *highways*. Our analytical work has highlighted the severe modal imbalance of the Chinese transport system (in which almost 60 percent of freight, and close to half the passenger traffic, is still carried by the railways). A modern highway system is urgently needed both to support the further development of marketized production activities and also as a key to greater domestic market integration and more balanced regional development. Within the overall transport system, this is the mode where future capital requirements are likely to be greatest. Our recent intermodal transport study of Guangdong province (Bank Discussion Paper No. 151), for example, recommended that some three quarters of future transport investment in the province should be directed to highway development. It is also, however, the field where domestic resource mobilization is currently least well-developed. We are therefore proposing a major increase in the relative weight given to highway development, and will be taking the study of, and support for, new models of resource mobilization as our leading sector policy objective.

39. In *agriculture* and the *social sectors* last year's CSP explicitly proposed the pursuit of *poverty alleviation* as our highest priority objective. In several of the regions of concentrated absolute poverty, including much of the northwest as well as the "red soils" areas found in much of the southeast, we consider that farming models already in existence (developed in part through earlier Bank projects) have proven their worth, and we are now preparing successor operations to promote their replication on a larger scale. Rural income generation in the most resource-poor areas of the southwest, by contrast, has less in the way of proven farm technology packages to build on. As an outgrowth of our recent poverty study (paras. 6-7), we plan very shortly to launch the identification of a poverty alleviation project in the southwest: given the difficult local conditions, innovative approaches (possibly including a multisectoral strategy) are likely to be required.

40. In the social sectors, similarly, operations recently approved or in the active pipeline exemplify the priority now being given to the problems of the poorest areas (para. 7), including basic education for girls and maternal health care priorities. The Education Development in Poor Provinces Project (Cr. 23390-CHA), which seeks to strengthen basic education provision in six of China's poorest provinces, is expected to be followed by a successor operation extending the approach to additional poor regions. Work is also under way on a Maternal and Child Health Project, similarly targeted at poor rural areas. A pending Rural Health Workers' Training Project includes provisions intended to help develop appropriate and sustainable financing mechanisms for rural health care which, if successful, could provide the basis for wider replication.

41. Beyond the primary goal of poverty alleviation, there are additional areas in agriculture and the social sectors where Bank assistance has an important role to play. Our support for the marketization of China's *grain* sector has already been noted (para. 30), as have our efforts, within the social sectors, in vocational retraining (para. 30) and health finance reform (box attached to para. 26). In addition, strengthened *water resource planning* is a vital priority for China, both for agricultural and other end-uses, and in both the water-scarce north of the country and flood-prone areas further south. Despite well-established domestic capability in irrigation development, particularly at the local level, water-use planning on a regional or cross-regional basis tends to strain both the older generation of planning models currently in use within China and established mechanisms for interprovincial coordination. In addition, while a recent Bank review has confirmed that Chinese mechanisms for planning and implementation of *resettlement* have generally produced very satisfactory results in recent years (and a report on this study has been issued in Gray Cover recently), it is also clear that it is the larger water development projects that are most likely to put pressure on the adequacy of these mechanisms. This sector is therefore proposed to continue as an area of active Bank involvement.

42. Our first comprehensive strategy paper on China's *environment* (No. 9669-CHA) was completed in April 1992 and its recommendations were summarized in last year's CSP. These recommendations provide the basis for what has become the fastest-growing area of concentration in our lending program, and we have recently concluded that a new sector division should be created, to focus exclusively on future environmental activities, while permitting sufficient attention also to be given to our work on education and health. Three investment operations addressing the amelioration of environmental conditions, especially in the field of water pollution, and located in—respectively—Southern Jiangsu, Zhejiang and Changchun, were approved during the course of FY93 (Ln. 3582-CHA; Credits 2475-CHA and 2457-CHA). Work is under way on a pipeline of further investment projects in additional priority cities and provinces: as in the earlier operations, each will include significant TA for the strengthening of local environmental management agencies and will also promote the corporatization of local public utilities such as water supply, sewage treatment and solid waste management services, to ensure that their operations are placed on a financially sustainable basis. In addition, we propose to follow the earlier overall strategy paper with a new phase of environmental ESW that will focus in greater depth on environmental management issues as seen from the *provincial and municipal* levels. More immediately, the Board has just approved a first Bank-supported Environmental Technical Assistance Project, intended to help strengthen further the institutional capability of China's National Environmental Protection Agency (NEPA) and other key sector agencies, as well as to support focused studies in priority areas of sector policy.

43. **Cooperation with Other Sources of Financing.** There are no major changes to report in our relations with the IMF, ADB, UNDP or with the principal sources of bilateral funding. As pointed out in last year's CSP, Chinese administrative mechanisms for financing development projects have generally not, in the past, been conducive to *cofinancing* on a larger scale. There have, however, been recent indications of possible interest in experimenting with more extensive use of cofinancing: in addition, the

Government's expressed intention to encourage greater *private* investment in the infrastructure sectors (para. 23) may open new possibilities in this area, and we intend to explore potential vehicles over the coming year.

44. **IFC and MIGA**. IFC's country assistance strategy for China focuses on three principal objectives: (i) promotion of a more favorable foreign investment framework, (ii) catalyst to the expansion of private sector investment, and (iii) acceleration and deepening of financial and capital markets. To respond effectively to the rapid development of the Chinese economy in the context of a continued move towards a market economy, IFC opened its first representative office in Beijing in October 1992. IFC's active participation is being sought by the authorities in China, particularly as the economy is moving towards a more market-based system, with an increasing emphasis on private sector led growth.

45. IFC's operations in China have so far concentrated on supporting joint ventures between foreign investors and Chinese enterprises. IFC plays an important advisory role in China in helping to structure these transactions and in arranging finance on a project risk basis without guarantees from government banks. Work in the capital markets area includes the establishment of a joint venture bank, and technical assistance to the new Securities Regulatory Commission, which will focus on the adequacy and regulations for the rapidly expanding stock markets in China. IFC has also encountered lively interest in infrastructure projects, where the scope for private investment is substantial, as China recently announced new policies to encourage foreign participation in infrastructure development. IFC's progress in infrastructure projects in the near future will depend on stronger efforts by the Chinese government to develop a suitable environment for private investments, including the legal and regulatory framework, as well as the institutional infrastructure, for private business operations. In the Bank's fiscal year 1993, IFC approved financing for four projects in China, in the areas of banking, cement and manufacturing, totaling $42.8 million, which brought IFC's accumulated total investments in China to $103.4 million. As of May 31, 1993, *MIGA* had approved one investment guarantee in China, with a package of additional guarantees expected to be submitted for approval very shortly.

46. **Proposed Bank Lending Program**. As discussed in Section B above, China's external position has been generally strong in recent years, with substantial inflows of FDI, especially into export-oriented manufacturing, and—until the recent deterioration—surpluses on the trade account. With strong private capital inflows into certain sectors of the economy (para. 13), and the current account deficit projected to remain moderate (para. 15), capital transfer is not the primary objective or determining principle of the level of Bank lending which, even at current and proposed levels, accounts for only a relatively minor share of China's total resource requirements. Rather, we see our operational program as a mechanism for helping to provide vital support for the nationwide implementation of the ongoing reforms, as well as the crucial objectives of poverty alleviation and environmental protection, discussed earlier in this paper.

47. The composition of our future lending program is proposed to continue to be broad-based in both geographical and sectoral terms, in view of the extensive agenda outlined in the present paper. In several sectors, as noted earlier (para. 39), social objectives have already prompted an increased emphasis on China's interior provinces, and we also believe a strong case exists for a similar relative shift of geographical focus in several others, including industry and highways. More broadly, we recognize the need for additional flexibility in the development of the lending program, including the ability to bring forward innovative operations on a fairly tight timetable as warranted by reform implementation needs, but equally the freedom to drop earlier proposals no longer seen as responsive to rapidly changing conditions. As such, the composition of any multiyear Lending Program proposed at the present time must be considered more subject to change than in previous years: it may be taken almost as a certainty that new operations, e.g., of the sector-specific TA or reform implementation support variety, will in fact be developed during the period in question, consistent with the reform impetus and support needs in different sectors and policy areas.

48. In terms of *scale* of future lending, a very crucial element that now needs to be allowed for is the change, since the last CSP, in China's status within IDA. We have explained to the Chinese authorities that, in practical terms, they should assume that IDA resources for China will henceforth decline by roughly $200 million a year (from about $850 million in FY94 to $50 million in FY98, assumed to be the pregraduation year), and this scenario has been accepted. We have additionally explained that: (a) future IDA flows will be concentrated on supporting IDA objectives in the areas of poverty alleviation, the environment and the social sectors, and will not be available to finance investment operations in other sectors; and (b) the Bank would expect, despite the IDA decline, to safeguard its current level of operational involvement in the above sectors. These factors have obvious implications for the substitution of IBRD for IDA lending within the overall portfolio—indeed, on resource transfer grounds, a case could be made for being prepared to offer such substitution on a more than one-to-one basis. As a minimum, the delivery of any given size of total lending program will now imply greater use of IBRD resources than was assumed at the time of the last CSP. This substitution, in turn, has the result of advancing, compared to the situation at the time of the CSP, the date at which IBRD exposure limits must be factored into the equation.

49. The *Base Case* for lending approved following last year's review of the CSP envisaged 45 operation over FY94-96, with an associated IBRD/IDA lending volume of close to $9 billion. With no change in circumstances, the subsequent acceleration in reform discussed in earlier sections of this memorandum may be considered to create a strong case for now recommending a move to the CSP High Case (51 operations; combined lending of $11 billion). We are still convinced that the Bank should now be maximizing its opportunity to provide support for the implementation of the next, crucial phase of China's reforms. We accept, however, that in view of the IDA substitution factor discussed above and the need to respect IBRD exposure guidelines (as well as internal budgetary constraints on the number of operations the Department can feasibly expect to deliver), such an outcome is, in practice, likely to be much closer to last year's Base Case than the original High Case. As such, we are now recommending a lending program for

FY94-96 of 44-45 operations, involving total lending of about $9.1 billion (IDA: $1.95 billion, phased as per para. 48 above; IBRD: $7.15 billion, assumed to be phased roughly: FY94, $2.25 billion; FY95, $2.35 billion; FY96, $2.55 billion). *For purposes of projecting exposure, we have assumed the FY96 level of IBRD commitments to be sustained in all subsequent years.*

50. On the above assumptions, China's DOD is projected by FRS, as shown below, to remain within the 10 percent guideline through the year 2000, which is considered, given the uncertainties involved in forecasting the all-country total, an acceptable planning horizon at this stage.

	(%)
FY93 (actual)	4.0
FY95	4.9
FY97	6.9
FY98	8.0
FY99	9.0
FY2000	9.9

THE WORLD BANK
INTERNATIONAL FINANCE CORPORATION
MULTILATERAL INVESTMENT GUARANTEE AGENCY

IDA - IBRD issues

Phase down IDA $200 in a year.
How to compensate for fall in IDA with increase in IBRD:
1:1, or more generous.
On exposure constraint, 10% should be regarded as a ceiling. Current assumptions imply that exposure will continue to rise beyond 10% after 2000. This means major cuts (will be needed) as early as FY97. Basically, the 10% rule means we have to cut now.
Stress cofinancing.

ESW - zero budget increase next year. Create policy analysis capability within China.
Can we have lower-cost projects?

Macro-stability, social unrest.

Elaborate hard vs soft landing; social unrest; current a/c developments.

IDA: What would our response be if they do not want social projects?

P-1852

Tabulation.

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

- income dist. matters as well.

DATE: June 30, 1993

TO: Those Listed Below

FROM: Shahid Javed Burki, Director, EA2DR SJ

EXTENSION: 82332

SUBJECT: China: 1993 CSP Updating Memorandum
Draft for Regional Review

- Rural sector
- MFN, GATT
- 3 gorges
- Trade policy goals.
- connection between SOEs and PSD

1. Attached please find a revised version of the above memorandum, which is scheduled to be reviewed at a meeting under the chairmanship of Mr. Gautam Kaji at 10:00 a.m. on Wednesday, July 7, 1993, Conference E10-048.

Attachment

- what does the IDA restriction mean?

Distribution:

cc: Messrs./Mmes. Kaji, Thomas, Agarwala, El Maaroufi (EAPVP); Burki, Kimura (EA2DR); Pearce, Harrold (EA2CO); Goldberg (EA2AG); Newfarmer (EA2IE); Stott (EA2TP); Ecevit (EA2EH); Bottelier (EA2CH); Jones-Carroll (EAPCA); Madavo (EA1DR); Haug (EA3DR); Ritchie (ASTDR); Ikram (EA1CO); Shilling (EA3CO); M. Koch-Weser (ASTEN); Rao (DECVP); McCarthy (DPG); Husain (AFRCE); Nankani (SASVP); Selowsky (ECAVP); Squire (MNAVP); Birdsall (PRDDR); Ray (DPGDR); Golan (EDIDR); M. Ahmed (IECDI); Yusuf (RAD); Amoako (ESPDR); Adams (OPRDR); de Merode (PHNDR); Iida (MIGEX); Long (FSDDR); Iskander (PSDDR); Stern (IENDR); El-Ashry (ENVDR); Petit (AGRDR); Pouliquen (TWUDR); Nishimizu (FRSDR); Horiguchi, Otani, Bell, Kochhar, Scott, Khor (IMF); Hassan (LEGEA); Freeman, Wang (CASDR); Khan, Perkins (CASD1); Bond (CPLD1); Farrell (CASCM); Dadush (IECAP)

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CHINA: 1993 CSP UPDATING MEMORANDUM

EXECUTIVE SUMMARY

i. The past year has witnessed key meetings of China's party congress and national legislature, which gave their approval to the collective leadership succession proposed by veteran leader Deng Xiaoping. In many ways even more importantly, the Congresses authoritatively changed the official definition of China's basic economic ideology, removing references to planning and public ownership and substituting a "socialist market" creed. With this clearing of the ideological air, recent months have witnessed a near-ferment of new market-oriented reform proposals in many key areas of public policy, including those targeted by last year's CSP [reform of state-owned enterprises (SOEs); housing and social security reform; financial sector reform; and reform of prices and markets]. In the latter area, indeed, the liberalization of product pricing and the adjustment of the most distorted prices (energy, rail tariffs, raw materials and grain) have come so far over the past two years that the remaining steps are starting to look significantly less challenging than before.

ii. Beyond the speeding-up of market-oriented reforms in these and other areas (see paras. iv, v), the news in recent months has been dominated by macroeconomic developments. The further acceleration of the boom during 1992 brought real GDP growth from around 7 percent in 1991 to almost 13 percent, well above the 8-9 percent which we and the Government see as the safe trend rate. Much of the fuel came from monetary expansion, running at over 30 percent. Results for the first quarter of 1993 confirmed the costs of this pace of growth, including a swift turnaround in the trade balance and escalating inflation, and the Government promptly accepted our advice on the need for immediate action to avoid further deterioration and try to achieve a "soft landing." The specific measures of monetary and fiscal tightening announced since the middle of May deserve to be welcomed for the emphasis they place on the use of indirect policy instruments, consistent with the economy's increasing market-orientation, as opposed to the old administrative armory of the past. At the same time, we are leaving the authorities in no doubt about our view that these measures do not yet go far enough. This message was given in very strong language at a high-level seminar held in June to discuss macroeconomic policy issues. In addition, while we do not expect the external accounts to be allowed to get out of hand, we are emphasizing the benefits of extending more market-oriented (rather than administrative) approaches in this area as well, and have recently completed a major ESW report advocating a combination of further trade liberalization with exchange rate reform. Helping to avoid another bout of chronic overheating, with the potential for reform setbacks this has brought in the past, has thus become our highest priority for the immediate future.

iii. The risk cannot be ruled out that, as has happened before, the Chinese authorities will miss the chance to achieve a relatively soft landing for their overheated economy. In favor of an *optimistic* view are the heightened sensitivity of central leaders, following the lessons of 1988-90, to the *dangers* of delaying an effective response and being subsequently forced into an abrupt deceleration (interruption of reform momentum, sociopolitical stresses, loss of domestic and international confidence), the increasing economic sophistication of their own domestic policy analysts and the fact that a substantially larger share of the economy is now more highly marketized and hence susceptible to management through indirect policy levers. The sources of *concern*, by contrast, are that much of the investment pressure still comes from the least reformed sectors of the economy—local authorities and locally-controlled state enterprises—which have their own powerful political patrons among provincial leaders. The latter have, in the past, too often put parochial development interests above the national need for stability until forced to give ground by an obvious crisis. No one can rule out the danger that this will happen again, and thus China *may* again experience a hard landing.

iv. On the reform front, the Government has announced new measures to increase further the role of private sector investment in the economy [including Foreign Direct Investment (FDI), currently running at record levels of around $10 billion a year.] These include opening-up inland areas, the service sectors and—in a recent initiative whose implications have yet to be fully assessed—even the provision of physical infrastructure to private FDI. In a more general sense, private sector development continues to move largely *in parallel* with SOE reform rather than being seen, as in some other economies attempting transition, as an immediate or large-scale component of the solution to the SOE's problems. The key features in the next phase of China's assault on SOE reform will thus, in general, involve not so much privatization as "corporatization" and "marketization." Consistent with our Strategy Paper on SOE Reform, approved earlier this year, these measures will be designed to convert the SOEs from miniature welfare-states, subject to extensive bureaucratic interference and protected from market discipline by a range of distortions in pricing, taxation and financial markets, into market-oriented commercial corporations, whose workers look outside the factory-gates for social security or housing provision, and whose managers are responsible for their performance to well-defined owners' representatives. The past year has seen further advances in defining and protecting managers' autonomy and promoting the adoption of more transparent mechanisms of corporate governance: we expect active innovation in this area to continue. In parallel, the Government has explicitly committed itself to cutting and restructuring the public bureaucracy so as to reorient it away from the micro-interventionist tendencies of the past.

Entry, exit

v. Recent months have also seen a new intensification of interest in the previously slow-moving area of financial sector reform. Sector reform is projected to include separating remaining directed "policy lending" from a newly commercialized mainstream banking sector, accompanied by the restructuring and further strengthening of China's Central Bank. These are changes the Bank has long been urging. They will also be ambitious and far-reaching changes and, when they start to be introduced in earnest, we can expect to be called on to supplement our largely advisory role of recent years with substantially expanded hands-on operational involvement.

vi. In addition to providing advice and practical implementation support for the new phase of economic reforms, Bank objectives also include other priority goals set out and approved in last year's CSP: helping to break the recurrent infrastructure bottlenecks which have repeatedly constrained China's growth; promoting the expansion of income-generating opportunities and improved provision of basic social services for the country's 100 million hardcore rural poor; and supporting policymakers and local administrations confronting the formidable challenges posed by air and water pollution. Broadly speaking, our strategies in these three areas will continue to follow the lines set out in the 1992 CSP. Some shifts of emphasis will, however, be warranted. In the infrastructure sectors, in particular, recent progress with tariff reform means that attention can increasingly shift to the corporatization of service provision along more commercial lines, accompanied by the development of more transparent regulatory frameworks. It also, however, leaves the inadequacy of China's highway network, starved for dependable sources of investment financing, all the more apparent—and we propose a further increase in the emphasis given to highways development in our own operational program.

vii. An additional challenge which has emerged since the approval of the 1992 CSP concerns the management of the decline in IDA availability resulting from decisions taken on "blend" countries during the tenth replenishment. Domestic onlending arrangements create a danger that the hardening of China's IBRD/IDA blend could lead to reduced willingness to borrow in the areas of poverty alleviation, the social sectors and the environment. We have communicated our view that such an outcome would be unacceptable. The early response has been encouraging, but we can expect this issue to resurface as the cuts start to become effective. Issue

viii. The accelerated pace of reform is being accompanied by a heightened appetite for Bank advice and assistance, not only with broad policy issues but also, very crucially, with the details of reform implementation, often delegated by the central decisionmakers to sectoral agencies or, more often, local authorities. With the major philosophical barriers now mostly crossed, these "nuts and bolts" questions will increasingly determine China's success in translating its bold reform intentions into working reality. In turn, with no other outside agency able to match the Bank's experience or credibility within China, we ourselves face difficult challenges in trying to leverage our own limited resources in innovative ways so as to maintain our responsiveness to the country's requirements and demands, including the related priority of strengthening our presence in China's less-advanced inland regions. Economic and sector work will need to become more flexible to meet calls for immediate advice on specific reform implementation choices, and we are restaffing our Resident Mission to help meet this need. Sector-specific technical assistance operations may offer another promising new model. In addition, our lending operations are rapidly acquiring more of a "reform implementation support" element, precisely to help meet the "nuts and bolts" needs of putting reform into practice.

ix. The quickening of the reform impulse outlined above may be considered to meet, in substantive terms, the basic conditions set out in last year's CSP for moving from the CSP's *Base Case* lending scenario (about 45 operations over FY94-96, with combined

IBRD/IDA lending of close to $9 billion) up to the *High Case* scenario (about 51 operations, with combined lending of about $11 billion). In *not* making such a recommendation at this time, we have been guided by three considerations:

(a) The decline in China's expected IDA allocation under IDA 10, compared to the assumptions made in the CSP, creates an imperative to substitute IBRD lending for previously anticipated IDA credits;

(b) This, in turn, brings forward the date at which attention needs to be given to issues of IBRD exposure limits; and

(c) The internal budgetary implications of seeking to process a larger number of projects.

x. Accordingly, we propose to continue working at a level approximately equivalent to last year's *Base Case* (44-45 operations over FY94-96, with combined lending of an estimated $9.1 billion). On this basis, China's share of IBRD debt outstanding and disbursed is forecast to remain within the 10 percent guideline through at least the turn of the decade.

CHINA: 1993 CSP UPDATING MEMORANDUM

1. The 1992 Country Strategy Paper (CSP) was reviewed and approved by the President's Office on June 12, 1993. The present "Country Strategy Note" (CSN) updates our analysis of the reform climate and macroeconomic situation to cover the events of the past twelve months, and proposes appropriate modifications in our country assistance strategy in keeping with the rapidly evolving situation in China. An Updating Economic Memorandum (UEM), based on a mission to China in April 1993, is being finalized in parallel with this CSN.

A. Background: Key Challenges

2. Last year's CSP and a number of other Bank documents have extensively documented the key achievements of China's reforms to date—the marketization of agriculture, the rapid growth of nonstate activity in industry and services, the "open door" to trade and foreign direct investment (FDI)—and the ensuing growth in GDP (averaging 9 percent) and productivity. Rather than repeating this discussion, we concentrate here on the areas where we still see major challenges remaining. Many of the priority areas from last year's CSP remain (e.g., the key nexus of SOE reform, connected social reforms and financial sector reform), though the recent impetus seen behind price reforms (paras. 4, 5) means that this area has now dropped somewhat down the scale of our priorities. By contrast, the short-term macroeconomic situation has emphatically increased in visibility since June of last year. We therefore list the following key challenges:

(a) Intensifying the marketization of those domestic producers of tradable goods still significantly shielded from market forces, i.e., *China's state-owned enterprises (SOEs)*: a process that needs to move in parallel with the further development of domestic *factor* markets (including *financial and labor market reforms*);

(b) Continuing to address perennial constraints to growth in the domestic nontradable sectors: principally energy, transport and communications *infrastructure bottlenecks*;

(c) Developing effective responses to the plight of the 100 million Chinese poor still largely bypassed by reform-induced development; and

(d) Further strengthening indirect instruments of *macroeconomic demand management* consistent with an increasingly marketized economy and, as the *highest and most urgent priority of short-term policy*, making effective use of them to achieve a "soft landing" from the pressures of overheating that have recently emerged.

3. **State-Owned Enterprises and Related Reforms.** As in the CSP, this continues to be seen as the key longer-term challenge. To summarize our basic analysis,

China's 100,000 SOEs have continued to operate in an environment characterized by significant administrative involvement in economic decision-making and to be sheltered from the ultimate discipline of "hard budget constraints." The relatively cautious pace of SOE marketization hitherto can be largely attributed to concerns over the potential social impact of fundamental restructuring on the SOEs' workforce, over 70 million strong and, together with dependents, covering the bulk of the population in the main cities. The SOE workers' vulnerability, in turn, has reflected patterns of social security provision designed in the context of traditional lifetime employment, including dependence on the employing enterprise for subsidized housing, unfunded and nontransferable pension rights and medical insurance, together with the absence, until very recently, of formal systems of unemployment compensation or meaningful urban labor markets. A variety of mechanisms has served, in practice, to soften SOE budget constraints so as to avoid redundancies or bankruptcy, including—in addition to explicit budgetary subsidies—concessional pricing on Plan allocations of energy and raw materials; ad hoc local negotiation of corporate income tax bills; and preferential access to directed credit, often on favorable terms, from the state banking system. Beyond this, SOE managers have continued to be subject to extensive involvement in business decisions by government agencies: the organization of these bureaus, both centrally and locally, along narrow, subsector-specific lines has served, inter alia, to inhibit diversification strategies and, to a considerable degree, to "freeze" the pattern of SOE investment and output.

entry/exit

4. A certain amount of progress has already been made in the marketization of the SOE sector. Final output markets are far less subject to state control (90 percent of retail prices are now uncontrolled) and have also been increasingly influenced by competitive pressure from nonstate entrants; the financing of industrial investment has been largely shifted from the budget to the banks and retained earnings; and energy supplies and raw materials are now subject to multiple-tier pricing, with at least out-of-Plan supplies at the margin at generally realistic market prices. In addition, "contract management system" reforms from the mid-1980s, which converted SOEs' formal objectives from gross output to profit maximization, provided managers substantially enhanced autonomy over the allocation of resources (including labor) *within* the individual enterprise: Bank-supported studies have identified a resulting upward trend in SOE productivity. At the same time, the earlier phase of reforms fell short of a more fundamental restructuring involving cross-enterprise or cross-sectoral resource reallocation; the SOEs continue to show slower growth in productivity or output than nonstate enterprises; SOEs still absorb a disproportionate share of formal credit (approximately four fifths) and of the best-qualified entrants to the workforce; and visible SOE losses (generally considered understated as a result of weak accounting standards) are equivalent to 4-5 percent of GDP, or close to double the total budget deficit. Broader ramifications of the SOEs' protected status include obstacles to relaxing continued government dominance over the allocation of bank lending (as well as to placing the taxation system on a more transparent basis). As such, SOE reform is needed not merely as an end in itself, but also as a means toward freeing-up markets (including the capital market) in order to permit greater responsiveness to demand from the *nonstate* sector. The Chinese authorities' recently reinforced commitment to more fundamental marketization of the SOEs is discussed in greater detail in Section C below.

5. **Infrastructure**. Basic infrastructure bottlenecks, as also noted by the CSP, have played a part in choking off growth in each of the recent episodes of overheating, including 1985 and 1988/89, and reports of power shortages and congestion on the railways and at the ports have again surfaced in recent months. Investment in transport and energy has been constrained from two sides—erosion of the budgetary funds that were the traditional sources, and low controlled prices for nontradable services, which inhibited self-financing (while also stimulating wasteful consumption). Bank-supported price reforms, which have accelerated over the past two years, have gone a long way toward removing past distortions: recently increased rail tariffs are expected to permit the self-financing of about 80 percent of planned sectoral investments, while average consumer electricity tariffs are now estimated to be in excess of 90 percent of long-run marginal cost. Even in these sectors, however, backlogs and unevenness in regional coverage remain. Meanwhile, efforts to develop a more balanced transport system, in particular a modern highway network, continue to be hampered by the absence of robust road financing mechanisms, while telecommunications coverage remains at low levels, in part reflecting quasi-monopolistic traditions and past resistance to competitive entry. Recent policy initiatives in the infrastructure area are also reviewed in Section C.

6. **Poverty**. A major Bank report finalized during the last year (No. 10409-CHA) has broadly confirmed the view of this issue taken in the 1992 CSP. It shows that, while the first five years of reform lifted some 170 million Chinese out of absolute poverty, the population remaining in poverty (close to 100 million) has shown no discernible reduction over the last decade. Absolute poverty in China today is almost exclusively *rural*; it affects *whole communities* rather than individuals; and it is heavily concentrated on a *regional* basis—affecting villages in remote, resource-poor (and often environmentally degraded) areas, primarily in the northwestern and southwestern interior. The challenge of alleviating this remaining hardcore poverty is a multidimensional one. In at least some of the poorest regions, technological packages now exist that are capable, with the necessary investment support, of yielding substantially improved agricultural incomes, on an environmentally sustainable basis, for at least part of the current population. Other sources of employment, however, such as small-scale industry, are widely constrained by infrastructure deficiencies and poor market access (although some border areas, in particular, should benefit from the recent expansion of the open-door policies). For some of the poor, outward migration may be the most promising option: this, though, is a field where earlier policy restrictions are only gradually yielding to pressures from below.

7. Low incomes in these regions are compounded by marked weaknesses in the provision of social services, and resulting indicators of health and education status strikingly below national averages. Women's health and girls' education are frequently the most severely affected. Central policy has traditionally stressed self-sufficiency by rural communities in social service financing and, although fiscal arrangements have long redistributed revenues to the poorest *provinces* (and, since the mid-1980s, also to the poorest *counties*), there is little indication that effective mechanisms yet exist to achieve sustained social improvements at the level of the poorest *villages* where the worst conditions are found. With no easy solutions, the plight of China's poor continues to

challenge the best efforts both of the Chinese authorities and of the international development community (paras. 39-40).

8. **Macroeconomic Management**. The cyclical nature of Chinese growth since 1978 has been widely discussed. By many international standards, the troughs have been neither particularly deep nor especially prolonged: the most recent cycle, at its lowest point, witnessed real GDP growth of 3.8 percent in 1990, with recovery to 7.2 percent in 1991. There is, nonetheless, legitimate cause for concern over the stresses created by very rapid deceleration, as well as over the extent to which, in past episodes, the pursuit of marketization reforms has become subordinated to the imperative of regaining control of aggregate demand, in turn achieved largely through administrative mechanisms and quantitative controls. The prevalence of such direct levers to date can be traced to several causes. The tax system, based largely on multiple-year contracts negotiated between the different layers of government, has not lent itself to demand fine-tuning (though Beijing has shown some inventiveness in introducing *new* taxes), so that deflationary fiscal policy has primarily comprised direct cutbacks in public investment (imposed administratively by the center). On the monetary side, although interest rate changes played a more important role in the most recent (1988/89) period, direct quantitative credit controls remained the principal instrument, reflecting partly the limited capability and experience of the central bank (People's Bank of China, PBC) in the use of indirect policy tools (and relatively thin, undiversified domestic money markets), but also reservations over the likely responsiveness of SOE credit demand to the interest rate changes then considered feasible.

9. The 1988/89 episode had specific features not likely to be repeated, including an abortive preannounced "big bang" attempt at price reform, which sparked a rapid upswing in consumer demand and complicated the design of an effective policy response. Beyond this, the earlier experience has itself served to increase the sensitivity of policymakers to the disruptive potential of overheating, and thus to improve the likelihood of a more timely response on subsequent occasions. Signs of the need for concern at the present time have indeed been building over recent months. Real GDP growth over 1992 proved close to 13 percent, significantly above the 8-9 percent level judged consistent, on a sustained basis, with noninflationary growth by the 1992 CEM (and subsequently adopted as the official target). At the same time, however, the trade and inflation results for 1992 were, in overall terms, still relatively comforting, with export growth at 18.2 percent (though imports grew faster, at 26.2 percent), and the retail price index (RPI) up by only 5.4 percent (though here, too, more worrying signals were visible in some of the disaggregated indices, including a rise of 15 percent in the "means of production" measure of raw materials prices).

10. Data now available for the first quarter of 1993 have eliminated remaining ambiguity over the danger of overheating. The turnaround in the trade balance has been particularly striking, with export growth slowed to 7.4 percent, while import expansion maintained its pace at an unabated 25.4 percent, resulting in the first trade deficit since 1989 ($1.2 billion for the quarter). This has been accompanied by substantial further widening of the divergence between the official exchange rate and that in the parallel market. Price data confirmed the trend, with the RPI rate of increase up to 8.6 percent

and the "means of production" index rising at a rate of 38 percent by the end of March. With the official budget deficit relatively stable in the internationally unexceptionable range of 2-3 percent of GDP, it is the monetary sector that has provided most of the fuel for the rapid expansion in demand (much of it, however, "quasi-fiscal" in nature and absorbed by the SOEs). Growth in broad money during 1992 reached 31.3 percent and, on top of perennial difficulties in containing lending by local branches of the state banks, a distinctive contribution has on this occasion originated from rapidly expanding nonbank financial institutions (NBFIs), to date effectively covered neither by PBC's traditional quantitative controls nor by the newer style of prudential regulation the central bank is attempting to introduce into the sector.

11. Starting in mid-May, and in line with warnings contained in our draft UEM, the central authorities have signaled their recognition of the need for immediate measures to avoid further deterioration in the macroeconomic balance. The steps so far announced are all consistent with our advice. They include increases in officially administered interest rates for bank deposits and loans, as well as on Government bonds; proposals to stiffen enforcement of the authorization process for capital market issues; and measures to curb the erosion of the fiscal revenue base by local governments via the multiplication of "development zones" conveying tax concessions. Earlier restrictions on access to the parallel market for foreign exchange are also reported to have been eased. Further credit tightening is proposed, including more effective regulation of the NBFI sector. While these actions are both welcome and timely, we have made very explicit in the strongest terms our view that the changes so far announced (e.g., in interest rates) are not going to be sufficient to achieve the desired results. We have also expressed concern over the fact that *deposit* rates have been raised significantly more than *lending* rates, with adverse implications predictable for financial sector viability. In addition, we are pressing the role which further *trade liberalization and exchange rate reforms* could play, in addition to their longer-term contribution to improved resource allocation, in helping to absorb the more immediate demand pressures.

12. It is clear that, over coming months, maintaining a very close dialogue on short-term macromanagement issues will need to absorb a considerable proportion of our efforts. On present showing, it is an area in which the central Government is both eager to receive, and responsive to, the Bank's advice. The discussions of the UEM (and those at a timely recent conference in China on macroeconomic management) indicated a very high degree of responsiveness to our message at both the working level and the very top. Given China's experience over recent years, and the increased sophistication of its policy analysts, our message on the potential dangers of a *hard landing* (renewed cycles, possible interruption of reform momentum) is one that has by now been well internalized. Some of our Chinese counterparts were, indeed, at pains to stress that, if indirect policy instruments *should* need to be supplemented by administrative restrictions, these should be concentrated precisely on the least market-oriented sectors (SOEs, local government), rather than being applied in blanket fashion to the economy as a whole. This is itself an indication of how far things have changed since 1988/89. At the same time, it serves to accentuate that the crucial test at this stage is less one of intellectual appreciation than of

political strength and will. As such, there is an element of uncertainty surrounding the outcome that no amount of analysis at this stage can fully remove.

B. External Environment

13. During recent years, with the relative isolation suffered following Tiananmen now largely dissipated, China has benefited from a generally favorable external environment, which permitted trade growth over 1989-92 of 15-20 percent per annum. In 1992, in particular, FDI (primarily targeted to export-oriented manufacturing) rose to around $10 billion, making China the largest developing country recipient of such investment. China has also continued to enjoy relatively easy access to international financial markets, made easier of late by the opening (albeit on a restricted basis) of China's internal financial markets to overseas portfolio investors. At the same time, however, as noted above (para. 10) and as predicted in last year's CSP, the trade balance has rather rapidly swung into deficit; not in itself necessarily an undesirable development, but one which will require careful monitoring.

14. In *trade*, there are three *external* issues. First, China's application to resume its seat at the GATT, which was filed in 1986, is still pending (and subject to difficult negotiations, which may take at least one more year to conclude). If completed satisfactorily, this would add a degree of certainty to China's external economic environment that has for some years been lacking. Second, on May 28, 1993, the US administration extended China's MFN status for another year, linking subsequent renewal to progress on human rights, but explicitly excluding bilateral trade and arms export issues. This approach helps to remove doubts about China's export markets in the most immediate future. Third, China stands to benefit more than many others from a hoped-for successful conclusion to the Uruguay Round, in view of its dependence on garment and footwear exports, which would be liberalized relatively more than other commodities.

15. China's *investment climate* continues to improve, as reflected in the doubling of FDI in 1992. The country is benefiting in this regard from the growing role of other Asian economies such as Japan, Taiwan (China) and Korea as overseas investors, supplementing China's original investment partners in Hong Kong. If this continues, FDI can be expected to make a significant and increasing contribution, both in established manufacturing sectors and also in new areas for FDI (such as services and infrastructure). The *financial markets* continue to look favorably on Chinese instruments. Bonds and syndications are issued with ease, especially on Asian financial markets, and at very favorable rates. China's excellent repayment record, and absence of rescheduling requests, combine to make the country a very desirable sovereign borrower. We expect China to continue to enjoy a strong creditworthiness position. As we forecast last year, the balance of payments current account has returned to its normal (pre-1989) stance of a moderate deficit. We see no reason to expect this to be allowed to get out of hand (see UEM for more detailed forecasts): the interesting question, rather, is whether its future management will take place primarily through traditional administrative measures or, as advocated in a recent major ESW report on *Trade Reform*, through a combination of liberalization of quantitative restrictions and exchange reform. Total debt outstanding stood at only

16 percent of GDP in 1992 and this is projected to fall gradually over the balance of the decade. The associated debt service level is also expected to remain healthy, declining further from its already modest level of 9.7 percent of export earnings in 1992 to about 7 percent in the second half of the decade. Indicators for IBRD exposure are reviewed in para. 50 below.

16. On the downside, some uncertainties remain. Trading arrangements are ad hoc, as noted, and subject to arbitrary change pending conclusion of ongoing negotiations. China's export growth has been highly concentrated in terms of markets and products (notably in garments, toys and footwear for the US market) and some of these niches may be approaching saturation. Finally, political tensions continue to affect relations with Hong Kong and Taiwan (China), which reduce the achievement of potential synergies from the much-discussed "fourth growth pole." These aspects will therefore continue to demand attention and monitoring.

C. Country Assistance Strategy

Recent Developments and Government Policies

17. **Political Developments.** The past year has witnessed developments of considerable importance at the policy-making and political levels, which have served inter alia to cement the policy consensus around further acceleration of China's marketization reforms. The key events were the meeting, in October 1992, of the fourteenth Party Congress, whose decisions set the overall policy direction for the next five years, and the subsequent inaugural session (March 1993) of the newly elected National People's Congress (NPC), China's legislature. These two bodies, the sources of policy legitimacy within the party and the state, took the critical symbolic steps of writing into party policy and the constitution, respectively, a redefinition of official economic philosophy that replaced the earlier formula of "a planned economy on the basis of socialist public ownership" by "a socialist market economy." In keeping with Chinese tradition, the latter concept does not readily lend itself to a precise or static legalistic definition. It may, however, be read (particularly taken together with an earlier reinterpretation of "socialist public ownership" to include not only SOEs but also local collectives) as an explicit downgrading of the weight attached to any specific ownership model, as well as a powerful public assertion of the central role further marketization is designed to play in future economic strategy. In summary, we see these steps as symbolizing the authoritative removal of residual ideological constraints to the ongoing marketization process. The *socialist* nature of the Chinese economic model, in turn, is likely in future to be manifested primarily by concern to protect basic social service provision and avoid extreme inequities in economic welfare and, more specifically, a continuing commitment to the eradication of China's remaining absolute poverty.

18. The two Congresses also gave their stamp of approval to the planned collective succession to the elders of the Long March generation. This included the reelection (with a number of dissenting ballots) of Li Peng to his second (and, constitutionally restricted, final) term as Premier; the elevation of Jiang Zemin to be State

President as well as Party Secretary and Chairman of the Central Military Commission; and the promotion of the reform-minded Zhu Rongji to the new post of *Senior* Vice Premier. In designing the new lineup, China's patriarch Deng Xiaoping appears to have succeeded in avoiding several potential political pitfalls. The rumored ambitions of the Yang family (outgoing President Yang Shangkun and his younger half-brother General Yang Baibin) were squashed, and both brothers sidelined, together with a number of potential allies in the military. Equally, several members of the "princelings' party" (the sons and daughters of older leaders whose activities helped fuel popular discontent in 1989), were passed over in the new appointments. The specific names that *were* chosen clearly reflected a good deal of back-room negotiations, and could yet be subject to disruption by unexpected events (e.g., the health of Premier Li Peng). However, the obvious success of and popular support for the basic policy line ratified by the Congresses is probably of greater ultimate significance for the future than the position of any particular individual among the designated successors. The Congresses' removal of remaining uncertainties over ideology has legitimized the recent and very obvious upsurge in the discussion, proposal and introduction of specific reform measures, at both central and local levels, in many of the most important reform areas. The current policy climate is reviewed in greater detail in the UEM, but key features are outlined below.

19. **SOE Reform.** The central thrust of official policy is now the aggressive promotion of corporatization and marketization reforms in the SOE sector. New regulations (July 1992) seek to improve the definition and protection of *management autonomy* over major business decisions. The center is, in addition, encouraging the conversion of SOEs into *shareholding companies*, with the ownership function exercised by Boards of Directors rather than government bureaus: this step will also help open the door to further *ownership diversification*. In parallel, a *government reorganization* has been announced, designed over several years to reduce the overall size of the bureaucracy and to reorient the work of ministries and bureaus away from their past micro-interventionist traditions. Meanwhile, *bankruptcy provisions and mergers* are being increasingly applied to SOEs. Official sanction has been extended for the *sale or leasing* of at least some of the smaller SOEs to collectives or private enterprises. A cautious approach is currently being taken, however, to the expansion of *stock exchange listings* (not inappropriate at this stage, given the gaps still to be filled in securities market regulations, as well as the generally weak state of *enterprise accounts*, an area where the Government has recently launched an urgent nationwide upgrading program: the last thing China's reforms need now is a series of stock exchange scandals and, without considerable caution, this is a real danger).

competition

20. **Labor Market (Housing and Social Security) Reform.** As noted earlier, this is a crucial corollary of SOE reform, and one in which the basic lines of official policy have by now been in place for about two years. The scope of fixed-term *labor contracts* for SOE workers (replacing lifetime guarantees) is being expanded. In *housing*, the center has established a timetable for previously nominal rents to increase to cover management, maintenance, depreciation, interest and property taxes by the end of the decade. In parallel, enterprise housing units are to be transferred to commercial housing corporations. As rents rise, the second prong of official policy, encouraging wider owner-occupation,

privatize

should also come into play. *Pension* rights are starting to be pooled across enterprises: similar reforms for *health insurance* are, however, at a more preliminary stage. Finally, *unemployment insurance* schemes are under development and introduction. It should be stressed, however, that the detailed *implementation* responsibility for the above reforms lies almost entirely at *local* (usually municipality) level, and this is where practical models are having to be worked out.

21. **Financial and Capital Market Reforms**. Following several years without basic policy movement, this area is now receiving reinforced attention. It is symptomatic—and encouraging—that we received a Government request, which has been met, for a strategy paper in this sector earlier this year. Beijing has committed itself in principle to converting the bulk of the existing State banking system into genuinely *commercial banks*, with the autonomy over lending this would imply. Remaining directed "*policy lending*" is to be segregated from commercial banking—initially on an accounting basis, but subsequently through the formation (probably by restructuring existing institutions) of one or more banks dedicated to the provision of policy loans. Banks' *accounting* practices are to be standardized as part of the basis for *more sophisticated methods of monetary control and bank regulation*. Consistent with these changes, gradual deregulation of *interest rates* is projected. On the *capital market* side, meanwhile, new regulatory bodies have been established for the securities exchanges, and foreign investors permitted to purchase certain categories of Chinese equity shares. Finally, there is active discussion of the need for a *reorganization of PBC*, to strengthen its ability to concentrate exclusively and more effectively on its *central banking* functions. Agreement has yet to be reached, however, on all aspects of the new design (including the crucial—and politically difficult—issue of whether to scrap the current system of organizing PBC on a *provincial* branch basis, which has done much to dilute central control in the past).

22. **Fiscal Reform**. This is an area where progress has long been complicated by conflicts of interest between the center and the lower-level administrations that actually carry out the assessment and collection of the great bulk of China's tax revenue. Initiatives under way include efforts to standardize the taxation of *corporate income* (another area where improved accounting standards are crucial), as well as the gradual diversification of the revenue base, including phased introduction of a *value added tax*. Despite Beijing's desire to regularize its fiscal relationship with lower levels, however, and experiments with "*tax-sharing systems*," there appears no sign of an imminent breakthrough in this politically difficult area: we plan to continue, nonetheless, to press its importance within our own dialogue.

23. **Private Sector Development**. In overall terms, the further development of the private sector is projected to continue to take place *in parallel* with the corporatization and marketization of the SOEs, rather than through efforts at a mass privatization of the existing public sector. The central authorities have undertaken to simplify further the *registration* of new private firms, and to *ease restrictions* over such firms' scope of business. Lower levels, meanwhile, are increasingly active in promoting new *joint venture* subsidiaries between Chinese enterprises (including both SOEs and local collectives) and foreign partners (even if some represent in part a response to advantageous tax treatment

of joint ventures). Such activity is likely to increase further following recent announcements *expanding the scope of the open door for FDI* both geographically (to cover *interior regions*) and sectorally (to encompass an increasing range of *tertiary activities*, including retailing, distribution and financial services). The center has also extended its blessing to increased FDI in *infrastructure* sectors. There are already examples of private Hong Kong investment in toll highways, other transport facilities and a 200 MW thermal power station in neighboring Guangdong province, as well as a recent Hong Kong-Chinese joint-venture agreement to develop Shanghai's container port. Assessing the potential for wider replication is now an area of active interest for IFC (paras. 44-45) and the Bank Group as a whole.

24. **Legal Reform**. The authorities recognize that further marketization calls for traditional reliance on administrative mechanisms to give way, across wide areas of the economy, to transparent rules-based systems and a more comprehensive framework of economic law. Given the many areas in which the current legal framework is either clearly deficient or nonexistent, as well as the numerous fields in which, as discussed above, new reform proposals are under active development, something close to a flood of draft legislation is at present circulating in Beijing. The authorities have indicated potential interest in Bank advice and assistance in helping to develop the legal framework in an effective and internally consistent manner: exploring possible modalities for such support will provide a new focus for our proposed assistance strategy (para. 29).

Main Objectives and IBRD/IDA Program of Assistance

25. **Lending and Portfolio.** New Bank commitments to China amounted to just over $2.5 billion in FY92 and $3.2 billion in FY93. Despite modest year-to-year changes in average supervision ratings, to be expected in a growing and maturing program, the overall implementation status of the Bank portfolio in China, currently comprising approximately 100 active investment projects, has continued to be robust (average supervision rating of 1.50), fundamentally reflecting a combination of strong local administrative capability and the powerful sense of borrower ownership that has consistently characterized the Bank-supported program in China. There are no major implementation problems identified as generic to a significant number of operations, and at any one time there are seldom more than 3-4 specific operations rated as having significant implementation difficulties (while the Government's responsiveness to concerns raised by the Bank is such that projects do not generally remain in this category very long).

26. **Country Dialogue and ESW.** The policy dialogue between China and the Bank is exceptionally strong, reflecting Chinese decisionmakers' trust in the objectivity and relevance of Bank ESW, respect for the quality of the Bank's investment project work across a broad range of sectors and regions, and recognition of the consistency of the institution's support of China's reforms and development throughout the past decade. Formal ESW reports are studied seriously both by the most senior decisionmakers and by officials in the relevant sectors, and studies in recent years have contributed to the evaluation of reform implementation alternatives in areas including the financial and fiscal

sectors, housing and social security reform, the development of urban land markets and grain market liberalization, as well as providing comprehensive overviews of issues relating to poverty and the environment. Major reports on China's trade policy and budgetary issues, respectively, are currently being finalized. Planned topics for work over FY94 are summarized in the box below.

CHINA: PROPOSED MAIN AREAS OF ESW FOR FY94

Studies:	Domestic Market Regulation and Development
	State-Owned Enterprise Reform
	Municipal Finance
	Quasi-Fiscal Deficit
	GNP/National Accounts
	Regional Patterns of Development
	Agricultural Marketing
	Water Resources Planning
	Provincial/Municipal Environmental Management
	Higher Education Efficiency
	Health Finance Reform
Strategy Papers:	Financial Sector
	Industrial Policy and Restructuring
	Power Sector
	Transport Sector
	Ports Subsector
	Highways Subsector

27. **Need for Innovation**. Our program in China over much of the past decade largely comprised the two products discussed above: formal ESW reports, prepared after intensive research and providing comprehensive coverage of issues in specific sectors or policy areas; and solid, well-prepared investment projects supporting technological modernization and institutional development objectives, as well as selected, well-defined sector reform objectives, such as tariff reform in the principal infrastructure sectors. This combination, and the "parallel track" approach which maintained some distance between the two products, helped to meet specific country needs and demands for technology transfer and institutional modernization during a period when China was still emerging from its earlier international isolation. It was also broadly compatible with the relatively deliberate approach to reform during much of the decade, and the manner in which the leadership then preferred to receive outside advice. What is now apparent, however, is that the earlier product range and the parallel track will no longer serve fully to meet the requirements and demands for assistance being generated by the recently accelerated pace of reform, and the Government's desire to see more intimate Bank involvement in the detailed implementation of the new generation of reforms. We are thus now being challenged to develop new approaches and incorporate additional flexibility into our country assistance program, and this is a challenge the proposed strategy will seek to meet.

28. One clearly identified demand is for the ability to provide *prompt feedback and advice* to decisionmakers on reform implementation alternatives in specific areas through succinct analytical papers, based more upon synthesis than on extensive original research, and produced on a more flexible schedule than formal ESW. During the past year, informal strategy papers of this kind have been provided to the Government in areas including SOE reform, financial sector strategy and short-term macroeconomic management issues: to help reinforce our capacity to respond to additional requests of this type, we are currently restructuring the staffing of the *Resident Mission in China (RMC)*, to put considerably greater emphasis on macro and sector policy analysis skills. Under a second model, we have to date provided intensive assistance, through international workshops and follow-up staff input, to two of China's most important coastal cities (Shanghai and Tianjin) with the design of city-level "*reform action plans*," intended to serve as "living documents" capable of guiding reform implementation on a multi-year basis and underpinning future Bank lending: we plan in the near future to start adapting this model to the needs of selected inland cities (tentatively, Wuhan and Shenyang).

29. In some of the key reform areas, the demand for external assistance with policy analysis and reform implementation issues will clearly go beyond what the Bank can provide from its own resources (in view of the *extent* of the support needed and/or the *specialized skills* involved). We thus expect to make increasing use of *sector-specific TA operations* in future. The first example was provided by the Financial Sector Technical Assistance Project (Credit. 2423-CHA), designed largely to help strengthen the capability of PBC, and approved in September 1992. We are actively discussing with the Government the potential for additional operations of this type, in such areas as economic law reform, further strengthening of financial and capital markets and the development of support services for newly marketized enterprises.

30. A further area where we are introducing innovative products might be described as *reform implementation support operations*. In many areas where reform plans are now active, effective reform implementation will itself call for significant investments in building new or modified institutions, imparting new skills and creating supporting infrastructure, not only at the center but throughout China's provinces and municipalities. One example concerns the marketization of China's hitherto tightly planned grain distribution system. This reform will not only require development of new institutions and skills (commodities exchanges, commercial trading corporations, etc.), but will also open up new possibilities for more economically rational domestic and international trading patterns that, however, without supporting physical investment, could be frustrated by infrastructure bottlenecks: a grain market reform implementation support operation was recently approved by the Board. A second area is housing and social security reform, where the city-level administrations charged with implementation require assistance with the creation of viable models of commercial housing corporations, housing finance institutions, etc. Here, too, preparation is at an advanced stage. A third example, where we are working actively, relates to labor redeployment issues raised by SOE reform. Existing vocational/technical training models in China focus heavily on *preservice* training: new approaches will be needed to meet the *retraining* requirements of older workers called on to change jobs.

31. **IDA Replenishment**. An additional challenge in the management of the country assistance program, on both the Bank and Government sides, is raised by the decline in availability of IDA resources for China resulting from the decisions, subsequent to last year's CSP, on blend countries in the context of the tenth replenishment (IDA-10). In this connection, we are already discussing with the Chinese authorities our aim of maintaining our existing levels of support for the social sectors, for the development of the poorest regions and for environmental protection and the amelioration of pollution. Internal arrangements for onlending make this a difficult issue for the Chinese to handle and, although the initial response has been encouraging, it will undoubtedly continue to require considerable attention, particularly as the cuts start to bite.

32. **Proposed Operational Program**. As earlier discussion has sought to demonstrate, the central policy stance has by now evolved to provide an enabling environment for rapid further marketization reforms. Certain key policy areas will continue of necessity to be addressed primarily through dialogue at the center—e.g., monetary and financial sector aspects, and fiscal and trade reform—though in these areas too we will explore all possible vehicles for Bank support, including the types of innovative products outlined above. In most other areas, however, reform progress will depend largely on developments at the level of individual sectors, provinces and municipalities, and it is at these levels that we propose to continue to concentrate the bulk of our future lending.

33. Our earliest operations in *industry* focused primarily on supporting the technological modernization of Chinese firms (primarily SOEs) in a selected number of subsectors, itself an important contribution given that prevailing standards were often decades behind international best-practice. Expectations today, however, are pitched much higher, and future involvement in this sector must clearly be designed with the primary objectives of fully supporting and advancing the processes of marketization and transformation now endorsed at the central level. In keeping with the recommendations of our *Enterprise Strategy Paper*, endorsed by Bank Senior Management earlier this year, understandings have therefore been reached with the Government that future Bank support in the industrial sector (at both the regional and sectoral levels) would need to be provided within specific frameworks fully consistent with marketization and transformation objectives, including:

(a) separation of state firms from government bureaus through restructured corporate forms (including transparent ownership mechanisms);

(b) promotion of ownership diversification;

(c) corporate income tax reform;

(d) accompanying social and labor market reforms (housing, social security, etc.);

(e) competitive market policies, including promoting freedom of entry and exit for both public and private producers; and

(f) satisfactory guarantees of access by nonstate enterprises to Bank support.

34. We are committed to experimenting with the design of industrial investment operations meeting the above objectives at the provincial/municipal level in several regions (including inland as well as more traditional coastal locations), and are also exploring the possibility of applying them in selected subsectors on a cross-provincial basis. One ongoing operation, the Rural Industrial Technology (Spark) Project (Ln. 3274-CHA, Cr. 2186-CHA) seeks to provide support exclusively to the domestic nonstate sector, and we will consider possible further operations with a similar focus. We will also review the possibility to make use of the innovative product models discussed earlier to support industrial enterprise marketization and restructuring.

35. In the *financial* sector, our initial goal was to help introduce modern investment evaluation approaches through the development of a new industrial DFC, the China Investment Bank, CIB (and parallel support, in rural areas, to the Agricultural Bank). Recent years have witnessed a shift in focus to the imperative of strengthening the overall sector policy framework and the institutional capability of PBC, an approach whose operationalization was launched with the recently approved TA project (para. 29). We expect our next financial sector operation to continue and broaden the focus on the sector-wide framework and infrastructure pioneered by the TA project. Given the expected pace of change in this sector, however, attention to the strengthening of PBC and other sector-level agencies will soon need to be supplemented by a focus on the transformation and restructuring of the operating institutions in the sector, including the commercialization of China's state banks. This is thus a sector in which our operational involvement may need to be intensified rather rapidly, and it is a sector in which finding innovative models for reform implementation support will be a central challenge for our assistance strategy.

36. China's *infrastructure* sectors (primarily power and—within transport—rail, roads and ports) have together absorbed over 40 percent of cumulative Bank lending to China. As discussed earlier (para. 5), these have been the key bottleneck sectors, with heavy absolute investment requirements, and the development of effective new mechanisms of *domestic* resource mobilization (fundamentally through tariff reform) has inevitably been a gradual process. As also discussed, however, it is a process now paying off, with the *railways* and the *power sector*, in particular, now far better placed for internal resource generation (para. 5) and the *ports* undergoing rapid commercialization, including experiments with the introduction of FDI (para. 23).

37. These changes are now prompting a reevaluation of the future role of the Bank in the infrastructure sectors. We recently submitted a strategy paper on the railways sector to the Board (No. 10592-CHA), and are planning similar papers on ports, highways and electric power, respectively, as well as a strategy document for the transport sector as a whole. With substantial progress already in tariff reform, greater attention is now called for within our policy goals, in the case of the natural monopolies, to promoting

corporatization accompanied by more transparent systems of *regulation* reflecting the lessons of international best-practice. In subsectors where competitive market structures are a realistic possibility, meanwhile, including ports and—potentially—*telecommunications* (an area where the Bank has yet to lend but where a possible first operation will shortly be appraised), our priority will be to promote the dual objectives of *commercialization* and subsectoral policy frameworks conducive to *competition* and the introduction of private capital, including FDI.

38. By contrast to the directly revenue-earning subsectors, there has been no comparable breakthrough in the case of China's *highways*. Our analytical work has highlighted the severe modal imbalance of the Chinese transport system (in which almost 60 percent of freight, and close to half the passenger traffic, is still carried by the railways). A modern highway system is urgently needed both to support the further development of marketized production activities and also as a key to greater domestic market integration and more balanced regional development. Within the overall transport system, this is the mode where future capital requirements are likely to be greatest. Our recent intermodal transport study of Guangdong province (Bank Discussion Paper No. 151), for example, recommended that some three quarters of future transport investment in the province should be directed to highway development. It is also, however, the field where domestic resource mobilization is currently least well-developed. We are therefore proposing a major increase in the relative weight given to highway development, and will be taking the study of, and support for, new models of resource mobilization as our leading sector policy objective.

39. In *agriculture* and the *social sectors* last year's CSP explicitly proposed the pursuit of *poverty alleviation* as our highest priority objective. In several of the regions of concentrated absolute poverty, including much of the northwest as well as the "red soils" areas found in much of the southeast, we consider that farming models already in existence (developed in part through earlier Bank projects) have proven their worth, and we are now preparing successor operations to promote their replication on a larger scale. Rural income generation in the most resource-poor areas of the southwest, by contrast, has less in the way of proven farm technology packages to build on. As an outgrowth of our recent poverty study (paras. 6-7), we plan very shortly to launch the identification of a poverty alleviation project in the southwest: given the difficult local conditions, innovative approaches (possibly including a multisectoral strategy) are likely to be required.

40. In the social sectors, similarly, operations recently approved or in the active pipeline exemplify the priority now being given to the problems of the poorest areas (para. 7), including basic education for girls and maternal health care priorities. The Education Development in Poor Provinces Project (Cr. 23390-CHA), which seeks to strengthen basic education provision in six of China's poorest provinces, is expected to be followed by a successor operation extending the approach to additional poor regions. Work is also under way on a Maternal and Child Health Project, similarly targeted at poor rural areas. A pending Rural Health Workers' Training Project includes provisions intended to help develop appropriate and sustainable financing mechanisms for rural health care which, if successful, could provide the basis for wider replication.

41. Beyond the primary goal of poverty alleviation, there are additional areas in agriculture and the social sectors where Bank assistance has an important role to play. Our support for the marketization of China's *grain* sector has already been noted (para. 30), as have our efforts, within the social sectors, in vocational retraining (para. 30) and health finance reform (box attached to para. 26). In addition, strengthened *water resource planning* is a vital priority for China, both for agricultural and other end-uses, and in both the water-scarce north of the country and flood-prone areas further south. Despite well-established domestic capability in irrigation development, particularly at the local level, water-use planning on a regional or cross-regional basis tends to strain both the older generation of planning models currently in use within China and established mechanisms for interprovincial coordination. In addition, while a recent Bank review has confirmed that Chinese mechanisms for planning and implementation of *resettlement* have generally produced very satisfactory results in recent years (and a report on this study has been issued in Gray Cover recently), it is also clear that it is the larger water development projects that are most likely to put pressure on the adequacy of these mechanisms. This sector is therefore proposed to continue as an area of active Bank involvement.

42. Our first comprehensive strategy paper on China's *environment* (No. 9669-CHA) was completed in April 1992 and its recommendations were summarized in last year's CSP. These recommendations provide the basis for what has become the fastest-growing area of concentration in our lending program, and we have recently concluded that a new sector division should be created, to focus exclusively on future environmental activities, while permitting sufficient attention also to be given to our work on education and health. Three investment operations addressing the amelioration of environmental conditions, especially in the field of water pollution, and located in—respectively—Southern Jiangsu, Zhejiang and Changchun, were approved during the course of FY93 (Ln. 3582-CHA; Credits 2475-CHA and 2457-CHA). Work is under way on a pipeline of further investment projects in additional priority cities and provinces: as in the earlier operations, each will include significant TA for the strengthening of local environmental management agencies and will also promote the corporatization of local public utilities such as water supply, sewage treatment and solid waste management services, to ensure that their operations are placed on a financially sustainable basis. In addition, we propose to follow the earlier overall strategy paper with a new phase of environmental ESW that will focus in greater depth on environmental management issues as seen from the *provincial and municipal* levels. More immediately, the Board has just approved a first Bank-supported Environmental Technical Assistance Project, intended to help strengthen further the institutional capability of China's National Environmental Protection Agency (NEPA) and other key sector agencies, as well as to support focused studies in priority areas of sector policy.

43. **Cooperation with Other Sources of Financing**. There are no major changes to report in our relations with the IMF, ADB, UNDP or with the principal sources of bilateral funding. As pointed out in last year's CSP, Chinese administrative mechanisms for financing development projects have generally not, in the past, been conducive to *cofinancing* on a larger scale. There have, however, been recent indications of possible interest in experimenting with more extensive use of cofinancing: in addition, the

Government's expressed intention to encourage greater *private* investment in the infrastructure sectors (para. 23) may open new possibilities in this area, and we intend to explore potential vehicles over the coming year.

44. **IFC and MIGA**. IFC's country assistance strategy for China focuses on three principal objectives: (i) promotion of a more favorable foreign investment framework, (ii) catalyst to the expansion of private sector investment, and (iii) acceleration and deepening of financial and capital markets. To respond effectively to the rapid development of the Chinese economy in the context of a continued move towards a market economy, IFC opened its first representative office in Beijing in October 1992. IFC's active participation is being sought by the authorities in China, particularly as the economy is moving towards a more market-based system, with an increasing emphasis on private sector led growth.

45. IFC's operations in China have so far concentrated on supporting joint ventures between foreign investors and Chinese enterprises. IFC plays an important advisory role in China in helping to structure these transactions and in arranging finance on a project risk basis without guarantees from government banks. Work in the capital markets area includes the establishment of a joint venture bank, and technical assistance to the new Securities Regulatory Commission, which will focus on the adequacy and regulations for the rapidly expanding stock markets in China. IFC has also encountered lively interest in infrastructure projects, where the scope for private investment is substantial, as China recently announced new policies to encourage foreign participation in infrastructure development. IFC's progress in infrastructure projects in the near future will depend on stronger efforts by the Chinese government to develop a suitable environment for private investments, including the legal and regulatory framework, as well as the institutional infrastructure, for private business operations. In the Bank's fiscal year 1993, IFC approved financing for four projects in China, in the areas of banking, cement and manufacturing, totaling \$42.8 million, which brought IFC's accumulated total investments in China to \$103.4 million. As of May 31, 1993, *MIGA* had approved one investment guarantee in China, with a package of additional guarantees expected to be submitted for approval very shortly.

46. **Proposed Bank Lending Program**. As discussed in Section B above, China's external position has been generally strong in recent years, with substantial inflows of FDI, especially into export-oriented manufacturing, and—until the recent deterioration—surpluses on the trade account. With strong private capital inflows into certain sectors of the economy (para. 13), and the current account deficit projected to remain moderate (para. 15), capital transfer is not the primary objective or determining principle of the level of Bank lending which, even at current and proposed levels, accounts for only a relatively minor share of China's total resource requirements. Rather, we see our operational program as a mechanism for helping to provide vital support for the nationwide implementation of the ongoing reforms, as well as the crucial objectives of poverty alleviation and environmental protection, discussed earlier in this paper.

47. The composition of our future lending program is proposed to continue to be broad-based in both geographical and sectoral terms, in view of the extensive agenda outlined in the present paper. In several sectors, as noted earlier (para. 39), social objectives have already prompted an increased emphasis on China's interior provinces, and we also believe a strong case exists for a similar relative shift of geographical focus in several others, including industry and highways. More broadly, we recognize the need for additional flexibility in the development of the lending program, including the ability to bring forward innovative operations on a fairly tight timetable as warranted by reform implementation needs, but equally the freedom to drop earlier proposals no longer seen as responsive to rapidly changing conditions. As such, the composition of any multiyear Lending Program proposed at the present time must be considered more subject to change than in previous years: it may be taken almost as a certainty that new operations, e.g., of the sector-specific TA or reform implementation support variety, will in fact be developed during the period in question, consistent with the reform impetus and support needs in different sectors and policy areas.

48. In terms of *scale* of future lending, a very crucial element that now needs to be allowed for is the change, since the last CSP, in China's status within IDA. We have explained to the Chinese authorities that, in practical terms, they should assume that IDA resources for China will henceforth decline by roughly $200 million a year (from about $850 million in FY94 to $50 million in FY98, assumed to be the pregraduation year), and this scenario has been accepted. We have additionally explained that: (a) future IDA flows will be concentrated on supporting IDA objectives in the areas of poverty alleviation, the environment and the social sectors, and will not be available to finance investment operations in other sectors; and (b) the Bank would expect, despite the IDA decline, to safeguard its current level of operational involvement in the above sectors. These factors have obvious implications for the substitution of IBRD for IDA lending within the overall portfolio—indeed, on resource transfer grounds, a case could be made for being prepared to offer such substitution on a more than one-to-one basis. As a minimum, the delivery of any given size of total lending program will now imply greater use of IBRD resources than was assumed at the time of the last CSP. This substitution, in turn, has the result of advancing, compared to the situation at the time of the CSP, the date at which IBRD exposure limits must be factored into the equation.

49. The *Base Case* for lending approved following last year's review of the CSP envisaged 45 operation over FY94-96, with an associated IBRD/IDA lending volume of close to $9 billion. With no change in circumstances, the subsequent acceleration in reform discussed in earlier sections of this memorandum may be considered to create a strong case for now recommending a move to the CSP High Case (51 operations; combined lending of $11 billion). We are still convinced that the Bank should now be maximizing its opportunity to provide support for the implementation of the next, crucial phase of China's reforms. We accept, however, that in view of the IDA substitution factor discussed above and the need to respect IBRD exposure guidelines (as well as internal budgetary constraints on the number of operations the Department can feasibly expect to deliver), such an outcome is, in practice, likely to be much closer to last year's Base Case than the original High Case. As such, we are now recommending a lending program for

FY94-96 of 44-45 operations, involving total lending of about $9.1 billion (IDA: $1.95 billion, phased as per para. 48 above; IBRD: $7.15 billion, assumed to be phased roughly: FY94, $2.25 billion; FY95, $2.35 billion; FY96, $2.55 billion). *For purposes of projecting exposure, we have assumed the FY96 level of IBRD commitments to be sustained in all subsequent years.*

50. On the above assumptions, China's DOD is projected by FRS, as shown below, to remain within the 10 percent guideline through the year 2000, which is considered, given the uncertainties involved in forecasting the all-country total, an acceptable planning horizon at this stage.

	(%)
FY93 (actual)	4.0
FY95	4.9
FY97	6.9
FY98	8.0
FY99	9.0
FY2000	9.9

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

Mr. Gall

DATE: June 26, 1992

TO: Files

FROM: Shahid Javed Burki, Director, EA2

EXTENSION: 82332

SUBJECT: CHINA: CSP

92 JUN 29 PM 4:27

RECEIVED
DEVELOPMENT ECONOMICS

1. Attached is a minute of the discussion of China CSP held in the President's Office on June 12, 1992. The minute was drafted by me and cleared by the President's Office.

cc: Messrs/Mesdames: Preston, Karaosmanoglu, Sandstrom, Stern, Kaji, Lynn, Rajagopalan, Shihata, Summers
Haug, Madavo, Ritchie, El-Maaroufi, Thomas, Vazquez

SJBurki:jd

NOTE ON CHINA CSP

The China CSP was discussed in a meeting chaired by Mr. Preston on Friday, June 12 at 10:00 a.m. Messrs. Sandstrom, Karaosmanoglu, Shihata, Rajagopalan, Summers, Lynn, Kaji and Burki attended the meeting.

The discussion focussed largely on the following four issues raised in the CSP:

Size of lending and differentiation among the low, base, and high case. There was agreement that given the size of the Chinese economy, its creditworthiness, the management of the World Bank financed portfolio of projects and China's growing commitment in addressing the problems of environment, there was a good case for lending at the level of the proposed base case scenario. This scenario as well as the one presented under the high case would not pose exposure problems for the Bank under any of the applicable criteria, although the need to maintain flexibility to meet China's financing needs over the longer term should be kept in mind. The region explained that even the base case scenario was contingent upon China pursuing reforms in a number of areas; in fact, all the projects being prepared had policy components explicitly identified in their design. However the Region agreed to reduce lending in the low case.

Lending for State owned enterprises (SOEs). The question of the advisability of large scale lending for SOE in the industrial sector had been raised in a memorandum circulated by Mr. Ryrie in advance of the meeting. The region explained that it was following a two-pronged approach in developing its industrial sector lending program: to help create an environment in which the non-state sector enterprises would grow, and to restructure the SOEs so that they function according to the dictates of the market. While a number of SOE operations were under preparation, the region will bring to the senior management a strategy paper on SOE reform before taking any final decision on these projects.

Estimate of Chinese GNP. It was suggested that the methodology used by China for estimating its GNP may have a serious downward bias. The region referred to a study under preparation in which the conclusion was that China was making appropriate adjustments in its methodology and that upward adjustment of some 25% would perhaps result from the application of the U.N. System of National Accounts. In any event, the Purchasing Power Parity adjustments for China was not out of line with those that are needed for a number of other developing countries. The region said that a research effort was being mounted in collaboration with DEC to introduce a more robust analytical base for national accounting in China.

IDA for China. The region's view that China remained eligible for IDA support was accepted but it was emphasised that a hardening of blend is now called for. The region indicated that a 70:30 IBRD:IDA blend would seem appropriate for the base case. Furthermore the blend in the low case would be hardened to match the blend in the base case.

Shahid Javed Burki
June 26, 1992

Mr. Gael

THE WORLD BANK / IFC / MIGA

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The discussion focussed largely on the following four issues raised in the CSP:

Size of lending and differentiation among the low, base, and high case. There was agreement that given the size of the Chinese economy, its creditworthiness, the management of the World Bank financed portfolio of projects and China's growing commitment in addressing the problems of environment, there was a good case for lending at the level of the proposed base case scenario. This scenario as well as the one presented under the high case would not pose exposure problems for the Bank under any of the applicable criteria, although the need to maintain flexibility to meet China's financing needs over the longer term should be kept in mind. The region explained that even the base case scenario was contingent upon China pursuing reforms in a number of areas; in fact, all the projects being prepared had policy components explicitly identified in their design. However the Region agreed to reduce lending in the low case.

Lending for State owned enterprises (SOEs). The question of the advisability of large scale lending for SOE in the industrial sector had been raised in a memorandum circulated by Mr. Ryrie in advance of the meeting. The region explained that it was following a two-pronged approach in developing its industrial sector lending program: to help create an environment in which the non-state sector enterprises would grow, and to restructure the SOEs so that they function according to the dictates of the market. While a number of SOE operations were under preparation, the region will bring to the senior management a strategy paper on SOE reform before taking any final decision on these projects.

Estimate of Chinese GNP. It was suggested that the methodology used by China for estimating its GNP may have a serious downward bias. The region referred to a study under preparation in which the conclusion was that China was making appropriate adjustments in its methodology and that upward adjustment of some 25% would perhaps result from the application of the U.N. System of National Accounts. In any event, the Purchasing Power Parity adjustments for China was not out of line with those that are needed for a number of other developing countries. The region said that a research effort was being mounted in collaboration with DEC to introduce a more robust analytical base for national accounting in China.

IDA for China. The region's view that China remained eligible for IDA support was accepted but it was emphasised that a hardening of blend is now called for. The region indicated that a 70:30 IBRD:IDA blend would seem appropriate for the base case. Furthermore the blend in the low case would be hardened to match the blend in the base case.

Shahid Javed Burki
June 26, 1992

CSP bb

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: June 10, 1993

TO: Those Listed Below

FROM: Anthony J. Ody, Principal Country Officer, EA2CO

EXTENSION: 82344

SUBJECT: China: CSP Updating Memorandum
Minutes of Department-level Review

1. A meeting was held on May 21, 1993 under Mr. Burki's chairmanship to review a draft "country strategy note" (CSN) for China. Attendance is listed below.

2. Mr. McCarthy (DPG) opened by saying that his Department shared the basic country view reflected in the draft, and its management wished to give recognition to the posture the China and Mongolia Department had adopted towards China over the recent past. This said, the current draft adopted a relatively broad-brush, almost pro forma approach to updating the earlier CSP. More, he felt, could usefully be said on some of the potential downside risks (the MFN issue in the US, or a growth slowdown). And if a more substantive updating were to be considered, greater detail might also be provided in a number of specific policy areas (e.g. trade policy, housing reform, new initiatives to promote private investment in infrastructure).

3. Mr. Agarwala (EAPVP), while welcoming the succinctness of the current draft, agreed that it left gaps to be filled. He thought the CSN should make more explicit the positive role which increased imports could play, in the short- as well as the longer term. Reference should be made to regional disparities, including the role greater factor mobility could play in their mitigation. A fuller account should also be provided of the proposed ESW program. The CSN should seek to interpret China's new "socialist market" philosophy, and also provide expanded treatment of overheating and State enterprise reform issues. Following discussion on whether the draft CSN's use of the phrase "detailed engineering of change" adequately conveyed the proposed new Bank approach, the Chairman requested that the CSN's account of the proposed modification of the earlier "parallel track" strategy be further clarified.

4. Mr. Bond (CPLD1) felt there was a need to expand the menu of reform options for China's State firms. Joint ventures between the public and private sectors were increasing in number and the positive features of this development should receive greater emphasis. Noting also the recent initiatives to promote greater foreign direct investment (FDI) in infrastructure, he said that private sector development now needed to assume a central position in the overall strategy. Consideration should be given, in particular, to adding China to the list of countries for which formal Private Sector Assessments were prepared. In addition, a better explanation was needed in the CSN of how Bank operational involvement with State enterprises would be designed actively to promote the reform process. Ms. Farrell (CASCM) commented that, in the financial sector, IFC fully accepted the Bank's proposed emphasis on the need for change in the

banking system: this was an area where it was appropriate for the Bank to take the lead. This emphasis needed to supplemented, however, by attention to the regulation of stock markets and non-bank financial institutions (NBFIs).

5. Mr. Harrold (EA2CO) emphasized that the current draft had been prepared before the findings of the recent Updating Economic Memorandum (UEM) mission became available. The latest data indicated that macroeconomic management needed to become the highest priority concern in the short-term, and this would be reflected in the revised draft of the CSN.

6. Mr. Dadush (IECAP) believed the CSN should address the sustainability of China's rapid recent trade growth, and also relate Chinese development to the "Greater China" phenomenon. Comparisons can be made, he said, between China's emergence onto world markets and that of Japan a generation ago. At least two factors, however, made China's trade expansion less threatening. First, it is less concentrated by product line; and second, there is much greater involvement of FDI.

7. Summing-up, the Chairman said that the revised CSN should give considerably greater emphasis to presenting recent developments in the macro-economic situation and discussing their implications. It should also make explicit reference to the Bank's advisory role in the area of trade policy. New policies towards FDI in infrastructure should be discussed in greater detail. An expanded treatment was also needed of the types of new products the Bank was developing to respond to accelerated reform in China (informal, quick turnaround ESW; focussed technical assistance operations; etc.). Finally, the CSN should be fully explicit that, out of the lending options presented in the 1992 CSP, a recommendation was now being made to move to the High Case scenario.

Cleared with and cc: Mr. Pearce (EA2CO)

Distribution:

Meeting Participants:

Messrs/Mmes. Burki, Kimura (EA2DR); Agarwala, Kawaguchi (EAPVP); Pearce, Ody, Harrold, Rix, Lall, Kumar, Raparla (EA2CO); Goldberg (EA2AG); Stott (EA2TP); Read (EA2EH); Lichtenstein (LEGEA); McCarthy (DPG); Perkins (CASD1); Bond (CPLD1); Farrell (CASCM); Dadush (IECAP) cc: Messrs./Mmes. Kaji, Thomas, El Maaroufi (EAPVP); Jones-Carroll (EAPCA); Madavo (EA1DR); Haug (EA3DR); Ritchie (ASTDR); Ikram (EA1CO); Shilling (EA3CO); M. Koch-Weser (ASTEN); Lall (EA2); Newfarmer (EA2IE); Ecevit (EA2EH); Bottelier (EA2CH); Rao (DECVP); Husain (AFRCE); Nankani (SASVP); Selowsky (ECAVP); Squire (MNAVP); Birdsall (PRDDR); Ray (DPGDR); Golan (EDIDR); M. Ahmed (IECDI); Yusuf (RAD); Amoako (ESPDR); Adams (OPRDR); de Merode (PHNDR); Iida (MIGEX); Long (FSDDR); Iskander (PSDDR); Stern (IENDR); El-Ashry (ENVDR); Petit (AGRDR); Pouliquen (TWUDR); Nishimizu (FRSDR); Horiguchi, Otani, Bell, Kochhar, Scott, Khor (IMF); Hassan (LEGEA); Freeman, Wang (CASDR); Khan (CASD1)

EA2CO H/L Staff
Asian Information Center

[AOdy:ef]
[CSN Up. Memo.Minutes]

China. CSW
Meeting: Dept. Mtg. May 21

(1)

Ram Agarw.

Gaps. 1. Stability & Effic..
- import liberalization & cooling of econ.
- Regional
3. ESW.

Trade Deficit is a problem - may be
part of the solution
Role of invt. led boom
- how to accomodate inflows and
FDI inflows

SOE - Outward orient. may be a
way to impose hard budget
constraints
Growth rates in diff. provinces
Public policy $\leftrightarrow$ tackle problems of
inner provinces

- ESW need some flavor of progr
with govt.

Socialist / Market Economy – pl. define

Overheating – Phillips curve

SOE reforms – perhaps a few key price reforms

para. 10. The strategy we are following & closing the gap.

4th growth pole – referred – global context.

areas of proposed concent. – legal context.

IFC – areas of comment

1) SOEs Options. the authorities are creating are getting wider

– Ownership does matter?

leverage money & haste reform

2) Infrastructure – is now being opened

100% for ports, telecomm.

Need for well coordinated infrast. proj. – given public / private.

3

3. Policy / Regulatory Reform

- should now be more private sector?
- P.S.D. initiatives

4. List of 20 countries to find out what are the obstacles to P.S.D.

IFC 2, Bulgaria
5. Financial: Regulatory: Stocks & Securities

Non Bank Financial Instit. - not too much progress

Core commercial banking: need strong regulation.

Reform priorities
Deemphasis: CEM. - We are more exercised about lack of macro-fiscal & trade reform.

If macro sit. allows then foreign banking / insurance maybe within a year.

Bank does lend to SOE because we need the reforms.

Give China the max. incentive to fund its program through the market.

Trade liberal.:
- bottle necks due to shortage of raw materials during inflation may be eased by import liberalization.

Also CEM, trade policy report, CAS

Dan 22. Risk of Downside Contingencies.

Housing: too detailed for CSN.

Macro liberalization ?
ESW -
- Moving towards the high case
- More than pro forma.
- Risks & sustainability of trade
2) Ready for increased lending
3) Quick response ESW
4) Tech. Asst project
5) Openness - trade issue
6) Constraints in infrastructure

to invite foreign particip.
- They have asked for framework in which to invite foreign participants.

A L L - I N - 1   N O T E

DATE: 20-May-1993 05:28pm

TO: David Pearce (DAVID PEARCE)

FROM: F. Desmond McCarthy, DPG (F. DESMOND MCCARTHY)

EXT.: 31362

SUBJECT: **China: Draft CSP Updating Memorandum**

1. We share the general feeling that for China the overall performance and prospects are excellent. We also congratulate the Region on its attitude, posture and overall strategy towards China.

2. To some extent one may consider the document as a pro forma CSN which tends to take a broad brush approach to a complex set of issues. It may not be appropriate to provide more details at this point. Nonetheless if there is a need for a CSN, then we might be more explicit on a few points. First, as China is the largest borrower one would like some detail on downside risks and exposure. For other large borrowers such as Brazil, India, and Mexico it has been usual to discuss risk and downside contingencies every year. For China one might relate the downside to the withdrawal of, or significant changes in, the MFN status; or perhaps to a radical slowdown in growth due to draconian measures to curtail inflation or correct the deterioration in the current account.

3. There may also be a case for further articulation of

- trade policy: what did we recommend to the authorities and how was it received.

- housing: the strategy is rather tersely discussed here. For instance, are there any precedents to draw upon? Would it make sense to simply divest some of the housing stock as part compensation to facilitate public sector retrenchment.

- links between the private and public sectors: What is the strategy to have the private sector more involved in the provision of infrastructure and telecommunications.

CC: Shahid Javed Burki (SHAHID JAVED BURKI)
CC: Shahid Yusuf (SHAHID YUSUF)
CC: Anandarup Ray (ANANDARUP RAY)

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: May 14, 1993

TO: Those Listed Below

FROM: David Pearce, Division Chief, EA2CO

EXTENSION: 82350

SUBJECT: China: Draft CSP Updating Memorandum

Attached please find a draft of the 1993 CSP Updating Memorandum for China, for which a Department-level review meeting is proposed to be held, under the chairmanship of Mr. Shahid Javed Burki, on Friday 21 May, at 2:30 pm in room E-9088.

cc: M/M Kaji, Thomas, Agarwala, El Maaroufi (EAPVP), Jones-Carroll (EAPCA), Madavo (EA1DR), Haug (EA3DR), Ritchie (ASTDR), Ikram (EA1CO), Shilling (EA3CO), M. Koch-Weser, (ASTEN), Burki, Yusuf, Kimura (EA2DR), Goldberg (EA2AG), Newfarmer (EA2IE), Stott (EA2TP), Ecevit (EA2EH), Bottelier (EA2CH), D.C. Rao (DECVP), Husain (AFRCE), Nankani (SASVP), Selowsky (ECAVP), Squire (MNAVP), Birdsall (CECDR), Ray (DPGDR), Golan (EDIDR), M. Ahmad (IECDR), Ingram (RAD), Amoako (ESPDR), Adams (OPRDR), de Merode (PHNDR), El-Rifai (MIGPA), Long (FSDDR), Iskander (PSDDR), Stern (IENDR), El-Ashry (ENVDR), Petit (AGRDR), Pouliquen (INUDR), Horiguchi, Otani, Bell, Kochhar, Scott, Khor (IMF), Hassan (LEGEA), Freeman (CLACM), Khan (CASD1), Bond (CPLD1)

EA2CO H/L Staff
Asia Information Center

A.Cody:jjp

CHINA

CSP UPDATING MEMORANDUM 1993

Introduction

1. Since the June 1992 CSP review, political developments within China have solidified the policy consensus in favor of further fundamental, market-oriented economic reforms, as well as ratifying the planned collective succession to Deng Xiaoping and his contemporaries from the revolutionary generation. The change in official economic philosophy, from a "planned economy on the basis of socialist public ownership" to a "socialist market economy", was endorsed by the 14th Party Congress in October 1992 and subsequently written into the Constitution by the opening session of the 8th National People's Congress (China's legislature) in March 1993. While this formulation may appear ambiguous and imprecise to some outsiders, our assessment is that, in the Chinese context, it has largely removed any remaining ideological constraints to thorough-going reform measures in the economic sphere.

2. On the personnel front, meanwhile, the Party Congress and the NPC endorsed the group succession planned by Deng, including Party General Secretary (and now also President) Jiang Zemin, and - in his second and final term - Premier Li Peng. Below this level, a member of old-style conservatives were retired and reformers and pragmatists advanced, most notably the strongly reform-minded Zhu Rongji, who was promoted to the new position of Senior Vice-Premier. The rumored dynastic ambitions of the outgoing President, the military figure Yang Shangkun, were dashed, as were the hopes of the children of several older leaders (the so-called "princelings' party"). If, in general, the successors now in place lack individual charisma, they embody something arguably more important, namely a collective and highly public commitment by China's leadership to the deepening of systemic economic reform. In the implementation of such deepening, it is already clear, fresh challenges will be posed to the Bank's own policy advice and operational support, which will test both our intellectual ability to remain current and relevant, and the resources we are prepared to commit to our China program.

3. The period since June 1992 has also witnessed the outcome of the IDA 10 replenishment discussions, which signalled a reduction in the volume of IDA resources expected to be available to China. This has presented the Department with the challenge of trying to minimize any impact on borrowing for poverty alleviation, social development and environmental protection(see para.21). It is, at the same time, testimony to a new maturity in the country relationship that - far from suggesting that less IBRD might now be borrowed - the authorities have stressed their desire to build further on the country's newly-acquired status as the Bank's largest borrower. China's medium- to long-term economic prospects look very strong (an assessment now rapidly becoming the international conventional wisdom). In the more immediate term, however, there are legitimate concerns that the current growth rate is too strong, and this is the first aspect to be addressed in the 1993 CSN.

A. Current Economic Situation

4. Since the 1992 CSP was reviewed, the authorities have revised their earlier cautious official 1991-1995 growth target (6 percent per annum), to bring it into line with the message of our 1992 CEM, i.e. that - with a strong continuing commitment to reform - there is no reason why China should not sustain real, non-inflationary growth at around 8-9 percent per annum. Actual performance in 1992 proved, however, still faster than even the revised targets, with real GDP growing by 12.8 percent, and there is so far no indication of any subsequent deceleration. This has made the question of possible over-heating a much talked about topic both within China and outside.

5. Several points need to be understood to put these concerns into perspective:

- Although the high level of growth has yet to show up in serious inflation of retail prices, demand for raw materials, especially for investment projects, has caused the 'means of production' price index to rise by over 30%. This suggests that continued very rapid growth would inevitably result in the return of double digit inflation.

- China entered this boom with foreign exchange reserves at the equivalent of more than nine months of imports. Although no constraints have yet emerged on the external side, it is to be noted that high domestic demand has caused export growth to fall to only seven percent, while import growth has continued at the same pace as in 1992, so that a trade deficit has emerged for the first time since 1989. reserves now?

- The bulk of the growth is coming from non-state and foreign-invested light manufacturing and assembly industries, as well as the domestic tertiary sector. These help absorb surplus labor but put less pressure than the old, State-owned heavy industrial sector on the Chinese economy's Achilles' heel - bottlenecks in bulk rail transport and energy supply.

6. With all of this said, however, two more somber points also seem clear. First, growth at the current rate can <u>not</u> be considered sustainable, on a non-inflationary basis, over the longer-term. And secondly, we do not believe that, at present, the central authorities are in full control of the macro-economic situation: rather, as has happened before, Beijing seems to be allowing things to drift, and may only make a concerted effort to take charge later, when the economy's temperature has already started to register a fever. Targets for monetary expansion, in particular, have been seriously overshot as a result of provincial pressure on local branches of the central bank (PBC) - 1992 witnessed monetary growth at 26 percent. Strengthening PBC's capability to manage indirect monetary policy instruments more effectively is a key Bank objective in China, though technical strengthening (however necessary) is not a substitute for stronger political will. At the same time, it is central to our diagnosis that sustaining rapid, non-inflationary growth <u>also</u> calls for

more fundamental systemic reforms to the real economy, and it is to these aspects that we now turn.

B. Areas of Proposed Concentration

7. Key Reform Challenges. The 1992 CSP presented in some detail our assessment of the key reform challenges now facing the Chinese economy. This view places China's State-owned Enterprises (SOEs) and their workforce squarely in the center of the picture. Though the SOEs' relative importance in the economy has shrunk considerably during the reform years (from four fifths of industrial output in 1978 to less than half now), they continue to employ the bulk of the workforce in China's main urban centers[1]. And while average productivity in the SOE sector has shown some improvement since the mid-1980s, when reforms began to enhance management autonomy, the SOEs continue to represent an obstacle to overall economic progress: their identified financial losses (certainly understated) account for some 4-5 percent of GDP (i.e. almost double the visible fiscal deficit), and they absorb at least 80 percent of all bank lending - in part amounting to a "quasi-fiscal deficit" (imposed on the banking system for "policy" reasons) to keep troubled firms afloat. The imperative to sustain the SOEs also hampers tax reform, and largely explains the remaining distortions to the domestic price structure: two-tiered prices for energy, raw materials and urban grain rations (though on the pricing front, in particular, the last two years have seen very significant movement). – has much

8. As seen above (para.1), the critical changes of the past year included the highly visible symbolic downgrading of the importance attached to public ownership per se. What remains is the practical political and economic difficulty of what to do with a troubled sector which employs over 70 million urban Chinese. The social and political dimension is heightened by the peculiarly close lifetime dependence which the past 40 years have created between the SOE worker and his or her "work unit" - under which the latter directly provides housing (renting for $1-5 per month), unfunded (and nontransferable) pensions, medical insurance, day-care, etc. - and the near-total absence of functioning labor markets (or, until very recently, any form of unemployment insurance).

9. In our own list of priorities for further reform, therefore, we would reiterate three crucial and closely related areas, identified in last year's CSP, as being the most important reform challenges both for the central government and for the Bank:

(a) Reform of State-owned Enterprises (SOEs);

(b) Reform of Housing and Social Security (as the immediate focus of longer-term labor market development); and

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[1]/ 1990 employment in all State-owned units was 103.5 million. While this also includes civil servants, teachers, health workers, etc., close to three quarters of the total are accounted for by SOEs in the productive sectors.

(c) Reform of the Financial Sector.

We would, in addition, emphasize the intimate connection which exists between these interlinked reforms and the macro-management challenge discussed earlier. Whatever the technical weaknesses of PBC, it is fundamentally the soft budget constraint of SOE borrowers that has limited the potency of interest rate policies to date. The fourth key area we identified last year, price and market reform, has witnessed continued strong progress over the past year. Distortions to energy prices are being reduced very rapidly, while several localities have in recent months effectively freed-up their internal grain markets. Thus, although market reform has not disappeared from the agenda, its objectives are now starting to shift from removal of the most glaring specific distortions in bulk materials prices and utility tariffs to the fostering of more meaningful factor markets (including for urban land and labor, both subjects of recently completed ESW) and the integration of domestic markets (where ESW is now underway).

10. As the Chinese commitment to fundamental reform in the above areas has intensified, and as our own relationship with China's reforms has matured, a change in expectations on both sides has become increasingly apparent. In earlier years, what might be called a "parallel track" approach was followed, whereby Bank ESW provided overall advice on reform principles, while specific lending operations supported technological and institutional modernization, but with only loose links between the two. The strategy we are now (and propose to continue) following, by contrast, increasingly closes that gap. The Chinese authorities now expect to be able to call on the Bank not only for major ESW reports, but also for shorter, highly focussed think pieces addressing immediate reform issues (a demand we hope to be able to meet, in part, through an ongoing re-orientation of the mandate and staffing of the Resident Mission). Beyond this, our operational lending program, rather than functioning at arm's length from the reforms, is increasingly involved with the "detailed engineering of change" required to translate centrally agreed reform principles into working models on the ground.

11. State Enterprise Reform. The SOE sector lies at the heart of the reform challenge and, as suggested earlier, may be the area most crucially affected by the recent changes in the political and policy climate. These do not mean that Beijing is about to launch the mass privatization of the SOE sector. No-one would lightly consider buying a Chinese SOE in today's circumstances (while, on the other hand, the situation does not involve the hopelessness that leads some other countries to consider giving SOEs away). What it does mean is that China's provinces, cities and counties, which are effectively responsible for the overwhelming bulk of the SOEs, have been given a large measure of freedom from ideological constraints in how they go about solving their problems. The NPC was told by the Premier, for example, that "some state enterprises may be leased or sold to collectives or individuals through public bidding". It would be wrong, though, to lose a sense of perspective on this. The first order of business for China's SOEs, in general, will not be privatization but corporatization: separating ownership from management (and from regulation), formation of Boards of Directors, reflection of ownership rights through shares, etc.. Public share issues are likely to develop more slowly, and this is appropriate given the questions that need to be resolved

on accounting and regulatory standards (the last thing China's reforms need now is a series of stock market scandals and, unless considerable caution and care continue to be exercised, this is a real danger). The center thus needs to continue exercising a strong oversight function in this area.

12. Our own strategy for further Bank involvement in support of SOE reform has been set out in a more detailed sector strategy paper, whose recommendations were recently approved by Bank management. Under the approved strategy, the ongoing reforms in the SOE sector will continue to be a central focus of our ESW program. In addition, future Bank lending in the industrial sector (and, by extension and mutatis mutandis, in other sectors, such as utilities) will seek explicitly to promote the "detailed engineering of change" in such areas as ownership reform (separation of enterprises from government bureaus, formation of share-holding enterprises, ownership diversification), competition policy (freedom of entry and exit), taxation reform, development of the non-state sector and fostering of new business support services.

13. Housing and Social Security Reform. Simultaneously, corporatization must involve enterprises shedding their welfare state functions. Beijing fully recognizes this need, and has a reasonably clear idea of what it would like the system to look like in five years or so. In housing, for example, enterprises would by then have shed their own direct responsibility, which would have been picked-up by commercial housing corporations, charging fully commercial rents. Meanwhile, increasing numbers of Chinese families would be choosing to become owner-occupiers. The center's vision is basically sound: the challenge lies in getting there from here. A typical family's rent might have to increase by about 3,000 percent in real terms between 1990 and the end-point of the reforms (currently projected for around 1997). In addition, until rent increases start to bite, the purchase option is unlikely to look attractive (unless itself subsidized). Again it should be understood that, while the center may set the broad lines of policy (and will also need to enforce standards and safeguards, e.g. on the protection of workers' pension rights), the basic responsibility for reform implementation in this sphere rests with the local governments. Our own first operation in support of these reforms is currently under development, in collaboration with half-a-dozen cities which are at the forefront of reform experimentation.

14. Financial Sector Reform is the third key area, and here - after an extended period in which little movement was seen - the central authorities have very recently signalled that they see the need for major change, and invited the Bank to submit a paper summarizing its recommendations. As noted earlier, the banks' autonomy in lending has been held in thrall to the need to sustain the SOE sector - and the weaning from this relationship will not occur overnight. At the same time, there is a new openness in discussions on how to segregate remaining "policy lending" from the balance sheets of what are now clearly expected to become increasingly commercial banks; how to encourage greater competition in the banking sector (including from foreign banks); diversification of non-bank financial institutions and capital markets; technical modernization of the sector; and the ongoing strengthening of both the monetary policy and prudential regulation functions of PBC. The role of the center in this sector is obvious, and it is an area where we expect to

deepen further our own role both in advice and, as our dialogue advances based on discussion of the draft sector strategy paper, in subsequent operational "detailed engineering" of institutional change and development.

15. Additional Sectoral Focusses. In addition to the main reform challenges covered above, we see three other key areas in which intensive Bank operational involvement will continue to deepen:

(a) addressing basic infrastructure bottlenecks to economic growth;

(b) combatting the remaining incidence of absolute poverty; and

(c) meeting environmental challenges.

16. Infrastructure Bottlenecks. Transport and energy supply constitute the two most notorious bottlenecks in the Chinese economy. The railways, while generally efficient, are overloaded by demand, and the road network is mostly of such poor quality as to barely offer an alternative. At the same time, above-average growth rapidly brings power outages to both firms and households, while telecommunications services (4 lines per 1000 of population) represent the third of the major bottlenecks. New channels for resource mobilization in these sectors are a critical requirement. Internal cash generation in the rail and power sectors should continue to improve, given the current momentum of (Bank-supported) price reform: as corporatization spreads, increasing attention will also be needed to new models of regulation. A greater challenge, from a financial point of view, will be finding ways to pay for the construction of a twentieth century highway system, a process still in its infancy and one in which we are now actively engaged. Telecommunications has continued, up to now, to be dominated by a ministerial quasi-monopoly which has resisted opening the sector to outside competition: we have undertaken ESW in this sector, but will need to see significant policy movement to justify hoped-for operational involvement.

17. Poverty. We have completed a major piece of ESW on Poverty since the CSP was reviewed, and this was discussed at a Workshop in Beijing in October. While China's long-term record in combatting poverty is impressive, some 100 million Chinese remain stuck in absolute poverty - concentrated almost entirely in remote, resource-poor rural communities - and the numbers do not seem to have changed since about 1985. Their problems do not lend themselves to easy resolution: the local agricultural resource base is often overloaded through population pressure. In some regions, proven technological packages now exist to reverse the resulting environmental degradation and raise yields and incomes, but even so some of the people will need to move off the land. Yet physical infrastructure in these regions is also often weak, and standards of education (and health) place them practically outside China's mainstream. Our ESW proposed increases in central funding for social services in these regions but, apart from symptoms of budget fatigue in Beijing, the real challenge may lie not so much in finding the money (a good deal is already allocated for poverty alleviation) as in finding mechanisms to ensure the resources actually reach (and are effectively used by) the remote villages where the poorest Chinese are to be found. Continued creativity will be

needed, and much of our effort in the social sectors and agriculture is proposed to be concentrated on these issues.

18. Environment. We have similarly completed a major ESW report on China's environment. Soviet-style industrialization bequeathed present-day China an environmental legacy which includes some of the heaviest urban air pollution (and most contaminated rivers) in the world. Policy innovation and institutional development in the environmental sphere since the mid-1980s represent something of a model of achievement among Bank borrowers but, in an era of nine percent average growth, have probably done no more than hold the line. Further follow-up analytical work is planned, and operations for environmental amelioration and more rational urban development now represent our fastest-growing area of lending.

C. Future Lending

19. Total new commitments to China in FY92, at $2.5 billion, made the country for the first time the Bank's largest current borrower, in itself a natural development given the size of the population and the economy, as well as the Government's commitment to (and track record in) economic reform, and an unsurpassed record with project implementation. It is expected that lending in FY93 will narrowly surpass $3 billion, an outcome reflecting priorities on both sides (though one accomplished at some cost to the originally planned FY94 pipeline).

20. We believe that, in terms of combined IBRD-IDA commitments, a continuation of lending at levels around the expected FY93 outcome will be warranted by China's development needs, income levels and overall economic and project implementation record. In terms of the scenarios set out in the 1992 CSP, the overall lending volume and lending program we are now proposing (Attachment 1) approximate more closely the "High" than the "Base" case. This we consider justified by the additional progress in the policy environment discussed in earlier sections of this memorandum.

21. The IDA 10 outcome implies that future borrowing will be undertaken on progressively harder terms. In aggregate, this presents less of a problem than it might have in earlier years, when some in China appeared to see IBRD borrowing primarily as a necessary price to pay for access to IDA resources. In recent discussions, by contrast, our Chinese counterparts have made it clear that China wishes to continue as a major borrower on IBRD terms. In the more specific area of IDA borrowing, at the same time, the Department sees it as a major challenge to ensure that the expected reductions in IDA availability do not cause serious damage to our engagement in poverty reduction and environmental management. Our first round of discussions on these aspects, held in Washington in late-March, indicated an encouraging receptiveness to the Bank's concerns on the part of our immediate counterparts. This will however clearly be a continuing challenge, and the more so as the IDA reductions start to bite.

22. Questions may be raised as to China's need for the proposed level of Bank lending, in view of the currently healthy position of the external accounts. [The completed CSN will incorporate the latest view of China's

external prospects, based on the work of the recently returned CEM mission, and cross-refer to RMSM projections to be provided in Attachment 2. It will include reference to significant areas of uncertainty: bilateral and multilateral trade negotiations; possible further trade liberalization; etc.].

23. Beyond this, it should be clear that the role the Bank is now playing in China is one which transcends capital transfer as such. The sectors in which our own lending is proposed to be concentrated (infrastructure supply, SOE reform, poverty reduction, environmental protection and amelioration, social reforms, etc.) are areas in which, at this stage, there is little overlap with private direct investment - even if, in several areas, helping develop new channels for greater private involvement represents an important medium-term objective. More fundamentally, the Bank is viewed as a highly trusted partner in the only clearly successful international model of economic transition to date. This role has been earned by a demonstrated willingness to supplement our advisory role with hands-on operational engagement with practical change on a broad sectoral and regional basis. It is the thrust of this memorandum that such engagement should continue, and should be backed by the resources needed to undertake it in a fully credible way.

Attachment

May 14, 1993

(C\Main\1CSP.AO)

CHINA: FY94-97S LENDING PROGRAM

FY95-97S: JW
APRIL 28, 1993

FY94

Div.		Project	Bank ($ Million)	IDA ($ Million)
AG		BONGLIAO PLAIN ADP		205.0
AG		RED SOILS II		150.0
AG		XIAOLANGDI MULTIPURPOSE	460.0	
AG		FORESTRY RESOURCE DEV.		200.0
		SUBTOTAL (AG) 4	460.0	555.0
				28%
IE		SCIENCE & TECH.	220.0	
IE		TELECOMMUNICATIONS I	300.0	
		SUBTOTAL (IND & FIN)	520.0	0.0
				15%
IE		SICHUAN GAS	250.0	
IE		YANGZHOU THERMAL POWER	400.0	
		SUBTOTAL (ENERGY)	650.0	0.0
				18%
		SUBTOTAL (IE) 4	1,170.0	0.0
				33%
TP		SHANGHAI MTP II	150.0	
TP		FUJIAN PROV. HIGHWAY	150.0	
TP		HEBEI/HENAN NAT'L HWY	360.0	
		SUBTOTAL (TP) 3	660.0	0.0
				19%
EH		LIAONING ENVIRONMENT	100.0	10.0
EH		HOUSING/SOC. SEC. REFORM	425.0	75.0
EH		RURAL HEALTH MNPR. TRG.		111.0
		SUBTOTAL (EH) 3	525.0	196.0
				20%
TOTAL			2,835.0	751.0
		(# OF OPERATIONS: 14)	SDRs	532.8

FY95

Div.		Project	Bank ($ Million)	IDA ($ Million)
CO	S	LEGAL REFORM T.A.		25.0
AG	S	XIAOLANGDI RESETTLEMENT		100.0
AG	S	LOESS PLATEAU		150.0
AG		YANGTZE BASIN WATER RES.	60.0	140.0
		SUBTOTAL (AG) 3	60.0	390.0
				15%
IE	S	SHENYANG ENG. IND.	150.0	
IE		SHANGHAI IND.ENTER.REF	150.0	
		SUBTOTAL (IND & FIN)	300.0	0.0
				10%
IE		ZHEJIANG POWER DEV.	400.0	
IE		ERTAN HYDRO II	500.0	
		SUBTOTAL (ENERGY)	900.0	0.0
				30%
		SUBTOTAL (IE) 4	1,200.0	0.0
				40%
TP	S	ZHEJIANG-SHANGHAI TRP.	200.0	
TP		XINJIANG HIGHWAY I	150.0	
TP		RAILWAYS VII	425.0	
		SUBTOTAL (TP) 3	835.0	0.0
				28%
EH	S	BASIC EDUC. POOR PROV.		100.0
EH	S	SHANGHAI ENVIRONMENT	150.0	
EH	S	MATER & CHILD HEALTH		135.0
EH		HUBEI ENVIRONMENT	100.0	25.0
		SUBTOTAL (EH) 4	250.0	260.0
				17%
TOTAL			2,345.0	675.0
		(# OF OPERATIONS: 15)	SDRs	478.7

FY96

Div.		Project	Bank ($ Million)	IDA ($ Million)
AG	S	FEED INDUSTRY DEV.	100.0	50.0
AG	S	SW POVERTY ALLEVIATION		200.0
AG		HEXI CORRIDOR	50.0	100.0
AG		STATE FARM COMM.	200.0	
		SUBTOTAL (AG) 4	350.0	350.0
				22%
IE	S	RESTRUCTURING FERT.	300.0	
IE		FINANCIAL SECTOR LOAN	250.0	
IE		CHONGQING IND. ENV. *	150.0	
		SUBTOTAL (IND&FIN)	700.0	0.0
				22%
IE		LONGTAN HYDRO	400.0	
IE		INNER MONG THERMAL PWR *	400.0	
		SUBTOTAL (ENERGY)	800.0	0.0
				25%
		SUBTOTAL (IE) 5	1,500.0	0.0
				47%
TP	S	PORTS VIII	150.0	
TP	S	INLAND WATERWAYS	150.0	
TP		GUANGZHOU METRO TRP.	200.0	
		SUBTOTAL (TP) 3	500.0	0.0
				16%
EH		VOCATIONAL EDUC. TRG.	165.0	75.0
EH		HEALTH EDUCATION *		100.0
EH	S	ZHEJIANG ENVIRONMENT	120.0	5.0
		SUBTOTAL (EH) 3	285.0	180.0
				15%
TOTAL			2,635.0	530.0
		(# OF OPERATIONS: 15)	SDRs	375.9

IDA 10 — TOTAL FY94-96

	Bank	IDA
(CO)	0.0	25.0
		0.3%
SUBTOTAL (AG)	870.0	1,295.0
		22%
SUBTOTAL (IND & FIN)	1,520.0	0.0
		16%
SUBTOTAL (ENERGY)	2,350.0	0.0
		24%
SUBTOTAL (IE)	3,870.0	0.0
		40%
SUBTOTAL (TP)	2,015.0	0.0
		21%
SUBTOTAL (EH)	1,060.0	636.0
		17%
TOTAL	7,815.0	1,956.0
	SDRs	1,387.2

FY97 (STANDBY)

Div.		Project	Bank ($ Million)	IDA ($ Million)
AG	S	AG COMMODITY DIST. I	200.0	
AG	S	SHANXI POVERTY	50.0	50.0
AG	S	SEEDS DEV. II	100.0	
AG	S	SO.NORTH WATER TRANSFER	150.0	150.0
		SUBTOTAL (AG) 3	500.0	200.0
				16%
IE	S	TELECOMMUNICATIONS II *	150.0	
IE	S	IND EFFICIENCY & ENV *	200.0	
IE	S	WUHAN INDUSTRY *	150.0	
IE	S	ELECTRONICS	150.0	
IE	S	PHARMACEUTICALS *	150.0	
		SUBTOTAL (IND&FIN)	800.0	0.0
				16%
IE	S	GUIZHOU HYDRO *	400.0	
IE	S	HENAN THERMAL POWER *	400.0	
		SUBTOTAL (ENERGY)	800.0	0.0
				18%
		SUBTOTAL (IE) 7	1,600.0	0.0
				36%
TP	S	TRANSP. LOGISTICS DEV. *	150.0	
TP	S	YANGTZE TRANSPORT	200.0	
TP	S	HUNAN/GUANG. HWY *	200.0	
TP	S	RAILWAYS VIII	300.0	
TP	S	XINJIANG HIGHWAY II	300.0	
TP	S	PORTS IX	150.0	
TP	S	SHAANXI HIGHWAY II *	200.0	
		SUBTOTAL (TP) 7	1,500.0	0.0
				34%
EH	S	NAT'L RUR WATER SUP	150.0	
EH	S	PROV URB MGMT		140.0
EH	S	RURAL HEALTH SERV.	50.0	50.0
EH	S	YUNAN ENVIRONMENT	100.0	50.0
EH	S	PUDONG ENVIRONMENT	75.0	25.0
		SUBTOTAL (EH) 5	375.0	265.0
				14%
TOTAL			3,975.0	465.0
			SDRs	329.8

Attachment 1

~~Alan Walters~~ A. Choksi

~~965-2979~~

202-

= 202-965-2

-861-8671

Amado

Pouliquen

cc: DM
AR
file CSN

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: April 6, 1993

TO: Files

FROM: Anthony J. Ody, Principal Country Officer, EA2CO

EXTENSION: 82344

SUBJECT: China: Country Strategy Note (CSN)
Initiating Memorandum (IM)
Minutes of Discussion

1. A meeting was held under Mr. Burki's chairmanship on February 12, 1993 to review the above IM.

2. Mr. McCarthy (DPG) opened by observing that there appeared to be three key policy areas deserving particular focus: monetary policy and the strengthening of the relevant policy instruments; reform of state-owned enterprises (SOEs); and trade reform (specifically import liberalization). He asked, in addition, about the IM's emphasis on the uncertainty of Balance of Payments (BOP) forecasts for China: was this intended to provide a rationale for future adjustment lending? To the latter point, EA2 representatives responded that the issue was rather one of gauging China's capital import requirements: past experience showed that the BOP could turn around very rapidly.

3. Mr. Bond (IFC) provided the meeting with indicators of the very rapid increase in IFC's role in China: there were now about 10 projects in the pipeline, and China's leadership was seeking IFC advice on issues involved in the privatization of SOEs. A vital requirement now was a more rational distinction between those issues which needed to be resolved at <u>central</u> level, and those best left to the local levels. To this, the chairman commented that, beyond the obvious macro questions (monetary, fiscal and trade policy), there were several others where a consistant policy line established by the center was essential, such as domestic market integration, grain distribution and housing policy.
Mr. Bottelier (EA2CH) added that, within this distinction, the Bank should make it an objective to focus much of its own effort on those issues which required significant <u>central</u> input: he gave the examples of the legal framework and the setting of industrial standards.

4. Mr. Agarwala (EAPVP) expressed concern at what he saw as the unduly defensive tone of the IM. More specifically, he emphasized the significance of the changes proposed in the current Trade Policy Report, and echoed the earlier comments on the possible volatility of the BOP: the CSN should avoid a mechanistic approach to BOP forecasting. The Bank's lending, in turn, could be seen in part as a source of insurance on this front. On another aspect, he wondered if the IM was not unduly pessimistic in projecting the decline in China's share of IDA beyond the tenth replenishment.

5. Continuing, Mr. Agarwala stated that, after saluting China's accomplishments and ongoing reform efforts, the CSN should take up some of

the remaining areas of concern: regional disparities, the possible emergence of a "new poor", environmental problems and deficiencies in the supply of physical infrastructure. On the latter point, the CSN should not be diverted by China's high aggregate investment/GDP ratio from making the case for increased infrastructure investment. All said, he concluded, China was a good client and there were not many such. Its current efforts in the field of enterprise reform constituted "a world-class experiment".

6. Thanking the opening speakers, the chairman observed that he hoped for a paper of perhaps 6-7 pages, which would make a restricted number of key arguments. He invited other participants to provide suggestions on which additional points might be selected.

7. Mr. Petit (AGRDR) commented that the redefinition of the role of government now ongoing in China could have implications for the provision of public goods, such as agricultural research, which would need to be watched. An instrument used by the Bank in some other countries under such circumstances was the Public Investment Review (PIR), though he recognized that the decentralization of responsibility that had occurred in China would make it hard to recommend a PIR. Mr. Petit asked whether sufficient attention was being directed to rural poverty in the Bank's program (EA2 staff advised that this formed the focus of a major ESW task very recently completed). He also asked what view the Department took of the danger of over-heating. The chairman responded that, while the issue was a definite concern, these were also reasons for cautious optimism - not only growing experience with monetary policy instruments, but also the contribution further trade reform could make to easing supply constraints.

8. Mr. Bottelier noted that some elements of uncertainty remained (e.g. the new National People's Congress, due to meet in March, and the future of China's MFN status in the U.S.): some caution in the CSN would be appropriate. He felt the Bank's "parallel track" approach had worked well to date, and the CSN could usefully emphasize the continuity with the future strategy whose endorsement it would seek. Mr. Agarwala added that a link could, in addition, be made to the recommendations of the recent Wapenhans report, i.e. the importance of Chinese "ownership" of the ongoing reforms. Mr. Goldberg (EA2AG) considered that, under any expected scenario, the overall country outcome was likely to prove satisfactory: no "special" justification was in his view needed for a large Bank program in China.

9. Mr. Bottelier pointed to concerns over possible future political/social unrest, and recalled the earlier experience of the Cultural Revolution. Other EA2 speakers commented that the lesson of the Cultural Revolution had been well-learnt in China: leaders and people understood that nothing of this kind could ever be allowed to happen again.

10. Summing-up, the chairman said that the CSN needed inter alia to address the issue of the overall size of the future Lending Program. Referring back to Mr. Agarwala's earlier comment on post IDA 10 trends, he said that the message from Bank management was that a process of weaning the country from IDA was now being set in motion. Mr. Burki said that he envisaged the following outline for the CSN.

the country from IDA was now being set in motion. Mr. Burki said that he envisaged the following outline for the CSN.

Part 1 Current economic situation
Limits to non-inflationary growth (role of monetary, fiscal and trade policies).

Part 2 Areas of Concentration for the Bank
The Parallel Track Approach

- The Role of the Center (especially in policy-setting):

  - SOE Reform
  - Financial Sector
  - Housing and Social Security Reform

- Areas of Sectoral Focus:

  - Industry (including SOE reform)
  - Infrastructure
  - Poverty
  - Environment

Part 3 Size of Lending Program

- IBRD: the relevant ratios should be reviewed (but "not myopically"); the importance of the Bank's "seat at the table" should also be reflected.

- IDA

11. Mr. Burki closed the meeting by thanking the participants for their contributions.

cc & cw: Mr. Pearce

cc: Participants
M/M: S.J. Burki(EA2DR), D. Pearce, A. Ody, B. Keidel, P Harrold, T. Raparla, B. Hofman, R. Lall(EA2CO), Z. Khan(EA2IE), J. Goldberg(EA2AG), Z. Ecevit(EA2EH), P. Bottelier (EA2CH), R. Agarwala(EAPVP), M. Petit(AGRDR), G. Bond(CPLD1), F.D. McCarthy (DPG)

G. Kaji, V. Thomas, A. El Maaroufi(EAPVP), C. Jones-Carroll(EAPCA), C. Madavo(EA1DR), K. Ikram((EA1CO), S. Yusuf, Y. Kimura(EA2DR), H. Levy(EA2TP), M. Haug(EA3DR), J. Shilling(EA3CO), D. Ritchie(ASTDR), M. Koch-Weser(ASTEN), D.C. Rao(DECVP), J. Husain(AFRCE), G. Nankani(SASVP), M. Selowsky(ECAVP), L. Squire(MNAVP), N. Birdsall(PRDDR), A. Ray(DPGDR), J. Adams(OPRDR), M. de Merode(PHNDR), G. El-Rifai(MIGPA), M. Long(FSDDR), M. Iskander(PSDDR), R. Stern(IENDR),

G. El-Ashry(ENVDR), L. Pouliquen(TWUDR), S. Hassan(LEGEA),
V. Freeman(CASDR), M. Khan(CASD1), Y. Horiguchi, I. Otani,
M. Bell, K. Kochhar, D. Scott, H. Khor(IMF).

AOdy:cs

A L L - I N - 1 N O T E

DATE: 11-Feb-1993 06:10pm

TO: Anthony Ody (ANTHONY ODY)

FROM: Anandarup Ray, DPG (ANANDARUP RAY)

EXT.: 31443

SUBJECT: **China: CSN 1993**

1. Your Initiating Memorandum for the CSP on China provides a wide range of choice. Among other things, you are proposing to provide or discuss:

(a) a survey of the most important developments in reforms and macromanagement; detailed evidence on sectoral reforms; results of our discussions with the Government on the various strategy papers; the possibility of sweeping import liberalization, etc.;

(b) the limits to non-inflationary growth;

(c) ESW and dialogue management; and

(d) the implications of China's reduced access to IDA; the level, composition, and policy content of our lending program.

2. This is a broad agenda, and adequate coverage will surely take you many more than the 4 or 5 pages you envisage. That would be fine; the appropriate length depends on the issues you wish to bring out for Management's attention. I have seen both very short and long updates.

3. We have no problem with the low-key, non-jargonistic, and non-ideological way you wish to continue to conduct the dialogue (para. 6), nor do we object to the pragmatism with which the Chinese are proceeding. The questions are: what strategic choices China is facing at this time, and what are the paths of adjustment we should recommend in the various areas? From this point of view we would be particularly interested in:

- monetary policy. It is generally acknowledged that improvements in monetary and financial policies in China are essential to its adjustment process. The CSN might report on the progress being made in our dialogue concerning the modernization of the monetary system.

- the strategy for reforming SOEs. As we have already indicated to you, it is quite unlikely that progress in this area can be sustained without decentralization, a competitive environment, and ownership changes in the direction of privatization. We, therefore, welcome your strategy paper, and look forward to further discussions either separately or in the CSN context.

- the strategy for trade reform. You have raised the question of accelerated import liberalization. We would very much welcome an analysis of the options in this area since the trade report seemed to suggest a good scope for import liberalization at this time.

4. Finally, I was puzzled by your search for a rationale for Bank lending in para. 9. Are you going to propose adjustment lending? In that case, of course, we would need a discussion along the lines of the recent policy paper on adjustment lending (OD 8.60).

CC: D. C. Rao	(D. C. RAO)
CC: Amnon Golan	(AMNON GOLAN)
CC: Michael Walton	(MICHAEL WALTON)
CC: F. Desmond McCarthy	(F. DESMOND MCCARTHY)
CC: Shahid Javed Burki	(SHAHID JAVED BURKI)
CC: Vinod Thomas	(VINOD THOMAS)
CC: Nancy Birdsall	(NANCY BIRDSALL)

February 10, 1993

Anando:

Re: **CHINA CSN**

Listed below is a preliminary list of topics for possible inclusion.

1. Macro management; need for policy instruments for monetary control; presently it seems to be a binary system either on or off.

2. The exchange rate; options for moving to a single exchange system; the advantages and disadvantages of alternate exchange rate regimes.

3. Removal of constraints/distortions to external and domestic trade.

4. Options for addressing the SOE's privatization; fiscal impact; and social implications of rationalization of the labor market.

5. China's role in global institutions; Uruguay round/Gatt, regional trading groups.

6. Resource mobilization; possible scenarios for the next decade; role of falling IDA component, increased infrastructural needs.

7. Population issues.

F. Desmond McCarthy

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

Desmond

Could you please write a little note listing the issues that we should want treated in the CSN, ~~within~~ by say, Tuesday? Thank you

Ray

AR.

DATE: February 2, 1993

TO: Those Listed Below

FROM: Anthony J. Ody, Principal Country Officer, EA2CO

EXTENSION: 82344

SUBJECT: CHINA: Country Strategy Note (CSN) 1993: Initiating Memorandum (IM)

1. Last year, this Department prepared a full-scale Country Strategy Paper (CSP) for China, which was discussed at the level of the President's Office on June 12, 1992. The CSP reviewed the very impressive achievements of China's reform era to date, indicated the significance of improving infrastructure provision and macroeconomic management to sustaining China's growth performance, and highlighted four central (and related) reform priorities for China and the Bank (completion of price/marketing reforms, especially for basic foods and materials; housing and social security; financial sector; and State-owned enterprise (SOE) reform). Challenges in the environment and the remaining (regionalized) incidence of absolute poverty were also discussed. The review of June 12, 1992 basically endorsed the Department's proposed lending and ESW strategies. The Department was, however, requested to prepare a more detailed paper defining and justifying its proposed strategy for Bank assistance in the specific area of SOE reform, and that paper has now been prepared for submission to the President's Office.

2. In FY93, the Department has committed to the preparation of a short CSP updating memorandum, or "country strategy note" (CSN), in conformity with the provisions of OD 2.10, para. 35, viz:

> For the very largest borrowers (currently India, China, Indonesia, Mexico, and Brazil) and 5-10 other major borrowers with particularly vulnerable economies or rapidly changing conditions, the Regions should prepare annual CSP updating memoranda of 4-5 pages. These memoranda should highlight important changes (in economic policies, political conditions, or such exogenous factors as commodity prices or natural disasters), and describe how these would affect Bank strategy as set out in the last CSP. Depending on the circumstances, the Region and the Economic Advisory Staff should recommend to the OPNSV that that there be either an interim review meeting between the OPNSV and key Regional staff or a short discussion at the OC (for which no formal agenda would normally be required).

The present IM serves to launch the process of preparation and review of the CSN. The IM will be reviewed at a meeting to be held at 10:30 a.m. on Friday, February 12 in Room D-8002. The full CSN timetable is attached to this memorandum.

3. Following the OD guidelines, the CSN will survey succinctly the most important developments on the reform front, as well as in macro-economic management, since the 1992 CSP.[1] The overall climate for system-wide reform is seen as having further improved very significantly over the past year, with the impetus initially created by senior leader Deng Xiaopeng's initiative at the outset of 1992 ratified authoritatively at the quinquennial Party Congress in October 1992. The CSN will analyze the implications of the Congress' formal decisions (as well as the concomitant personnel changes made). This will be supplemented selectively by more detailed evidence on sectoral reform progress in key areas, based on our own operational involvement (e.g. our review with the Government of strategy papers on SOEs and the financial sector; the processing of reform-linked projects in grain marketing and housing and social security; review of current ESW on trade reform; and corporatization trends in public utilities). The CSN should also be in a position to incorporate the outcome of the March-April National People's Congress, which is expected to approve translation of the Party Congress' strategy for separating government and enterprises into a detailed government reorganization.

4. The Party Congress also authorized the revision of the 1991-95 Plan's overall growth target (set initially at an unreasonably low 6 percent) to a figure of 8.5 percent (in line with the pace considered realistic, provided reform was stepped up, by our last CEM). Actual growth has, however, been even faster than this (12 percent in 1992), which raises the questions of whether renewed overheating is imminent and what policy measures may be called for to avoid it. Analysis of these issues, currently underway, will be summarized in the CSN. Macro

5. The recent decisions by the Chinese leadership provide support for further fundamental reforms very much in line with Bank advice, and are also fresh confirmation of China's highly pragmatic approach to economic policy formation. At the same time, potential macro-economic stresses serve as a reminder of past difficulties, which last year's CSP saw not only as issues of technical policy-making weaknesses but also as symptoms of deeper systemic flaws, especially in the SOE sector. We thus see the developments of the past year as essentially confirming the 1992 CSP's analysis of both the strengths of China's approach to reform and the agenda for further progress. Similarly, we believe the overall strategy for Bank involvement proposed in the CSP has also been validated.

6. That strategy, in outline, seeks to combine high quality ESW on key policy choices and sectoral or cross-sectoral problems (e.g. poverty, environment), which finds a responsive audience among policy-makers, with detailed lending involvement (generally with significant policy content) across a broad range of sectors, and nowadays more often at the sub-national than the national level. This strategy has at times been challenged in the Bank, and some have suggested that we should concentrate more on

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1/ It may be noted that the CSN will be processed in parallel with a new CEM, which would provide greater detail on these aspects.

negotiating broad statements of reform policy at the national level. This alternative seems to us flawed, however, given the realities of China's situation. First, in part because of the size of the country, lower levels have, throughout the reform era, very frequently been the leaders in developing new reforms, with successful initiatives generally diffused rapidly (and often endorsed ex post by Beijing). Secondly, we see the decisions of last year's Party Congress as largely eliminating residual ideological constraints to further reform. Across a wide range, therefore, a national policy environment supportive of further reform now exists, and the challenge remaining is to translate this into practical workable models, new institutional structures, etc. The Bank's support in this "detailed engineering of change" is eagerly sought, and is most effectively provided by the comparatively "micro" approach outlined above. The CSN will elaborate the implications for the Bank's further work program.

7. At least two additional developments will need to be analyzed by the CSN for their possible implications for the Bank's strategy. The decisions on the Tenth Replenishment of IDA (IDA 10), while endorsing China's continued eligibility, will imply a significant reduction in China's share. As China starts down the road towards IDA graduation, we will be challenged to work out, together with our counterparts, operational mechanisms to safeguard the pursuit of our objectives in the areas of poverty alleviation and the environment, as well as in the social sectors more generally.

8. Finally, although recent trends in the balance of payments show, as anticipated by the 1992 CSP, that imports are rising faster than exports (26.3 percent in 1992 versus 18.3 percent), the implied shrinking of China's current account surplus is, at this stage, a fairly gradual one. Meanwhile, record levels of commitments for foreign direct investment (FDI) in manufacturing are being reported, while policy decisions are increasingly opening the tertiary sectors also to FDI. The possibility of accelerated movement on the trade side should not be ruled out: sweeping import liberalization has been put on the table in both bilateral and multilateral discussions, and could also help deal with a number of domestic issues (including, but not limited to, macromanagement). At the same time, we realize a case can be made that the pure resource transfer rationale for Bank Group support to China is, at least for the time being, less strong than in earlier years. ? Options

9. There is, however, a broader rationale underlying the Bank-China relationship. China is a credit-worthy and reliable client, eager to continue borrowing on a substantial scale from the Bank Group, and highly responsive - as seen earlier - to Bank advice across a very wide range of economic, social and environmental issues. DFI may be flowing well into (generally green-field) directly productive activities (and the revival of IFC's program, in particular, will be reflected), but there is little if any overlap here with the Bank's lending operations. More specifically, it needs to be recognized that - even with continued strong progress on public sector price reform - severe constraints will still exist for some time to the domestic mobilization of resources to meet China's heavy needs for infrastructure investment, social service provision or the restructuring of longer-established enterprises. The CSN will review all the above

elements in order to provide a basis for management guidance on the broad dimensions of the future Bank program in China.

Attachment

Cleared with and cc: Mr. Burki (EA2DR)

cc: M/M Kaji, Thomas, Agarwala, El Maaroufi (EAPVP), Jones-Carroll (EAPCA), Madavo (EA1DR), Haug (EA3DR), Ritchie (ASTDR), Ikram (EA1CO), Shilling (EA3CO), M. Koch-Weser, (ASTEN), Yusuf, Kimura (EA2DR), Pearce (EA2CO), Goldberg (EA2AG), Khan (EA2IE), Levy (EA2TP), Ecevit (EA2EH), Bottelier (EA2CH), D.C. Rao (DECVP), Husain (AFRCE), Nankani (SASVP), Selowsky (ECAVP), Squire (MNAVP), Birdsall (CECDR), Ray (DPGDR), Golan (EDIDR), M. Ahmad (IECDR), Ingram (RAD), Amoako (ESPDR), Adams (OPRDR), de Merode (PHNDR), El-Rifai (MIGPA), Long (FSDDR), Iskander (PSDDR), Stern (IENDR), El-Ashry (ENVDR), Petit (AGRDR), Pouliquen (INUDR), Horiguchi, Otani, Bell, Kochhar, Scott, Khor (IMF), Hassan (LEGEA) Freeman (CLACM), Khan (CASD1), Bond (CPLD1)

EA2CO H/L Staff
Asia Information Center

1. What ~~are~~ is the proposed strategy for privatization? and reform of SOEs?

2. For trade reform?

~~3. For spreading~~ modernization in

[CSN.IM]
AOdy:ef

India – 3 credit

- We should think of comparison to other countries
- cyclical issues in CSN

Banks
1) Size of lending program
2. Weaned away from IDA

Current – limits to nonconflat
– monet. fiscal trends
use their overheating?

Areas of Concentration of ESW
- 11 track approach
Role of central govt
SOE
fiscal sect. ref
housing
Sectoral Concentrat.
- Poverty
SOET
Agric.
Envir

Size of lending program

Use ratios
argue for fairly large program

Attachment

China 1992 CSN
Proposed Timetable

Initiating Meeting	Feb 12
Circulate Preliminary Draft	Apr 23
Working Level Review	May 7
Circulate Discussion Draft	May 21
RVP Meeting	Jun 4
Review Draft to MD	Jun 18

1. Adjustment lending needed guidance for
   — Neg. B.O.P.   mangmt a strategy
   Not a great need for external Capital
   — tech. asst., econ. work

Projecting 95.
Uncertainty element — B.O.P.
— MFN
What will Clinton Admin.

Reserves Acc gross and net
trade surplus narrowing.

2. Integration through trade
   — e.g. commercial code.

3. SSN & SOE → general price reform
   → financial?

4. Seek endorsement of S.M. on current approach
to China — upfront policy changes for projects by
— policy dialogue & parallel track — seminars etc.

C.S.P file
China

CHINA: Central Asia Updated On:Monday, November 23, 1992

11/23/92

EVENT: The Chinese foreign minister is now into the second week of a visit to Central Asia.

SIGNIFICANCE: China's cultivation of ties with Central Asia is driven in part by a fear that ethnic unrest and Islamic revivalism could spread to the Xinjiang-Uighur Autonomous Region.

ANALYSIS: Despite constraints and a degree of mutual suspicion -- a hangover from the Cold War -- China is attempting to expand trade, economic and political links with Central Asia. The first high-level Chinese economic delegation visited the region in December 1991 -- before the break-up of the Soviet Union -- to explore the possibility of commercial ties independent of Moscow. China recognised the independence of all five republics shortly afterwards.

rlier this year, a railway line from Alma Ata to the Chinese order was completed, passing through the Ala Tau mountains via the Kazakh towns of Aktogay and Druzhba. It links up with a Chinese-built railway -- still under construction -- which crosses the Gobi desert and Xinjiang. Eventually the line will join Beijing, Alma Ata, Tashkent and Ashkabad to Tehran and finally Istanbul. Kazakh officials intend the line to increase trade with both China and Europe.

Rail links with Kazakhstan have complemented road links and a large cross-border trade has developed, with Chinese consumer goods exchanged in Alma Ata for minerals and metals. President Nursultan Nazarbaev of Kazakhstan visited Beijing earlier in the year.

China's contacts extend beyond Kazakhstan:

-- Relations with Uzbekistan received a boost in March, when President Islam Karimov visited Beijing and signed 14 agreements on trade, transport and investment.

-- Trade with Kyrgyzstan has also expanded in recent months, following a recent visit by President Askar Akaev to Beijing.

Food, consumer items and light engineering goods are also being traded in the wider region.

-- China is in discussion with Pakistan, Kazakhstan and Kyrgyzstan about recreating the ancient Silk Road by linking Alma Ata, through Xinjiang, to Pakistan's northern areas and the Indian Ocean port of Karachi. For Central Asian republics, excluding Turkmenistan, Karachi is their closest link to the sea.

-- Relations with Turkmenistan were cemented last week with the visit to Beijing of President Saparmurad Niyasov and the signing of a number of economic accords.

China's main political goal is to ensure that ethnic unrest and Islamic fundamentalism in Afghanistan (see OADB, October 30, 1992, III) and Central Asia do not spread to Xinjiang:

-- There are an estimated 5 million Muslim Uighurs in Xinjiang and 300,000 -- who fled from the communists in 1949 -- in Kazakhstan and Kyrgyzstan. There is also a substantial Kyrgyz population in Xinjiang which now has links with Kyrgyzstan for the first time in 75 years.

In Kazakhstan, Uighur exiles have set up the Uighurstan Liberation Front.

With anti-Han Chinese nationalism and Islamic fundamentalism on the rise amongst the Uighurs, Beijing is anxious to develop relations with Kazakhstan and Kyrgyzstan, to ensure that Uighur exiles do not foment separatism among their ethnic brothers in Xinjiang. Recent contact with Uzbekistan is an attempt to prevent it being absorbed into a southern bloc of Islamic countries.

Beijing is prepared to use force to crush opposition. In Xinjiang, around 50 people were killed in April 1989, when the militia put down a Uighur revolt in the town of Baran, near Kashgar, only 150 miles from the Kazakh border. Nowadays, however, Beijing's emphasis is on raising the Uighurs' standard of living in the hope of reducing the potential for unrest. This year, it has increased investment in Xinjiang by 23%, with 370 million dollars targeted for investment in industry and communications. It plans to develop Xinjiang as a processing zone for imports of minerals and metals from Kazakhstan.

Nevertheless, suspicions remain on both sides. As a legacy of the Sino-Soviet hostility of the 1960s and 1970s, nuclear missiles in Kazakhstan are still aimed at Chinese targets, while missiles in Xinjiang are aimed at Central Asia. However, China derives comfort from a perception that the Central Asian republics are following its 'model' of encouraging economic liberalisation, while maintaining autocratic rule to check the growth of political -- particularly Islamic -- opposition.

CHINA: Central Asia

CONCLUSION: Longer term, China cannot insulate Xinjiang from political and economic change in Central Asia. Cross-fertilisation will reinforce Uighur separatist sentiment.

Keywords: AP, EE/SU, China, Central Asia, politics, economy, religion, ethnic, nationality, trade, investment, transport

copfile

CHINA/SOUTH KOREA: Diplomatic Ties Updated On:Monday, August 24, 1992

08/24/92

EVENT: China and South Korea established full diplomatic relations today.

SIGNIFICANCE: The agreement ends decades of hostility between the two countries and will further isolate North Korea.

ANALYSIS: Chinese Foreign Minister Qian Qichen and his South Korean counterpart Lee Sang-ock signed an agreement establishing full diplomatic relations in Beijing this morning. The two countries fought on opposite sides in the Korean war and have circled each other warily ever since; the agreement therefore brings four decades of hostility to a close. As a consequence, Taiwan will break off its existing relations with Seoul. It was also announced that South Korean President Roh Tae-woo would make an official visit to Beijing in the near future.

s is yet another victory for South Korea's 'nordpolitik', whereby Seoul abandoned its former staunch anti-communism in order to woo Pyongyang's major allies in Moscow and Beijing.

Although such overtures originally cut little ice in the era of Brezhnev and Mao, they began to bear fruit during the 1980s in the growth of trade, sports and other unofficial contacts. The breakthrough was the 1988 Seoul Olympic Games, attended by China, the Soviet Union and other Soviet bloc states.

Although none recognised South Korea at that point, diplomatic relations with East European countries followed rapidly, culminating in full ties with the Soviet Union in September 1990. This was a particularly bitter blow to North Korea, both symbolically and financially. North Korea has its very origins in Soviet military government north of the 38th parallel between 1945 and 1948, and (like Seoul pari passu) had always counted on its allies accepting its claim to be the only legitimate government of the peninsula.

In one of the less publicised and more unlikely political friendships of recent times, Gorbachev and Roh Tae-woo met three times in less than a year: in San Francisco, Moscow and South Korea, all in 1991. Gorbachev never visited North Korea, and added injury to insult when in January 1991 Moscow insisted that ngyang pay for trade in hard currency at world market prices. is caused North Korea's total trade to slump by 25% last year, as its formerly preponderant trade with the Soviet Union/CIS all but collapsed.

The Soviet Union's perceived defection pushed North Korea closer to China, which until today appeared warier of offending Kim Il

Sung's sensibilities. But Beijing has experienced all the same frustrations as did Moscow vis-a-vis its wayward Korean allies:

-- Sino-North Korean trade -- although it rose by 17% from 519 million dollars in 1990 to 609 million dollars last year -- comprised 524 million dollars of Chinese exports as against only 85 million dollars of imports. Pyongyang's inability either to reduce or finance this deficit has compelled China to insist on payment in hard currency from this year.

-- Although Kim Il Sung was pointedly shown around numerous joint ventures and special economic zones when he visited China last October, North Korea is still refusing to embrace economic reform.

-- China shares the general concern regarding Pyongyang's suspected nuclear ambitions, even though it has not yet said so publicly.

Meanwhile, trade and other unofficial ties between China and South Korea have developed rapidly since the late 1980s:

-- Direct trade alone totalled 4.4 billion dollars in 1991, with at least a further 1.4 billion dollars passing through Hong Kong.

-- Regular ferry services and charter flights connect the two countries, although there are as yet no scheduled air services.

-- South Korean companies have begun investing in China, especially in the nearby Shandong and Jilin provinces (see OADB, July 6, 1992, II). While most are small firms in low-wage sectors (eg footwear and textiles), projects already in motion include a 60 million dollar Samsung VCR assembly plant in Tianjin, and a huge 250 million dollar cattle ranch (the biggest in Asia) and beef business in Yanbian Korean autonomous zone, close to the North Korean border.

Ever since Li Peng's remark at a UN regional meeting in Beijing in April -- when he told the visiting South Korean foreign minister that "running water naturally makes a ditch" -- Seoul has had high hopes for a full normalisation of ties. The current ascendancy of the reformists in the Chinese leadership has expedited the process.

Economically, trade -- and in particular investment -- will now accelerate still further. There are also reports that Seoul will loan Beijing 2 billion dollars.

CHINA/SOUTH KOREA: Diplomatic Ties

Besides being neighbours, the two countries' assets and needs are neatly dovetailed. China's raw materials and low wages complement Seoul's technological and manufacturing skills. For China, South Korea is a useful alternative source of technology to Japan. For Seoul, growth of the Chinese and other Asian export destinations partly compensates for declining expansion and fear of protectionism in its traditional OECD markets.

Politically, this resumption of an ancient relationship -- Korea was for centuries culturally influenced by China, and paid tribute to the imperial court -- represents a reassertion of geo-political realities over the artificial barriers created by the Cold War. There are also security implications: it remains to be seen whether China -- or North Korea -- will now revise the 1961 treaty of alliance between Beijing and Pyongyang.

More probably it will be supplemented, rather than replaced, by a Beijing-Seoul security agreement. In similar vein, President ris Yeltsin is expected to sign a Russia-South Korea friendship agreement when he visits Seoul in mid-September, without necessarily formally repudiating the 1961 Soviet Union-North Korea treaty.

One immediate, and predictable, consequence has been Taiwan's simultaneous termination of diplomatic ties with Seoul in response to its worst diplomatic setback since Washington switched recognition to Beijing in 1979. Today's agreement robs Taipei of its only remaining ally in Asia (as well as a prime piece of Seoul real estate, with its embassy going to Beijing). Sanctions already announced include suspension of flights and cancellation of trade preferences.

Yet Taipei has been expecting this defection for some time. Sharing as they do common economic goals -- primarily to increase their mutual trade, and thus reduce their common dependence on Japan -- neither Seoul nor Taipei, despite the rhetoric, will in the long run allow bilateral economic ties to be greatly damaged. Roh has said that he hopes favourable unofficial ties will be maintained, and officials have pointed out that Taiwan's policy of 'flexible diplomacy' -- which allows it to nourish thriving trade and civilian links with countries which do not recognise it diplomatically -- would also be applied to South Korea.

th Korea, however, is the real loser. Pyongyang's isolation now complete (even distant Cuba is commencing sports exchanges with Seoul). The pressure on Kim Il Sung's regime wholeheartedly to embrace dialogue and economic reform will now be acute.

One small silver lining for both countries is that nothing now prevents links between Pyongyang and Taipei. Taiwanese business groups have already made exploratory trips, while a North Korean delegation is said to have visited Taiwan secretly in June.

CONCLUSION: Formalised relations between China and South Korea, in addition to shaping the emerging post-Cold War political order in East Asia, will increase pressure on North Korea to commit itself to diplomatic pragmatism, political normalisation and economic reform.

Keywords: AP, China, South Korea, North Korea, Taiwan, Russia, international relations, economy, foreign policy, trade, foreign investment

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

Mr. Gurley

DATE: June 26, 1992

TO: Files

FROM: Shahid Javed Burki, Director, EA2

EXTENSION: 82332

SUBJECT: CHINA: CSP

92 JUN 29 PM 4:27

RECEIVED DEVELOPMENT ECONOMICS

1. Attached is a minute of the discussion of China CSP held in the President's Office on June 12, 1992. The minute was drafted by me and cleared by the President's Office.

cc: Messrs/Mesdames: Preston, Karaosmanoglu, Sandstrom, Stern, Kaji, Lynn, Rajagopalan, Shihata, Summers
Haug, Madavo, Ritchie, El-Maaroufi, Thomas, Vazquez

SJBurki:jd

NOTE ON CHINA CSP

The China CSP was discussed in a meeting chaired by Mr. Preston on Friday, June 12 at 10:00 a.m. Messrs. Sandstrom, Karaosmanoglu, Shihata, Rajagopalan, Summers, Lynn, Kaji and Burki attended the meeting.

The discussion focussed largely on the following four issues raised in the CSP:

Size of lending and differentiation among the low, base, and high case. There was agreement that given the size of the Chinese economy, its creditworthiness, the management of the World Bank financed portfolio of projects and China's growing commitment in addressing the problems of environment, there was a good case for lending at the level of the proposed base case scenario. This scenario as well as the one presented under the high case would not pose exposure problems for the Bank under any of the applicable criteria, although the need to maintain flexibility to meet China's financing needs over the longer term should be kept in mind. The region explained that even the base case scenario was contingent upon China pursuing reforms in a number of areas; in fact, all the projects being prepared had policy components explicitly identified in their design. However the Region agreed to reduce lending in the low case.

Lending for State owned enterprises (SOEs). The question of the advisability of large scale lending for SOE in the industrial sector had been raised in a memorandum circulated by Mr. Ryrie in advance of the meeting. The region explained that it was following a two-pronged approach in developing its industrial sector lending program: to help create an environment in which the non-state sector enterprises would grow, and to restructure the SOEs so that they function according to the dictates of the market. While a number of SOE operations were under preparation, the region will bring to the senior management a strategy paper on SOE reform before taking any final decision on these projects.

Estimate of Chinese GNP. It was suggested that the methodology used by China for estimating its GNP may have a serious downward bias. The region referred to a study under preparation in which the conclusion was that China was making appropriate adjustments in its methodology and that upward adjustment of some 25% would perhaps result from the application of the U.N. System of National Accounts. In any event, the Purchasing Power Parity adjustments for China was not out of line with those that are needed for a number of other developing countries. The region said that a research effort was being mounted in collaboration with DEC to introduce a more robust analytical base for national accounting in China.

IDA for China. The region's view that China remained eligible for IDA support was accepted but it was emphasised that a hardening of blend is now called for. The region indicated that a 70:30 IBRD:IDA blend would seem appropriate for the base case. Furthermore the blend in the low case would be hardened to match the blend in the base case.

Shahid Javed Burki
June 26, 1992

4592

F;le

The World Bank
Washington, D.C. 20433
U.S.A.

SVEN SANDSTRÖM
Managing Director

92 JUN 18 PM 2:04

June 17, 1992

Mr. Gautam Kaji

China Country Strategy Paper

The CSP is well written and sets out the four areas of reform which will be emphasized: housing and social security, the financial sector, state owned enterprises, and commodity pricing and marketing. Individual operations would be closely linked to the reform agenda.

The forthcoming strategy paper on state enterprise reform will address in more detail questions with regard to, inter alia, the improvement of the policy and institutional environment for private sector development, the content and pace of state enterprise reform, and the justification for future Bank lending to state enterprises. The paper should take into account the suggestions made during our meeting last Friday and the comments made by Mr. Ryrie in his memorandum of June 11. We should review the strategy paper before the end of 1992. In the meantime, we should minimize further work on any new direct lending to state enterprises, particularly in competitive markets. Policy reform and institutional restructuring should be clearly articulated in other operations already under preparation, which would demonstrate how the proposed strategy for state enterprise reform could be effectively implemented.

Significant lending is proposed in all three lending scenarios. More differentiation would be appropriate. In particular, lending in the low case should be reduced. Also, the blend should not be softer in the low case than in the base case (i.e., no more than 1/3 IDA; further hardening of the blend may be necessary depending on the outcome of the IDA-10 replenishment).

cc: Messrs. Burki, Linn, Rajagopalan, Ryrie, Shihata, Summers, Terasawa

Husain, Jaycox, Koch-Weser, Thalwitz, Wood

Karaosmanoglu, Stern

3/30

Lonney - RECENT DEVELOPMENTS IN CHINA

Structure of control & ownership.
how manifest itself

re: SOE's
more incentives -
few penalties - even if problems
no bankruptcy - reform needed

Price adj - not reforms
eliminate subsidies - ad

housing -
Financial Sector
Tax system -
Fx Regime
Macro Management

Role of US necessarily marginal - but may be important

$E = \hat{E}$

$\hat{E} = U + A + S + \omega$

$P = P_0 (1+r)^t$

$Y = f(P, T, ?)$

$\dot{Y} = f(\Delta P, \Delta T, Pol.)$

$Y = C + T$

$U = \alpha P + \beta \dot{Y}^2$

$A = \beta Y - \delta T$

$S = \delta Y + \varphi \dot{Y}^2 - \theta T$

$*$ -

$*$ —

B - lead of tip.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 14, 1992

TO: Mr. Gautam S. Kaji

FROM: Lawrence H. Summers

EXTENSION: 33774

SUBJECT: CHINA - Country Strategy Paper

1. We have reviewed the revised draft of the China CSP, which as you know will be the subject of a meeting to be chaired by Mr. Preston on June 12. The basic strategy as it is now envisaged is, we believe, a good one, where we welcome the strong linkage proposed in both the Base and High cases to significant further progress on policy reform. And as the CSP notes, policy reform for the state-owned enterprise sector will be especially important, but is also a complex area, where further work is required to specify precisely what the Bank should expect in order to be able to proceed with lending in the industry and finance sectors. Therefore, the proposal to draft an Enterprise Reform Strategy Paper in the first half of FY93 is a reasonable one, and we look forward to working closely with you on it.

2. The strategy as now presented, along with somewhat lower Base Case lending amounts plus revised projections by FRS on the overall Bank portfolio, also means that the projected portfolio share of China now is less of an issue than it was before.

3. We are still concerned, however, over one area of the CSP, which can hopefully be cleared up prior to the June 12 meeting. There appear to be a number of arithmetic errors (as well as other problems of this nature), in the standard tables on the balance of payments projections attached to the CSP. For example, the current account balance does not add up, short-term capital flows appear to be double-counted, short-term capital stocks are presented in the table on disbursements, and entire sections of several tables were simply left blank.

4. A more fundamental concern is whether the resulting financing scenario is a reasonable one. Although in part it may be a consequence of the arithmetic errors, the previous draft of the CSP had the stock of commercial bank debt falling from $14.5 billion in 1990, to $11.1 billion in 1993. In the current draft, the stock of this debt rises from the $14.5 billion figure for 1990, to $32.0 billion in 1993.

5. This may not be unreasonable, but there is little discussion of whether this is so. It is also not clear whether any of the "adding up" problems play a role in this. It is not an issue, however, which should come up at the June 12 meeting. Rather, it would be preferable that a corrected set of projections be circulated prior to the meeting, along with a one or two page covering memo which explains and justifies the financing scenario presented.

cc: Messrs. Karaosmanoglu, Sandstrom, Burki

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 7, 1992

TO: Mr. Lawrence Summers

FROM: Frank J. Lysy, Economic Adviser, DPG FJL
(Through: EG Enzo Grilli, Director, Development Policy)

EXTENSION: 81945

SUBJECT: CHINA CSP

1. A revised draft of the China CSP was submitted to the Office of the President, and circulated to Senior Managers within the Bank, in mid-April. The President's Office has confirmed to us that there will be a meeting on the CSP, to be chaired by Mr. Preston, although probably not until mid-June (due to the travel schedules of Mr. Kaji and then Mr. Preston). The purpose of this memo is to brief you on the status of this CSP and on how it was revised from its earlier version. The revisions appear to have been at least in part in response to concerns you had earlier expressed.

The Basic Strategy on State-Owned Enterprises

2. A principal concern we had expressed on the previous draft of the CSP was whether the Bank would be following a proposed lending program which would bring us to the ceiling on possible exposure, but where the policies being followed reflected only partial reforms and were ultimately unsustainable. Not only would this be non-viable in the long-run (inadequate policies being non-sustainable), but in addition, we would not be in a position to support through increased lending a new Government which wished to follow a fundamental change in policies in a market-oriented direction. A key area of policy concern is the state-owned enterprise (SOE) sector.

3. There has been a significant improvement in the treatment of these issues in the revised draft of the CSP. The basic strategy as now proposed should be welcomed. The main issue that remains is how it will be implemented in practice.

4. There is a better articulation of the problems in the SOE sector in the revised CSP, with the point made that if these problems are not addressed, there could be severe consequences for the rest of the economy. The revised CSP makes explicit and clear that the Bank's lending program, in the Base Case as well as in the High Case, should be conditioned on significant and continued progress in addressing the SOE (as well as other) policy issues (see para. 33 and 35 on pages 16-17). The CSP also states that Bank lending operations in Industry and Finance would not proceed without progress on these policy issues (see para. E1 of Annex E). There has also been some scaling back of the Base Case lending program (by about 9%), which when coupled with new projections from FRS on the size of the total Bank portfolio, leads to

less of a concern on our overall exposure in China (this is discussed in the next section below).

5. Finally, and perhaps most importantly, the revised CSP proposes that on the key area of Bank strategy on the SOE sector, that an Enterprise Reform Strategy Paper be prepared in the first half of FY93 (see the end of para. 35, as well as para. D21 in Annex D). Although perhaps a bureaucratic response, it is not unreasonable in the present circumstances. The subject is complex as well as important, and the preparation of such a sector strategy paper would allow attention to be focussed on precisely what reforms are prerequisites for Bank lending in the area.

6. These changes basically respond to our concerns. They recognize the importance of SOE reforms, and link a substantial amount of our lending to it. Based on the titles of the projects in the lending program tables, it appears roughly 28% of the Base Case IBRD lending program (about 19% of the Bank and IDA together), would be linked to progress on SOE reforms. Excluding these operations, one might view the true "Base" Case as averaging about $1.4 billion in new IBRD commitments per year, versus $1.9 billion in new commitments per year under the Base Case of the CSP (and $2.7 billion per year in the High Case). This would also leave us some headroom for an expansion in future lending in the event there is a fundamental change in policies in the right direction sometime later in this decade.

7. Our main concern is whether there will really be such linkage. The key question will center on the assessment of what should be considered to be sufficient in the area of SOE "reform". The Region appears willing to accept the position of the Chinese authorities that basic ownership reform should not be necessary, while the views of DEC, based on the experience elsewhere (and as expressed in the recent Board Paper on Privatization), is that without basic ownership changes, attempts at SOE reform ultimately are disappointing. These issues will be worked out in the context of the proposed Enterprise Reform Strategy Paper, which the CSP states will synthesize the work of CEC and others with the experience so far in China (para. D21 of Annex D). We should follow the drafting of this sector strategy paper closely, and staff of DEC (in particular of CECPS and CECSE, as well as of DPG) should be involved. Mr. John Nellis could be of particular help, and we have discussed this with him. This sector strategy paper for China should be a good opportunity to apply in Bank practice the principles worked out in the Privatization Paper.

The Portfolio Share Issue

8. The Base Case program of the earlier version of the CSP, coupled with the projection of the total Bank loan portfolio provided us by FRS, implied that China would have accounted for 11 to 12% of the Bank's total loan portfolio by the year 2000, with the share still rising. The Bank's portfolio diversification guideline is that in

general, the share of the Bank's loan portfolio for any one country should not normally exceed 10%. Under the High Case, the share would have course been even higher. Our concern with these shares was not so much over the breaching of the guideline limits themselves (which is more a concern of FRS in the Bank, rather than DEC), but rather that with portfolio limits reached, we would not then be in a position to support a true reform program in China, if one were to be adopted at some point in the future.

9. This appears now to be less of an issue than before. In part this is because of a reduction (by 9%) in the proposed Base Case lending program of the CSP. Perhaps of more importance is the linkage of a significant share (28%) of this Base Case lending to significant SOE reform; the Base Case levels of lending would only be reached (if the CSP is to be trusted) under a significant improvement in the policy environment. Finally, the FRS projection of the figure for the total Bank portfolio in the year 2000 is now significantly greater than what they had provided us before. They had previously provided a figure of $135 billion, with this including $15 billion (we were told) for loans outstanding for that year to the CIS. This was a preliminary and not yet official projection, and may have been in error (it may have excluded the CIS in fact). In any case, the current FRS projection for the Bank portfolio for the year 2000 is $170 billion (including $19 billion for the CIS). This is 26% above their earlier figure.

10. The combination of a lower level of Base Case lending (by 9% in terms of commitments, for FY93-97), and a larger Bank-wide portfolio (by 26%), means that the projected China share of the Bank's portfolio in the year 2000 would be 9.0%, if one uses the disbursement projections of the Region (which are the ones used for the balance of payments projections of the CSP). If one uses the standard disbursement profiles that FRS has developed for its projections of the total Bank portfolio (which are based on Bank-wide averages, where these averages are slower than the disbursement pace for loans to China), the China share in the year 2000 would be only 7.4%. And if lending for industry and finance is held up due to inadequate progress on SOE reform, the shares would be even less. However, under the High Case projections of the CSP, the projected share would reach 11.4% in the year 2000, thus indicating that the High Case is not a totally credible scenario (unless Bank portfolio policies change).

11. All these projections are, of course, subject to a significant degree of uncertainty. And too much significance should not be attached to the year 2000; if the guideline limits are breached in the year 2002 or 2003 (as simple extrapolation would indicate), then we should take that into account now, for the lending program proposed in the CSP for FY93 to FY97. However, the figures are now in a range where it should no longer be such an issue for DEC. Rather, our focus should be on the <u>quality</u> of the lending and its linkage to policy reform (and in particular to SOE reform). This was discussed above.

The Balance of Payments Projections

12. The balance of payments projections provided in the CSP are an additional area of concern. The worry is not so much over whether the basic figures are reasonable (they could be), but rather whether much thought has been given to them and what they imply. In particular, we are concerned over the figures on the financing of the balance of payments. Although debt issues are not paramount in China, under the proposed scenario the Bank and IDA will be the largest single creditor to China. Despite this, it does not appear that much consideration has been given to how this lending from the Bank Group will fit in to the overall financing of the balance of payments. The balance of payments projections themselves are full of arithmetic errors, with the picture presented changing totally between that presented in the earlier draft of the CSP and the current one. Although there is no need to place any emphasis on the projections of the earlier draft of the CSP, what is worrying is that the scenarios in the two drafts of the CSP are presented as if they had not changed in a fundamental way. Yet the figures on the financing are totally different.

13. This can be seen most readily in the figures on the commercial bank debt:

	Commercial bank debt outstanding				
	1990	1991	1992	1993	1995
Draft of 1/30/92:	\$14.5b	\$16.3b	\$11.7b	\$11.1b	\$14.2b
Draft of 4/13/92:	\$14.5b	\$22.3b	\$26.4b	\$32.0b	\$42.3b

For 1993, only one year from now, the difference is \$21 billion, which for most Third World countries (including China) is not a small amount 1/. The resulting picture on China's creditors becomes:

	Change in debt outstanding, 1990-95	
	Draft of 1/30/92	Draft of 4/13/92
IBRD	\$5,825m	\$5,390m
IDA	\$4,536m	\$4,356m
Other Multilateral	\$726m	\$726m
Bilateral sources	\$2,558m	\$2,558m
Private lenders	-\$9,044m	\$19,103m
Total	\$4,601m	\$32,133m

14. Note that for the period to 1995, the Resource Balance in the two projections is unchanged. Part of the problem in the projections appears to stem from arithmetic problems in the earlier draft of the CSP. However, arithmetic problems remain (the current account balance does not add up, for example, and short-term lending seems to be

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1/ As the late Senator Dirksen of Illinois said: "a billion here, a billion there, soon you're talking real money."

double-counted). In addition, many of the lines (as well as certain complete sections) in the standard attachment tables were simply left blank.

15. This is not really satisfactory. Although the projections themselves (once the arithmetic problems are cleared up) may not be unreasonable, our main concern is whether Regional Management has given much consideration to the financial picture being presented. If they had, they would have found some of the errors. Perhaps the best way to deal with this would be to request the Region to submit a corrected set of projections prior to the President's meeting on the CSP, with a one or two page covering memo explaining why the financing scenario being presented is a reasonable one. In particular, they should explain why they are comfortable with the projected level of commercial bank lending. The point would not be to embarrass them, but to elicit consideration of these issues. Finally, the projections should include at least an extrapolation of the standard Bank exposure ratios to the year 2005; when the exposure ratios are rising so rapidly, the projections should not be cut off only three years beyond the last year of the lending program being proposed.

16. If you agree that the Region should be asked to submit a corrected set of projections, we would draft a simple memo on this for your signature.

FJLysy:

cc: Walton, Nellis, Lav

p.s.: You might find the attached news report, from today's Wall Street Journal, of interest. It appears to indicate that the Chinese authorities may be willing (at some point in the not too distant future, although perhaps not yet), to consider the privatization of state enterprises on a significant scale, at least in areas such as light industry. The CSP presents the view that this is unlikely.

5/7/92

China's Easing Of Some Rules Lures Investors

Allowing Foreigners to Buy Stakes in Firms Prompts Hong Kong Enthusiasm

By Jesse Wong
Staff Reporter of The Wall Street Journal

HONG KONG – The bureaucracy remains as dense as ever. But with the pace of economic change in China picking up this year, the door to foreign investment is opening wider.

Though only vaguely publicized, the shift has enabled foreigners to acquire sizable minority stakes, along with a degree of management control, in a handful of state-owned concerns. This form of direct investment in existing enterprises marks a departure from the past, when foreigners were generally restricted to building up businesses from scratch.

Coming on the heels of a limited opening of the country's stock exchanges to foreigners, the latest easing has generated enthusiasm in Hong Kong, which has long been China's biggest source of foreign investment. So far, the enthusiasm has yielded results only for a few Hong Kong investors. But many others are trying.

"There is a lot of talking going on, even though we haven't seen much yet in the way of actual investment," says Meocre Lee, a Hong Kong partner and China expert at Arthur Andersen & Co., the international accounting firm.

Inefficient State Sector

The shift toward direct investment is yet another signal of Beijing's concern about the inefficient state sector. Run like government bureaucracies and with little regard for market demand, many state enterprises need subsidies to survive. Yet they account for more than 50% of the country's industrial output. Collectives—semiprivate businesses often operated by local officials but not funded by the state—and a sprinkling of private companies account for the rest.

While privatization seems a possible way out, it has been resisted by Beijing as contrary to socialism's ideals. The issue gets even more sensitive when it comes to selling assets to foreigners. The few privatizations that have taken place were done on an experimental basis. Typically, they involved the sale of tiny, ailing companies to Chinese entrepreneurs. If the current shift toward direct investment proves feasible on a wide scale, it would be a milestone in the country's tortuous attempt to liberalize its centrally planned economy.

"Beijing used to be fairly hostile to the idea of letting foreigners profit from investing in state-owned enterprises," says Woo Tun-oy, an economist at Hong Kong Baptist College. "But it may be becoming more flexible because nothing else seems to be working very well."

For China's economy as a whole, the star performer since reform first began in 1979 is the foreign sector. Last year alone, foreign-invested enterprises increased their output 56%. The state sector, by contrast, grew a meager 8%. The foreign sector is dominated by Sino-foreign joint ventures, along with a handful of ventures wholly owned by overseas investors. With few exceptions, these foreign-invested enterprises were all created from scratch.

Potential Investments

Beijing doesn't seem prepared yet to sell off whole businesses, and some industries remain off limits to foreign involvement. But increasingly, selected sectors, especially retailers and makers of consumer products, are being cited as potential investments. In general, it appears foreigners will be allowed to acquire at most 50% of any state company.

In their public rhetoric, Chinese officials ranging from Premier Li Peng to provincial leaders are vague on the matter. But in the past few months, many of them have come to Hong Kong in search of investment capital.

Such visits have prompted the Hong Kong Trade Development Council to act. Funded by taxpayer money, the agency's primary task is to help the colony's manufacturers seek out trade and investment opportunities. Since March, it has been scouting for such opportunities among state companies in the cities of Shanghai and Beijing and in Guangdong province.

Although some of the businesses are small, the size of the potential investment required ranges up to $50 million. Mary Wong, a senior manager with the council, is confident of results, though nothing concrete has emerged so far.

"What we're doing is playing matchmaker. We look for promising enterprises that need modernizing or fixing up and we try to find them the right partner," she says. "We feel that the climate is right for this kind of exercise."

Even with the right climate, reaching an investment agreement can be a tedious process. With the Chinese side insisting on valuating a business according to its assets and the typical investor preferring to go by earnings potential, the two sides could easily end up in a deadlock. "This can be an insurmountable problem in many cases. The Chinese side tends to be very concerned that it may be selling state assets too cheaply," says Peter Fung, a director of Sun Hung Kai & Co., a Hong Kong investment company.

Such problems notwithstanding, Sun Hung Kai is about to complete negotiations on two investments after a half year of talks. Both of them involve state-owned companies in Guangdong; one makes electric appliances, and the other mattresses.

Many Hong Kong investors prefer Guangdong because of the province's proximity to the colony. Others argue that better values can be found further north, where foreign investment is harder to come by. That's the approach of Victor Chu, a prominent Hong Kong investor and senior partner of the law firm Victor Chu & Co. He was one of the first Hong Kong investors to get in amid the current race to gain an investment foothold in China.

His investment of about $1 million has bought him a minority stake in a chemical factory in Jiangsu, a province near Shanghai, in partnership with a local government entity. Mr. Chu has staffed the joint venture with legal, accounting and management professionals whom he recruited in China. Their familiarity with the domestic investment climate helped facilitate negotiations, he says.

FORM NO. 75
(6–83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: March 31, 1992

NAME	ROOM NO.
Mr. Lawrence H. Summers	S-9-035
(THRU: LG Mr. Enzo Grilli)	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL	X	SIGNATURE
	NOTE AND FILE		URGENT

REMARKS:

CHINA: Country Strategy Paper

Michael Lav

FROM:	ROOM NO.:	EXTENSION:
Michael Lav	E-3-075	81941

ROUTING SLIP	Date March 31, 1992

NAME	ROOM NO.
Michael Walton	S-9-039

	URGENT		For Action/Comment		Per Your Request
	Appropriate Disposition		Information/Discard		Returned
	Approval/Clearance		Note And Return		See My E-Mail
	File	X	Per Our Conversation		Signature/Initial

RE:

REMARKS

Michael Lav

From	Room No.	Ext.
Michael Lav	E-3-075	81941

P-1862

THE WORLD BANK/IFC/MIGA
OFFICE MEMORANDUM

DATE: March 31, 1992

TO: Mr. Gautum S. Kaji

FROM: Lawrence H. Summers LS

EXTENSION: 33774

SUBJECT: CHINA - Comments on the Country Strategy Paper

1. In some important respects, recent trends in Chinese economic reforms are indeed encouraging. China certainly warrants substantial intellectual support backed by a sizeable lending program. However, I continue to have concerns about the strategy proposed in the CSP regarding two related issues: the proposed level of IBRD assistance and the pace (and extent) of enterprise reform. The CSP proposes a "base case" level of lending which would bring China to about 11-12% of the Bank's portfolio in 2000 and a "high case" for which China's DOD would be over 13% of the Bank's portfolio in that year, thereby substantially exceeding the portfolio guideline.1/ Against this, we do not yet know the outlines of a new industrial framework which could merit such support. Therefore, when and if (a) a new industrial policy framework is identified and agreed, (b) a reasonable transition is identified and agreed, and (c) government implements other essential economic policies, there would be no headroom to allow increased support. My representative raised these issues at the Bank-wide review of the CSP, and while subsequent discussion with staff have usefully clarified the issues, my concerns have not been allayed.

2. Industrial reform is the key challenge. I agree there have been productivity improvements in the state enterprise sector as a consequence of the reforms introduced in the 1980s, but these gains have lagged those outside the state enterprise sector. The losses afflicting parts of the sector are of increasing concern to both the Chinese and the Bank and could eventually undermine the overall reform effort. The CSP assumption is that an adequately improved industrial framework can be formulated and a transition to that new framework efficiently managed to warrant a maximal level of support, and for which commitment levels in the range of \$3.5-\$4.0 billion in the next few years are appropriate. However, we do not now have evidence that such a framework, short of private ownership, can be identified much less implemented; similarly, we do not know the outlines of a feasible transition for China. In this vein, the CSP candidly and appropriately speaks of targeting assistance to design the next stage of a regulatory framework, state ownership mechanisms, and industrial restructuring experiments.

1/ The projections for the Bank as a whole are based on a level of commitments and disbursements for the CIS which are quite tentative; if not achieved, China's DOD would be an even higher percentage of the total.

3. Against this uncertainty, we plan to commit resources to China that would leave little room to support any future government in the course of the mid or late 1990s which might be ready to implement a coherent program of more radical change. Rather, we would be put in the position of greeting that development with negative net transfers in "support" of the program. Do we really want to pre-empt the possibility of such increased financial support on the basis of what we know now about both government and our ability to define/implement an industrial framework?

4. The proposed scenario also leaves no room for an increased IBRD allocation to compensate for a possible shortfall in IDA 10 resources. While this undesirable possibility is far from certain, I think it is fair to ask what the Region would suggest as a reasonable response should such a shortfall materialize.

5. Given these considerations, I think it makes more sense to scrap the CSP's "high case" and to redefine the proposed "base case" as a scenario to be followed if good progress, as we can now foresee it, is made in industrial reform (and, of course, all the good things happened in trade, fiscal, and other sectors). The CSP could then be reformulated with something like the current "low case" as a more realistic base case. This would leave open the possibility of increased support in the future if events so warrant.

6. Regarding ESW, I feel that the proposed level is entirely appropriate given the magnitude and variety of the issues to be addressed. Similarly, I think it makes sense to protect technical assistance now envisaged, and, to the extent that the high case contains incremental technical assistance, to find new vehicles for such t.a. within the smaller lending programs.

cc: Messrs. Sandstrom; Burki, Yusuf, EA2DR; Thomas, EAPVP;
Grilli DPG; Walton, DECVP.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: March 11, 1992

TO: Mr. Lawrence H. Summers

FROM: Frank J. Lysy, Economic Adviser, DPG FJL

EXTENSION: 81945

SUBJECT: CHINA - Information Requested

1. Attached are three brief notes which address the three issues you requested we look at on China. The first is on possible biases in the estimates of China's per capita GNP, and was prepared by Mr. Michael Lav. It draws on the project Mr. Ramesh Chander is leading on the estimation of China's GNP. The second note discusses the three 1991 Bank projects in China, which John Nellis and Sunita Kikeri identified as providing World Bank loans to public enterprises in potentially competitive sectors (industry), but which were not linked to time-bound programs of ownership change. The third note discusses the issue of inter-provincial income inequality during the period of 1978-89.

2. You have already received the package of news clippings on China that you requested. Attached here are two further news articles that appeared this week, and which suggest China may be serious about proceeding with significant economic reforms at this time.

FJLysy:

cc: Grilli (o/r), Shilling, Lav, Nellis

Annex I
Michael Lav

China GNP

The Numbers

In brief, there are a range of estimates of China's per capita GNP. According to the Bank's Atlas methodology, $370 is the right number. An agency of the United States Gvoernment puts the number at $900[1]. Various experts have come up with correction factors of two to four times the official number as best guesses.

For comparison, the Atlas estimate puts China on a level with Pakistan, while a multiple of two would place China above Egypt ($600) and about equal to the Philippines ($760). A correction factor of three would place China at about the level of Columbia, Peru, or Syria.

The research project managed by Ramesh Chander should have some estimates in about 3 months, which promise to be a distinct improvement over existing estimates.

The Problems

1) GDP estimates:

"Real GDP" growth calculations are highly suspect. China constructs an official constant price series using a list of government prescribed prices for a base year. The implicit GDP deflator is then derived from current GDP and the official constant price series. (Current GDP is measured from surveys of prices, input/output tables, and other tools.) The bias may well be to generate estimates of GDP level and growth which are too high. Apart from inconsistent application of methodology, the methodology means that the whole exercise rests on assumptions, rather than a carefully defined benchmark.

2) generalized issues:

price controls: These generally bias GDP estimates downward, but some controlled prices (i.e. those for grains) are ceilings. Direct price controls are imposed on important components of the economy although there does not seem to be an estimate of the proportion of total GDP in the "controlled price regime". Commodities with direct price controls include grains, petroleum, cotton, soybeans, and many others. Indirect price controls are also important. However, no one seems willing to guess the level to which GDP would increase if one used market based prices for all of GDP.

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[1]Note that the CIA has produced some highly questionable GNP estimates. For example, during the 1980s, Poland's per capita GNP was estimated to be the same as Spain's.

corrections for quality: A correction for quality would probably lower the GDP estimate, although for a less industrialized China this would probably be less of a problem than it was for Eastern Europe.

exchange rate: Impact on GDP estimates unclear. The presence of foreign exchange controls including controls on purchases of the SOEs would normally suggest an overestimation of GDP, but China's combination of foreign exchange controls and a current account surplus (designed to re-build foregin exchange reserves) suggests a more careful analysis than now possible would be required.

3) sectoral issues: all the problems cited below bias reported GDP downward:

i) industry: TVEs widely report the value of output using constant prices, which is then interrpreted in the national accounts as if it had been reported in current prices. Also, new businesses in the collective sector, particularly in newer subsectors such as electronics, frequently follow the same practice.

ii) service sector activities: sparse coverage throughout the country. Particular problems include the items below.

iii) urban housing: severely undervalued, imputed rents are very low. Housing accounts for only 1% of GDP, while in other similar countries it is more normally 8-10% of GDP.

iv) governmnet services: the national accounts exclude subsidized housing, transport and other services provided for government employees.

v) enterprise supplied nonhousing services: not included in the national accounts

vi) rural services: transportation, repair shops, and other activities are severely underreported.

Annex II
Frank Lysy

China - Three World Bank Projects With Lending to Industry

1. In work done for the recent Privatization Paper, John Nellis and Sunita Kikeri screened 228 non-SAL, non-social sector, Bank and IDA projects approved in CY90, to determine how many might be affected by their recommendation that "the Bank should not lend directly to enterprises functioning in competitive or potentially competitive markets except where it can be shown that such lending will facilitate an agreed upon, time bound, program to privatize that enterprise". Of the 228 projects, 54 went to SOE's, and of these, only 12 went to enterprises in competitive or potentially competitive markets (the rest being basically to utilities). Of these 12, Nellis and Kikeri concluded that with relatively slight changes in the project formulations, 7 of the 12 would have been in line with the policy recommendation of the Privatization Paper. Of the remaining 5 projects, 3 were for China.

2. We have examined the President's Reports presented to the Board for these three projects, to determine more precisely what is being planned. The findings are interesting, although it is not clear to what extent one should generalize from just three operations. We will first describe what is being planned under these projects, and then discuss what conclusions might be drawn.

The Three Projects

3. The three operations are:

(a) Medium-Sized Cities Development Project, with a loan of \$79.4 million from the IBRD and the equivalent of \$89.0 million from IDA (a total of \$168.4 million);

(b) Henan Agricultural Development Project, with a credit of \$110 million equivalent from IDA;

(c) Shanghai Industrial Development Project, with a loan of \$150 million from the IBRD.

4. The Medium-Sized Cities Development Project is a comprehensive urban development project for three cities in China, with components in a broad range of areas, including urban planning (accounting for \$5.3 million of the Bank and IDA funds), education and health (\$21.7 million), transport (\$9.7 million), water and sewerage (\$17.0 million), housing (\$15.2 million), industrial water pollution control (\$7.2 million), and lines of credit for industry (\$55.0 million). An additional \$37.3 million of project funds would be initially unallocated, to be available for contingencies. Excluding the unallocated amounts, 42% of the project funds provided by the Bank and IDA would be for the lines of credit to industry. This industrial component "would make available sub-loans for upgrading technology in selected local enterprises on the basis of municipal strategies for industrial development". The sub-loans would be from the respective municipalities, with appraisal and

supervision of the industrial sub-loans done "on each city's behalf" by the China Investment Bank.

5. In essence, this is an urban development project, with perhaps innovative actions being planned in the area of urban planning. However, the largest single component provides credit from the municipal authorities to local industrial enterprises. There is no suggestion that this would be done in the context of any industrial sector reform program, nor would there be any ownership change.

6. The Henan Agricultural Development Project is a comprehensive agricultural development project for a specific geographical area of Henan Province. It too contains a wide range of components, including funds for irrigation and drainage ($32.2 million of foreign exchange costs, to be covered by IDA), agricultural credit to farmers ($11.4 million), livestock development ($8.1 million), aquaculture ($3.9 million), institutional support ($1.0 million), and credit to agro-industry ($20.1 million). The Henan Provincial Government would be responsible for the project, and would on-lend funds to the farmers through four county-level revolving funds, and to agroindustrial enterprises and for agroprocessing through procedures which were still to be determined when the project went to the Board.

7. This is basically a comprehensive agricultural development project, with components in a broad range of areas, but with credit to agro-industry being one of the more important in terms of project funds. There was no indication in the documentation that the funds would be provided to agro-industry in the context of any reform program, nor were ownership issues mentioned.

8. The Shanghai Industrial Development Project, in contrast to the other two, is a project centered on industrial development issues. The IBRD funds would be provided to the Shanghai Municipality, which would on-lend the funds through five participating financial institutions, to state enterprises in four specific sub-sectors in Shanghai: electronic components, precision and scientific instruments, printing machinery, and electrical apparatus. The investments financed would be in support of sub-sector restructuring plans, where there would first be an "organizational restructuring" to create "reconstituted subsector corporations, which are integrated corporations able to carry out the product and manufacturing rationalization needed in each subsector". These reconstituted subsector corporations would have the necessary authority to direct the state enterprises under them to restructure, by for example closing certain production lines. The President's Report states that "the factories are characterized by overlapping products, duplicate manufacturing processes, poor product quality, and limited marketing and distribution channels".

9. This Shanghai Industrial Development project was clearly conceived in the context of a sectoral "reform" (or at least restructuring) program. The documentation states that the Bank "has initiated a series of provincial operations [of which this would be the second] designed to assist the provincial authorities in identifying and resolving policy and enterprise reform issues in conjunction with specific subsector and enterprise-level restructuring". However, it is not at all clear that the reforms being supported are as fundamental as called for in the Privatization Paper as to

justify World Bank lending in the sector. In particular, there would not be a fundamental change in the structure of ownership through any sort of privatization. Rather, the report indicates that there would be a strengthening of subsector "corporations", which would be given the power to direct, centrally, the rationalization programs they feel are required in the subsector. This at least appears to be a move to more centralized control, rather than to decentralized private ownership. However, without a much more complete understanding of the issues in Shanghai, we are not really in a good position to second-guess the Regional staff on what should be done. Perhaps the best analogy to what would be done under this operation, is the rationalization program General Motors is now carrying out (with perhaps similar prospects for a return to profitability).

Generalizations

10. Although it is dangerous to generalize from only three projects, the review of the projects suggests a few interesting findings. First, if the focus of concern is on lending in an appropriate policy environment, then at least the Shanghai Industrial Development project makes a bow in that direction. However, it is not at all clear that the policy reforms being supported are adequate, and the lack of true ownership changes is a particular concern. This suggest the need to examine more closely the content of the "policy reform" programs that these operations support.

11. Second, in two out of the three cases, the lending to industrial enterprises operating in competitive sectors will be done through operations whose primary focus is not industry but something else: urban development and agriculture in the cases examined here. The staff teams that put together these operations were probably not overly concerned about industry or policy issues for industry. Nonetheless, a substantial portion of Bank and IDA funds in these operations would be used to support state enterprises operating in potentially competitive industrial sectors. This suggests that we should examine more closely all of the components the Bank is financing in non-industrial operations; it is not clear that the quick screening that Mr. Nellis and Ms. Kikeri were able to do necessarily picked up all of these cases. If the problem is widespread, it suggests the need for a broader review of Bank lending operations to ensure consistency with policy objectives in sectors such as industry.

Annex III
Frank Lysy

China: Inter-Provincial Income Inequality

1. There has been a substantial amount of work done on developments in inter-provincial income inequality in China, which would be impossible to summarize here. Much of it is conflicting, with opposite conclusions sometimes drawn from basically the same data. Rather, I will present some recent figures which cover the period of reform of 1978 to 1989, and then discuss what basic conclusions one might draw from it.

The Numbers

2. The following information on regional incomes and growth is drawn from (with some rearrangement) Table 1.3 of the Yellow Cover draft of the World Bank report China - Strategies for Reducing Poverty in the 1990s, dated March 4, 1992.

Region:	North	North-east	North-west	Yangtze River	South	South-west
A. Income per capita, constant 1980 yuan, national income concept						
1978	341	509	297	382	314	218
1989	771	1029	614	908	872	457
% change	126%	102%	107%	138%	178%	110%
B. Simple Rankings, from Highest to Lowest						
1978	3	1	5	2	4	6
1989	4	1	5	2	3	6
% change	3	6	5	2	1	4
C. Population in millions						
1989	242	98	128	325	96	217

The definitions of the Regions are (briefly, for full detail see the report):

(a) North: Beijing, Tianjin, Hebei, Henan, and Shandong

(b) North-east: former Manchuria

(c) North-west: Shanxi, Shaanxi, and farther west

(d) Yangtze River: Shanghai, Jiangsu, Zhejiang, and up river

(e) South: Guangdong, Fujian, and Hainan

(f) South-west: Guangxi, Sichuan, Guizhou, and Yunnan

Interpretation

3. Whether one would consider these figures as indicating increasing or decreasing regional inequality may depend in part on the implicit weighting scheme one uses. Over the eleven year period involved (which is rather short for the points at issue), the simple ranking across regions did not change much; only the regions in place 3 and 4 switched positions.

4. However, the more relevant growth story was quite different. It is interesting that the richest region (Manchuria) had the slowest rate of growth, while the most rapid growth was in the South (around Guangdong), whose per capita income placed it in the middle range among regions. The poorest regions (the North-west and South-west, i.e. the interior) did not do well in growth terms relative to the other regions; only the richest region grew more slowly, and the difference in the growth rates among these bottom three regions may not be considered significant.

5. The basic story therefore is that the middle-income regions (led by Guangdong) grew fastest over 1978-89, while the richest and poorest regions did not do so well. However, it should also be noted that even the regions with the "worst" growth saw a more than doubling of their per capita incomes over this eleven year period. They thus did significantly better, according to these figures, than most regions of the world.

6. One could easily write a book on the possible causes of these differentials in growth performance across regions in China. Furthermore, the story at the regional level only may be too aggregative; one should probably examine more closely movements in the rural-urban differential, for example. But briefly, there are two broad issues to examine: first, why did some regions grow more rapidly than others, and second, what would have been the effects of migration.

7. On the regional growth issue, it appears clear that the southern coastal areas grew most quickly due to the policies followed in those regions. They not only moved furthest from central planning, but they also were the regions most open to foreign investment (both due to central policy which dictated that foreign investment should be focussed on the coastal regions, and due to the receptive environment these regions offered foreign investment). In contrast, the richest region, Manchuria, which grew the slowest, is characterized by old industrial areas, with large state enterprises dominant and resistant to change. The poorest regions, which also grew slowly, were in the interior, and as the above cited World Bank report notes, in these areas "state pricing and procurement procedures remained relatively authoritarian". Finally, there was the explicit government policy for much of the decade which dictated that there would be a flow of raw materials and other real resources from the interior areas to the coast, with these resources provided at controlled prices which implied a real transfer to the coastal areas.

8. In a market economy with labor mobility, migration might have played a role to smooth any regional changes. However, labor mobility is severely circumscribed in China for several reasons, plus eleven years is really too short for such effects to become clear. But it should also be noted that the story above is not that the richest regions grew the fastest. Rather, it was

the middle income regions that grew the fastest. What the effect of migration might have been is therefore not fully clear.

Hard-Line Beijing Official to Step Down

By Lena H. Sun
Washington Post Foreign Service

BEIJING, March 8—China's hard-line culture minister has submitted his resignation to top Communist Party officials, apparently falling victim to a renewed struggle in the leadership between reformers and conservatives, Chinese sources said.

He Jingzhi, 67, a Communist ideologue who has called for a resurgence of politicized art, was named acting minister of culture in 1989 in the wake of the army's brutal suppression of the student-led democracy movement. The sources said He announced his intention to step down in a letter to party leaders 10 days ago and that his departure could be announced formally later this month.

He's resignation comes as party reformists, evidently with the backing of senior leader Deng Xiaoping, appear to have gained enough momentum to press for economic reforms and to play down ideological differences with the West that have been encouraged by party diehards.

"Deng is trying to show that he means business," said one Chinese political analyst. "If there is just talk [about reform], that would not be a strong enough signal. [Deng] can't rely on people like He."

Deng recently toured two special economic zones in the country's quasicapitalist south, and his laudatory remarks about the free-market boom there initially were disseminated only to government ministers. Now, however, his views on the subject have been assembled into a 10-page major policy speech, and party members and non-party members alike are being urged to study it, sources said. By spreading the message so broadly, party reform advocates apparently hope to gain as much popular support as possible.

The most widely distributed version of Deng's speech mentions no official by name, but sources said that versions available to high-ranking leaders single out He and two other officials for failing to promote economic reform. The other two men are Gao Di, who heads the People's Daily, the official party organ, and Wang Renzhi, head of the party propaganda department.

Financial Times 3/10/92

China on human rights

Premier hints at possibility of political reform

Colina MacDougall perceives a shifting of emphasis in the Chinese leader's attitudes

FOR THE FIRST first time since the 1989 Tiananmen troubles, a hint of political change has dawned in China. Li Peng, China's usually hardline premier, declared at a State Council meeting this month that economic reform should be "matched with political reform."

This follows the initiative launched by Deng Xiaoping, the country's supreme leader, to boost economic reform, which is currently sweeping the country. Deng spent time in south China and Shanghai last month praising the "open policy" and the capitalist features of the Special Economic Zones. These SEZs, set up to attract foreign investment, display economic growth far beyond that elsewhere in China.

Diplomats in Beijing said it was unlikely that Li's remarks meant he was calling for a more pluralist system. He was more probably referring to the administrative reforms China had tried to launch in the mid-1980s. But as one diplomat noted: "Once this kind of thing is on the agenda, it's likely to stray further afield, further than the leaders want it to."

Li's comments are the latest and most important sign yet of a possible victory for the reformers in China's long-running battle with the conservatives.

But the trend had already begun. Towards the end of last month even the People's Daily, for the 33 months since Tiananmen the chief mouthpiece for a tough line demanding Chinese-style socialism, switched to urging boldness and experiment.

Reports have even surfaced of the possible rehabilitation of Zhao Ziyang, the party leader dismissed because of his soft line towards the demonstrators in the Tiananmen protests.

One party insider was reported as saying that Zhao, who has been virtually under house arrest since June 1989, had recently been consulted on economic policy.

Even the hardliners seem reluctantly to have agreed that economic reform is required to maintain stability, since growing living standards mean less discontent. Deng's speeches in the SEZs of the south are now being studied throughout China, in preparation for the session of the National People's Congress, the rubber-stamp parliament, later this month.

The evaporation of Marxism-Leninism in the formerly socialist world may have something to do with this new approach. Deng was probably speaking for all worried officials when he reportedly noted in Shenzhen, the SEZ adjoining Hong Kong: "Everything can collapse very quickly if mismanaged. Did east Europe and the Soviet Union not crumble overnight?"

Deng has apparently not minced words in his battle against the conservatives for economic reform. In his speeches reportedly conveyed to the enlarged meeting of the politburo in mid-February by Jiang Zemin, the party leader and Deng protégé, he declared: "Some comrades have opposed opening up right from the start...not just once, but consistently." All this year the Hong Kong Chinese press, which often has excellent contacts inside China, has been awash with tales of disputes between him and the old guard.

The elders are fighting for more than their own positions. They plan to ensure their children will inherit power on their demise since they can probably be trusted to continue the party line.

Many hold key jobs in the hierarchy, unsurprisingly in a society where the concept of family holds sway. As the conservative patriarch Chen Yun said a few weeks ago, "the children will not pull down the monuments of their parents."

Chen Yun's son, Chen Yuan, is a vice-governor of the People's Bank of China, the central bank. Wang Zhen's son Wang Jun is a director of the key China International Trust and Investment Corporation. Deng's own children are in top positions, with a son-in-law controlling a major part of China's arms sales.

More than half the potential central committee candidates (to be elected at the forthcoming party congress) are the offspring of high-level officials, the "party of princes," as the Hong Kong Chinese press ironically calls them.

This does not mean they share the political views of their parents (foreigners who have met them believe they are more liberal than the previous generation) but they are certain to support the power of party rule since it confers privilege.

The leaders, Deng included, draw a sharp distinction between economic and genuinely political issues. But since all the previous bursts of economic reform have been followed by rising political demands, it remains to be seen whether Beijing can successfully ride the tiger.

The leader of far west China's predominantly Moslem region has announced a crackdown on worsening "sabotage and subversive activities," according to an official report, AP reports from Beijing.

Tomur Dawamat, chairman of the government of the Xinjiang Autonomous Region, voiced fears held by Chinese leaders that the break-up of the Soviet Union and independence for its former republics would encourage China's own restive minorities, most of whom live in remote, border areas. "The changeable international situation has affected and is still affecting Xinjiang's social stability," Tomur said.

Xinjiang borders the newly independent republics of Kazakhstan, Kirghizstan and Tajikistan, and many Xinjiang residents share the same culture, language and blood ties with residents across the border.

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

file

DATE: March 10, 1992

TO: Distribution

FROM: Anthony J. Ody, EA2EH

EXTENSION: 84081 82344

SUBJECT: CHINA: Country Strategy Paper (CSP) - RVP Review Meeting

1. A meeting was held under Mr. Kaji's chairmanship, on February 19, 1992, to review the above draft CSP. Attendance is listed below.

2. In his opening remarks, the chairman indicated his view that the paper could benefit from a stronger initial stocktaking of past progress with economic reform in China, which should stress the distinctive nature of the Chinese reform model. He drew attention to the fact that, within the paper's classification of low, base and high case scenarios, even the base case assumed distinct further movement in key policy areas such as enterprise reform. He also asked the meeting to consider the stance of the proposed lending program, which was clearly based on the view that, in China, the Bank's leverage was primarily of a sectoral nature. Finally he highlighted for discussion the emphases of the planned ESW program: in his own view, the recommended targeting of trade, enterprise reform and fiscal policies was an appropriate one. Mr. Burki supplemented the chairman's remarks by asking the meeting whether a sufficiently convincing case was made in the paper for China's continuing access to substantial IDA resources.

3. Picking up Mr. Burki's point, Mr. Madavo (EA1DR) wondered if the link between IDA access and performance (including on economic reforms) was adequately made. Mr. Burki responded that reform performance per se was not an IDA criterion, and the chairman reminded the meeting that China was subject to an artificial ceiling on IDA availability - on any comparison of performance the country would earn high marks. Ms. Elliott (FRM) reported on recent contacts with potential IDA donors, which indicated that a strong case for China would need to be made - this case could be strengthened, she suggested, if more explicit connections could be made between IDA availability and further progress in sectors of IDA concentration. Mr. Burki saw additional areas where the IDA case might be reinforced: the importance of China's participatory style of project design at local level, and the fact that many of those raised out of poverty in recent years were even now only barely above the poverty line - past achievements in this respect needed to be sustained. Asked by the CSP team whether the audience for the IDA case was an internal or external one, Mr. Kaji stressed the usefulness of the CSP exercise for briefing the Bank's senior management on the case to be made for China.

4. In response to questions from Ms. Lichtenstein (LEGEA) on the monitorability of further progress in key reform areas, and the explicitness with which the CSP's proposed linkage between lending and reform had been made to the Chinese authorities, Mr. Burki explained that an element of judgement was inevitable in assessing reform progress.

He added that, in discussions with China's leadership, the need for further progress in such fields as housing and social security and industrial reforms had been made very explicitly. The policy dialogue, he said, was continuing and progress could be seen.

5. Mr. Schmidt-Hebbel (CECMG) questioned whether the CSP's low case was sufficiently pessimistic: he wondered about the dangers of violent disruption or a collapse of production as seen in Eastern Europe. The paper spoke of strengthening the Central Bank (PBC) - did this include establishing the independence of monetary from fiscal policy? He also asked whether the Bank was clear on the model it supported for social security reform? Both the chairman and Mr. Burki addressed the issue of a possible "cataclysmic" downside scenario. Such a case could, in principle, be constructed for almost any borrowing country, but of what practical value would it be? Mr. Burki emphasized that such an outcome was not considered of significant probability - in his own view a new generation of leaders was now in place. On PBC independence, the CSP team accepted that an incremental approach was involved: for a more independent monetary policy to be possible, PBC must first be strengthened institutionally to be capable of managing such a policy. Drawing on the Department's recent sector report on social security reform, Mr. Burki explained that the Bank supported a model with decentralized administration, but within a centrally-established framework mandating the portability of benefits. Possible private involvement in the system was a longer-term issue.

6. Mr. Ritchie (ASTDR) found less emphasis on trade issues in this CSP than when the Bank dealt, for example, with India, and wondered why this was. Mr. Burki and the CSP team agreed that China's remarkable success in expanding its trade volume (comparable to Korea rather than India) meant that, until recently, the Bank had accorded this issue relatively low priority. However, export success should not obscure the need for more progress with import liberalization - the Department intended to give greater emphasis to trade policy in future, and this was reflected in the CSP's ESW proposals.

7. Messrs. Earwaker (FRSCR) and Lysy (DPGDR) both called attention to possible implications of the CSP's macroeconomic scenarios for China's future credit-worthiness. Mr. Earwaker believed the paper should look more closely at the effect on credit-worthiness of slower economic growth under the "low" case. Mr. Burki suggested that the best guide under such circumstances was the cautious debt management China had displayed in the past, but the chairman indicated that the paper should nonetheless address such questions more explicitly. Mr. Lysy felt that the justification (e.g. on balance of payments grounds) for fast-disbursing lending under the high case had not been established convincingly. More broadly, he considered the issue for China was less one of credit-worthiness than of burden-sharing. In the near-term, at least, the Annex Tables suggested that Bank Group lending might constitute a relatively high proportion of the total capital inflow. The CSP team agreed to re-examine the reliability of the specific data and assumptions included in the Annex. Mr. Burki in turn accepted that the case for fast-disbursing operations in China was not a strong one, and agreed with the chairman's suggestion that it needed re-consideration.

8. Mr. Kupasrimonkol (CSIDI) indicated that China needed to do more to sustain the growth of the domestic non-state enterprise sector, a point the CSP team accepted. He was also concerned about the sustainability of China's success in attracting foreign direct investment (FDI) - the country needed to move beyond low tech ventures, largely funded by overseas Chinese, but the emphasis on foreign-exchange balancing remained a constraint, and cultural restrictions on management autonomy were, in his view, a deterrent particularly for Japanese investors. The CSP team argued that the freeing-up of the parallel market in foreign exchange had done much to resolve the balancing issue, and Mr. Kupasrimonkol agreed that his remaining concerns focussed largely on the project approval stage. Mr. Yusuf (EA2DR) added that the past year had seen excellent results for FDI, which suggested that China was viewed by Japanese investors as highly attractive compared to other host countries in the region, such as Thailand, Malaysia and Indonesia.

9. In closing the meeting, Mr. Burki emphasized that the differences between the CSP's base and high cases referred largely to the speed of reform implementation rather than the depth of the changes implied. Mr. Kaji recommended that, where judgement calls on reform progress were likely to be called for, the revised CSP should clearly point up this fact.

cc and cleared w/Mr. Thomas (EAPVP)

Distribution:

Attendees: Messrs./Mmes.: Kaji, Thomas, El Maaroufi (EAPVP); Burki, Yusuf (EA2DR); Ritchie (ASTDR); Bock (OSPDR); Madavo (EA1DR); Lysy (DPGDR); Cadario, Harrold (EA2CO); Jones-Carroll (EAPCA); Lichtenstein (LEGEA); Kupasrimonkol, Wogart (IFC-Asia 1); Ezekiel, Bond (IFC-CEXSU); Elliott (FRMRO); Schmidt-Hebbel (CECMG); Earwaker (FRSCR)

cc: Messrs./Mmes.: Pearce (EA2CO); Kimura (EA2DR); Sonmez (EA2CH); Haug (EA3DR); Grilli (DPGDR); Rao (IECDR); Birdsall (CECDR); Golan (EDIDR); Wyss (CODDR); Kashiwaya (CFSVP); Nishimizu (FRSDR); Pfeffermann (CEIED); Quan (CS1DR); El-Rifai (MIGPA); Hassan (LEGEA); Raghavan (LOA); Neiss (IMF); El-Ashry (ENVDR); Hamilton (PHRDR); Petit (AGRDR); Churchill (IENDR); Pouliquen (INUDR); Lynn (PBDDR); Weigel (CEIFI)

Asia Information Center

AJOdy:ao

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: February 19, 1992 **CONFIDENTIAL** DECLASSIFIED

MAR 17 2017

WBG ARCHIVES

TO: Mr. Lawrence Summers

FROM: Frank J. Lysy, Economic Adviser, DPG FJL
(Through: EG Enzo Grilli, Director, Development Policy)

EXTENSION: 81945

SUBJECT: CHINA - Country Strategy Paper

1. I attended this morning the Vice Presidential Review Meeting (chaired by Mr. Kaji) on the draft CSP for China. Overall, the CSP was well written and reflected a well thought out strategy. There is, however, a key issue that is developing on the Bank's approach in China that you should be aware of. Mr. Grilli requested that I send a short note to you on it.

2. Shahid Javed Burki is developing and pushing the position that, in contrast to the more common (and recent) Bank view that comprehensive and relatively rapid policy reform is needed in Centrally Planned economies, China is correct in pursuing an approach of Gradualist change. This view is being developed in the CSP (for presentation to Senior Bank Management), as well as in the CEM for China that is now being drafted (where the key review meeting was held last month; Michael Lav of DPG looked at this CEM closely as one of the designated Peer Reviewers). Clearly, the outcome of this debate will be important to the size of our total lending program.

3. The issue is whether a Gradualist approach is a sustainable one. The Bank record on predicting this is unfortunately not a good one. We have in the past (in the 1970's) provided strong support to countries in Eastern Europe (in particular Yugoslavia) based on a Gradualist approach to reforming the planning system, but this has turned out to be a disaster. In hindsight, the reforms that were attempted in the countries of Eastern Europe in those years were clearly insufficient, and the economies fell apart in the 1980's. Yet at the time, many argued (as is now being done for China) that the policies being followed were appropriate or at least adequate, where the reasonably good growth record, as officially recorded, was cited. In the official accounts, the GDP of Yugoslavia grew at a rate of 5.9% per annum over 1960-70 and at a rate of 5.8% per annum over 1970-81. The exports of Yugoslavia grew at a rate of 10.1% per annum in real terms over the 1960's. By the official figures, China has also been growing rapidly.

4. It may take decades for problems of a similar nature to appear in China, particularly as it is starting as a relatively low income country where agriculture (not industry) is the leading sector. There are also many important differences between the approach being followed in China and that which was followed in Eastern Europe. But if the path being followed by China is not a sustainable one, then the Bank will be facing a failure in a country that not only accounts for one-

fourth of mankind, but which by then might account for 10% of the IBRD portfolio and billions of dollars of IDA funds.

5. The basic operational issue at this stage, although somewhat simplistic, is whether the reforms the Region is proposing as justifying a High Case lending program, should in fact be required for a Base Case of Bank activity. These reforms include:

(a) An accelerated move to unified, market-determined, pricing of basic commodities, in contrast to the current system of a dual pricing system for these goods (a low official price and a flexible private price);

(b) Liberalization of the import regime, so as to expose domestic firms to international competition; and

(c) A more level playing field between state enterprises (which receive subsidies from the budget and preferential access to credit), and non-state enterprises.

6. It would appear to us that such reforms will be absolutely necessary for the system to be sustainable. Others at the meeting, in particular the representatives of the IFC, also took this view. We will have to see in the next draft of the CSP to what extent the Region modifies their position in response to the discussion at the meeting (I doubt it will be by much). These issues are likely to arise again at the next level of review, which will be with the Office of the President. You may wish to intervene beforehand with a note to Mr. Burki.

FJLysy:

cc: Walton, Lav

1 ·rld Bank/IFC/MIGA
O . . I C E M E M O R A N D U M

DATE: November 20, 1991 12:10pm

TO: Anthony Ody (ANTHONY ODY)
TO: Peter Harrold (PETER HARROLD)

FROM: Gerardo Sicat, EAS (GERARDO SICAT)

EXT.: 81943

SUBJECT: CHINA -- 1991 CSP Draft

As a preface, I think that the CSP draft covers the ground very well. The following comments on the draft CSP therefore are designed largely to clarify points or to provoke a constructive response to issues that are important.

Uncertainties resulting from noneconomic factors which could affect reforms. I do not think that the uncertainties facing China in the medium- term are fully discussed. This might be for a tactical reason. These uncertainties present certain important contingencies that need to be addressed directly. For instance, I can think of two objective factors that are faced by China presently:

(a) the elder leaders from which much leadership directions continue to be received would, at one time or other, suddenly or in the foreseeable future, make way for the next cadre of leaders. Even though it might be useful to assume that the present thinking could prevail, the uncertainty must be dealt with in a CSP.

(b) the fast political and economic changes in the Soviet Union and the rest of the communist economic systems elsewhere would have some impact on China's directions. Even though the present leadership might prefer to be insulated from these developments, they would have a likely impact nonetheless.

Pace/ content/ and/ or objective of reforms. The CSP makes a clear case in favor of the present objectives of reforms. This is discussed in paras. 25 to 28. The success of the China reforms of the last decade, based on this gradualism, happened during a period in the international environment when China was the only central planning economy undertaking any credible reforms. Hence China's success flourished under a supportive international environment -- although this should not detract from the successful management of the changes under the country's leadership. The situation is the reverse at this point in time. Today, all the other socialist economies are undertaking major reforms in their economies, and China -- from this standpoint -- has become the conservative vanguard. As a result of this changed international environment, it might prove more difficult to gain new markets -- not only because of competition -- but more so because some barriers could be erected which would affect market access. It would therefore be useful to have an assessment of how this change in the international environment would affect the strategy of gradualist reform.

Economic scenarios. How sensitive are the economic scenarios to the uncertainties mentioned above? Does this alter the base case, or does it make it less likely to occur than alternative scenarions? The issue here is whether the base case assumptions are realistic in terms of the projections of growth and financing requirements, whether the upper and lower bounds of financing requirements are robust. Public and private sources of financing might not respond in the same way to any change in perceptions about conditions in China. Probably, the same could be said of multilateral and bilateral sources.

Bank strategy: lending scenariosfor FY93-97. The core program -- or the low case lending scenario -- contains 57 operations for a total amount of \$10.2 billion; the base case, 77 operations for \$14.7 billion; and the high case, 84 operations for \$16.8 billion. The core program is about 61 percent of the high case scenario in terms of volume of anticipated lending. The following are issues that come to mind --

(a) Whether the core program is really the true core program. From para. 43, it appears that there is a core program which is a subset of what is proposed. All the three scenarios assume that China would continue to remain creditworthy. A true test of the core program -- or something close to it -- would be a lending scenario close to what had been the case during the uncertain period between 1989-1991.

(b) Whether the proposed IDA blend in the base case is consistent with the anticipated allocation of that resource, in view of new countries that could qualify for support under IDA and of traditional countries adopting strong programs (India?).

(c) Composition of lending. The priorities enunciated in the draft -- for instance the proposed greater attention to poverty and the social sectors is welcome. It would be useful to get some indications of how much would be the mix of lending vis a vis the productive sectors. It would depend on the volume and role of financing from other donors, especially if they would leave certain gaps in investments in productive sectors. Another issue is the possibility of adjustment lending; is this planned in the the higher case lending scenarios? These are not discussed explicitly, although there are hints to the effect that some adjustment lending would be proposed.

ESW. The economic and sector work is fairly tight and the priorities reflect in part the past composition of ESW efforts. Two questions may be asked: (a) Is there a need to tilt the balance between policy advice and more basic studies at this point? (b) Population. Recent analysis indicates the China's population is undercounted. There is no mention of population in the ESW plans as presented in the annex. Are there any planned on the subject?

CC:	David Pearce	(DAVID PEARCE)
CC:	Shahid Javed Burki	(SHAHID JAVED BURKI)
CC:	Enzo Grilli	(ENZO GRILLI)

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: November 12, 1991

TO: Distribution

FROM: David Pearce, Chief, AS3CO

EXTENSION: 82350

SUBJECT: CHINA: 1991 Country Strategy Paper - Preliminary Draft

The Working Level Review of the attached paper will be held under Mr. Burki's chairmanship at 10:00 a.m. on Thursday, November 21 in Room A-8063. Comments or questions may be directed to Anthony Ody (A-8029, ext. 82340) or Peter Harrold (A-8033, ext. 82341).

Attachment

Distribution:

cc: M/M Kaji (AS2DR); Karaosmanoglu, Thomas, Agarwala, Johansen, Schaeffer, Sud (ASIVP); Jones-Carroll (ASICA); Burki, Yusuf, Kimura, Walsh (AS3DR); Goldberg (2), Kafka (2), Ahmad (2), Ecevit (2), Sonmez (2) (AS3); Ritchie (ASTDR); Davis (ASTEN); Grilli, Lysy (EAS); Wyss (COD); Kashiwaya (3) (CFSVP); Isenman, Liebenthal (PRD); de Tray (DECVP); Rao (IEC); Stoutjesdijk, Kilby (FRS); Pfeffermann (CEI); Quan, Kupasrimonkol (CS1DR); Weigel (FIAS); Hollywood, El-Rifai (MIGPA); Vorkink (LEGAS); Hwang (LOAAS); Wang (IMF); El-Ashry (ENVDR); Hamilton (PHRDR); Petit (AGRDR); Churchill (IENDR); Pouliquen (INUDR); Linn (CECDR); Lynn (PBDDR)

AS3CO HL Staff
Asia Information Center

AOdy:ef

Grilli

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CHINA - Country Strategy Paper

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A. Background and Historical Perspective

1. Since the last CSP was reviewed by the President's Council in September 1988 (and bearing out that paper's warning on incipient overheating), China went through a period of macroeconomic instability more severe than the two experienced earlier in its reform decade. The second half of 1988 was characterized by a rapid upsurge in urban inflation, at its peak approaching 80% on an annualized basis. Publicly announced plans to decontrol prices of most major commodities helped trigger panic buying and were almost immediately overtaken by the adoption of an economic stabilization and retrenchment program. With the benefit of hindsight, this may have been a critical precursor of the upheaval that culminated in the events of June 3-4, 1989 in Beijing. In the immediate aftermath of Tiananmen, China's leaders were to be almost wholly preoccupied with efforts to restore and maintain political, social and economic stability.

2. By early 1990, the economy had largely stabilized, thanks to the dramatic effectiveness of the steps taken, comprising determined administrative measures, including credit rationing, as well as significant use by China's central bank, the People's Bank of China (PBC), of indirect levers such as higher interest rates (see China - Between Plan and Market, the 1990 CEM). In the meanwhile, however, the authorities had felt obliged to place the implementation of many reforms on hold in the immediate interests of macroeconomic and political stability.

3. Although on the surface, and taking a short-term perspective, economic management over the last three years may be considered satisfactory, deep-seated structural problems remain to be adequately addressed (see Section B). There are also more recent signs (though not at this stage unambiguous) that the economy may again face overheating and could head towards another stop-go cycle. The past year has not been devoid of reform measures, including major price adjustments for food and transport, continued experiments with fiscal and enterprise reform and a rationalization of trade practices to eliminate central subsidization of exports. Recent statements by prominent leaders have also reemphasized the authorities' continuing support for overall reform and the "open door". Nonetheless, the priority still given to stability, the renewed, if temporary, influence of China's elderly and more conservative leaders, the unknown attitudes and role of the armed forces and Beijing's sensitivity to the potential for further economic and social distress all suggest that current uncertainty about the depth of commitment to and likely pace of reform in China may continue for some time.

retrenchment /recentralization

4. Utilization of Bank assistance. Despite the dislocation of our lending commitments over 1989-90, and their own need to focus on short-term concerns, the Bank's ESW has continued to command serious attention among senior policy-makers in Beijing. In some instances a major report has helped to crystallize the terms of the internal debate, in other cases it is sustained work over a number of years that more gradually influences the current of domestic thinking. In the financial sphere, our messages on the need to strengthen PBC, control credit more effectively and reinforce the institutional, accounting and regulatory framework of

the banking sector are being taken actively on board (and are expected to be operationalized in part through future lending). On the fiscal side, we have continued to help the Government explore alternatives to the prevailing tax contracting system between different levels: no fundamental change is imminent but reform experiments are now underway in rationalizing tax structures and revenue assignment. Though the record on price reform is still uneven, our sustained emphasis on tariff reform for power and railways (two sectors of major operational involvement) has gradually gained ground, and the Government now appears increasingly serious about further reforms of energy prices and grain pricing and marketing. Our work on the reform of housing and social security provision - increasingly recognized as a precondition for fundamental reform of State enterprises - has also received attention, and may be followed up by operational support for innovative local programs. Finally, recent sector work in the health and education fields has exposed current policy choices to objective analysis informed by international parallels, though as practical policy-making in these sectors now largely takes place at lower levels of the system, it is as yet too early to assess the ultimate impact of our recommendations.

5. Supervision ratings of China's overall effectiveness in the implementation of Bank projects dipped markedly in FY90, in part reflecting stresses caused by the austerity program. FY91 showed some recovery, however, and the absolute ratings have continued throughout to be very substantially superior to either Bank-wide or regional averages (an assessment essentially confirmed by PCR/Project Audit findings to date). Perhaps equally striking, in a program of this size, is the consistency of the portfolio quality: only 4 percent of Chinese projects are currently assessed as exhibiting major problems. Achievement of development objectives and compliance with legal covenants continue to be rated particularly highly, and earlier delays with procurement have been addressed by streamlining procedures, with some success. Areas of comparative weakness, where further emphasis will be needed, include progress with training and technical assistance components. More broadly, the supervision burden can be expected to intensify further as the portfolio matures, the reform objectives of operations become more ambitious and implementation responsibilities within China continue to be decentralized. A PCR recently completed for the Department's only policy-based loan to date, the Rural Sector Adjustment Loan, concludes that, while less progress was achieved on key policy aspects during the disbursement period than projected (e.g. reform of grain pricing and marketing), reflecting the authorities' preoccupation with stability and the containment of inflation, the pace of rural reform shows more recent signs of revival.

6. Relations with Other Sources of Finance. China has made no use of IMF lending since a one year standby arrangement agreed in 1986. The most recent Article IV consultation took note of the country's maintenance of a multiple exchange rate system and exchange restrictions and urged reform of these arrangements: the Government has confirmed its intention to unify the official and parallel rates, and differentials have indeed narrowed substantially. Bank and Fund staff frequently participate in each others' missions, and are co-operating particularly closely on monitoring macroeconomic developments and designing measures to strengthen PBC. Other multilateral and bilateral sources of funding, including the Asian Development Bank (ADB), have generally looked to the Bank for leadership in overall relations

with China: most followed our example in suspending new commitments immediately following June 1989, most have subsequently followed our lead in resuming active lending. China continues to be seen as creditworthy by the commercial banks, although the exceptionally low margins above LIBOR previously available were marked up to more normal levels (comparable to other East Asian borrowers) in the aftermath of June 1989. Disputes over responsibility for guaranteeing various commercial loans, mostly incurred in 1985-86, are progressively being cleared up. There remains, however, some lack of transparency over the definition of sovereign debt, which needs clarification if similar misunderstandings are to be avoided in future.

B. Development Issues and Policy Agenda

7. At the time of the last CSP, China was rapidly slipping into a serious bout of inflation, caused by overheating and an inappropriate macroeconomic policy stance. Overcoming inflation became the priority economic goal during 1989-90, and it was not until mid-1990 that serious attention began to be given once more to medium term reform and development issues. Since mid-1990, the economy has been growing quite rapidly, at annual rates around 7%, and, despite credit growth of over 20% p.a., without any significant resurgence of inflation to date, although the possibility remains a major concern.

8. Thus, with the economy in recovery (and with international relations also returning to normal), the Chinese authorities were able to approve the formulation of the Eighth Five Year Plan for 1991-95 (8FYP) with a fresh approach. This differs from earlier plans inasmuch as it focuses on overall development strategy and reform issues, rather than on detailed physical targets as in the past. It thus forms a useful backdrop against which to address these issues in a CSP context.

9. Development Strategy and Constraints. The past decade has seen a very high growth performance (+/- 9% p.a.) with emphasis on rapid development in coastal provinces. It also saw an initial period of rapid productivity growth in agriculture (1980-84), which helped to generate very high national savings rates and create investment resources to finance the subsequent rapid growth of industry, especially in rural areas (1985-88). It can be expected that the next decade will see a qualitatively different development path, with four particular characteristics:

(a) a relatively slower overall pace of economic growth, at an average 6% p.a., in part reflecting a conscious attempt to avoid the stop-go cycles of the 1980s;

(b) in coastal and urban areas, the service sectors becoming the largest source of growth, especially in financial, transport, and information services;

(c) relatively higher growth in interior provinces, especially in the processing of raw materials and food industries (encouraged in part by the regional impact of further price reform for basic commodities); and

(d) in the coastal areas, an adjustment of the industrial structure in the light of (b) and (c).

10. While China's comparative advantage will remain in the labor-intensive, lower value products in which its export industry has excelled in recent years (garments, shoes, toys), the continued modernization and increased sophistication of the industrial sector should permit the country to compete internationally across a wide range of industries, most notably in consumer electronics, machine tools and light machinery, and transport equipment. At the same time, the external environment facing China's exports in the 1990s is not without its share of uncertainties, including likely slower overall trade growth, trends in protectionism and the possibility of political discrimination against Chinese products.

11. The constraints to China's development do not come from the typical sources, such as lack of savings, natural resource depletion or inability to borrow. Rather, constraints come from two sources: infrastructure bottlenecks and the policy framework. With respect to the former, the rapid pace of industrialization in the latter half of the 1980s put severe strains on the energy and transport sectors. Unless these two areas in particular receive the attention they deserve, they will serve increasingly to slow the aggregate pace of development. It is for this reason that the Government's investment program -- and the Bank's lending program -- put considerable emphasis on these two sectors. At the same time, inefficiency of resource utilization, especially for energy, continues to be a serious problem for China, which needs to be addressed through more appropriate pricing policies as well as specific energy-saving investments, especially in heavy industry.

12. The second source of constraints comes from the policy framework. This is in two respects: whether appropriate macroeconomic reforms will be instituted, so that growth can continue at a rapid pace, but without the recurrence of such serious economic cycles; and whether additional policy reforms will be instituted to encourage further efficiency gains and improve resource allocation in the economy, especially in the State-owned Enterprises.

13. Policy Issues and Agenda. The reform agenda is wide-ranging and is aimed at creating by the year 2000 what China calls a 'socialist commodity economy', which would combine market determination of prices and most investment decision-making, with a strong public ownership function and central regulation of markets. The following paragraphs review the Government's intentions in key policy areas.

14. The financial sector has seen little significant progress in the last three years, and Government influence over lending by the banking system continues to be pervasive. The Government has stated its intention of strengthening the central bank's supervisory and

regulatory capability, and of separating more clearly directed policy lending from commercial lending in the banking system. Particular attention is being given to capital market development.

15. Fiscal management and tax policy are scheduled for reform only in the second half of the decade, following a number of reform experiments in the present plan period. These experiments are in two areas: in new arrangements for the separation of taxes and profits, and in separating the tax system from the enterprise contract system, so as to introduce more uniform effective tax rates. Essentially, the latter involves converting the contracts to an after-tax basis. At the same time, the central budget deficit has been the leading source of pressure in recent months for price reform (and has also forced the authorities to start thinking seriously about the future of loss-making State enterprises).

16. In terms of planning reforms, the stated goal is to continue to reduce the role of the State in the direct management of the economy, and to focus instead on management by indirect levers. In particular, this means reduction of the State's role in fixing prices and allocating resources administratively, with markets taking over these functions. No specific targets have been identified in this regard.

17. Aside from these three key areas of macroeconomic management, there is a range of key policy issues within the incentive system. Enterprise reform remains at the heart of this, and policies towards the State-owned Enterprises (SOEs) are the nexus of most of the major issues. The Government now recognizes that this remains the least satisfactory sector of the economy, and the policy area where least progress has been made. While maintaining public ownership, the Government continues to look for ways to separate ownership and management more effectively and harden currently soft budget constraints, so as to create more efficient and dynamic SOEs. The two main routes to this are the separation from the enterprises of their welfare functions -- in housing, pensions, health and (over)employment -- and the merging of currently weak and strong enterprises into enterprise groups. The latter is seen as the preferred route to the restructuring of poorly performing enterprises, while the former is seen removing the major constraint to such restructuring.

18. Non-State enterprises, especially township and village enterprises, are seen as having a continued significant role to play, especially in employment creation, but not necessarily as a source of competition to the SOEs.

19. Price reform continues to be an area to which major Government attention is being given, with a noticeable increase in such attention of late. In particular, Government is working to adjust the most heavily distorted prices -- for energy, transport and grain -- and to convert price subsidies into wages. After the major distortions are corrected, there would then be scope for greater market determination of prices, although clearly the former will be the major focus of activity in the short term.

20. External sector reforms are not high on the Government's agenda at present. This said, major attention continues to be paid to the role of foreign investment, and of the Special

Economic Zones and Development Areas, such as Pudong in Shanghai, as sources of capital, technology and management expertise. However, after the reforms of January 1991, which evened export incentives across sectors and provinces, little further is scheduled in trade reform, and specifically no import liberalization is at present on the cards.

21. The Bank's Dialogue with the Government. The Bank continues to have a very strong and active dialogue with the Government on major policy issues, and, as will be seen (Section D), these are being brought increasingly into the lending arena. There is a broad consensus between the Bank and the Government on the overall shape of reforms, but there are three particular areas where we consider that more effort is needed: the financial sector; SOE ownership reform; and price reform. As will be seen later, it is in these three areas that we are proposing lending operations to support a deepening of reforms, with such lending to be incremental and contingent on significant progress.

22. In the financial sector we remain very concerned about the level of directed lending, the weak ability of the central bank in supervising and regulating the financial system, and the resulting deterioration (albeit unquantified) in the banks' portfolios. The major areas where reform intentions seem to be inadequate are in the creation of independent commercial banks, and in the associated increased role of the interest rate. This will inter alia require innovative approaches to the financing of the Government's investment programs (e.g. separating infrastructure financing from commercial banking through separate investment corporations or funds, and/or expanded use of bonds).

23. Ownership reform has been simultaneously the scene of great success and of failure. The great success has come in the remarkable growth of the non-State sector in the past ten years, and we hope and expect this will continue to expand. The failure, as noted, has been in the SOEs, whose losses help drain the budget and whose appetite for credit imperils the solvency of the banks. We have urged the rapid removal of constraints to SOE reform, in particular through housing and social security reforms, and the development of new institutional mechanisms to separate Government from the day-to-day operations of enterprises. In addition, we have urged the Government to facilitate and encourage the role of non-State enterprises as a source of competition with the SOEs.

24. On price reform Government is now responding to our repeated emphasis on the priority of this area. However, while price adjustments, especially for grain and energy, will remove many of the most serious distortions, the Government has been much less clear on increasing the role of markets. This is of particular relevance in agriculture, where we have urged a much greater role for markets, especially in the grain sector, while recognizing that the development of such markets will, to be efficient, require substantial investments in infrastructure, such as storage and distribution facilities.

25. The Pace of Reform: the "Gradualist" Approach. China has adopted a 'gradualist' pace of reform: "feeling the stones to cross the river" instead of "crossing the chasm in one leap". This is a system based on reform experimentation prior to generalization, and of

implementing reforms on an ad hoc basis when the timing seems prudent, convenient or necessary (especially, of late, as a response to fiscal pressures), rather than on a specific pre-announced timetable.[1] While some steps are being taken to articulate the overall program more clearly, there is no intention to deviate from past patterns significantly.

26. The case for gradualism in China is based on two arguments. First, the success of China's reform program over the last thirteen years is not in dispute. Indeed, until its reputation became tarnished by the events of 1989, it was being hailed as the model for other reforming socialist economies to emulate. There is no reason to doubt that there exists further scope for incremental gains to be made in terms of efficiency improvements as a result of additional reforms. Thus the success of the past lends support to the view that this strategy of reform suits China.

27. The second reason concerns the desired end result of reforms. China is not trying to create a western, market economy. It is not trying to eradicate the vestiges of the socialist system. Instead, it is trying to introduce reforms and new institutional mechanisms to modernize and increase the efficiency of the socialist system, which includes a very significant role for markets in resource allocation and for the private (or non-State) sector. However, this implies that it is not desired (or necessary) to tear down old systems, and it also implies that the reform design will continue to evolve, as China is operating in areas not yet fully designed or tested, especially in terms of institutional development. In this context, talk of 'shock therapy' for China makes little sense, for there is no clear idea of what the new institutions would be like, nor is it apparent what disease such therapy would be designed to cure.

28. This does not mean that the Bank has no argument with the specifics of the reform program, or the pace at which it is proceeding (paras. 21-24). What it does mean is that we accept that a gradualist approach has worked in the past and continues to be appropriate for China.

C. Macroeconomic Prospects, Creditworthiness and External Capital Requirements[2]

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[1] China's experience in 1988 with the destabilizing impact of "announcement" effects for future price increases (para. 1) has helped strengthen an innate caution in this area. It also emphasizes the point that it is the capacity of the urban population to absorb the consequences of reform that is the chief determinant of the politically substainable rate of change.

[2] It should be noted that these projections relate only to the present People's Republic of China (PRC) and we do not make any adjustment for the change in Hong Kong's status in 1997, assuming that debt would continue to be treated separately for the PRC and the Hong Kong S.A.R..

29. Macroeconomic Prospects. We consider China's macroeconomic prospects under three scenarios, which differ as a matter of degree rather than in terms of substantially different assumptions. The base case assumes a moderate, steady pace of reform over the decade, roughly in line with the current policy pronouncements and plans of the Government. The high case assumes that the pace of reform quickens in the next year or so, with consequent gains in efficiency. The low case, by contrast, assumes a repetition of the economic cycles of the 1980s, with associated reform cycles. In each case, however, we see a strong growth performance and continued creditworthiness. The key distinctions between the cases are in the degree of efficiency improvement, and consequently in the level of welfare.

30. The base case projects that growth will average the Government target of 6% per annum, with slightly higher average rates in the second half of the decade than in the first. The present reform strategy calls for an acceleration of policy change in the second half of the decade, and this is reflected in a gradually falling ICOR over the period, from 6.5 to 5.5, with the associated necessary rate of investment falling from 39% of GDP in 1990, to 36% by the end of the decade. Inflation control is assumed to remain a priority for the Government -- hence the lower rate of growth than in the 1980s -- and inflation is expected to be in the 5-6% range over the period. Any sign of a return to double-digit inflation is expected to generate the firm policy response witnessed in 1988-89. The composition of growth is, however, expected to be somewhat different than in the recent past. Industry is expected to show more moderate growth, at about 5% in GDP terms, while the service sectors, and especially transport, finance and information services, are expected to be the leading source of growth, at around 9% per annum.

31. The external sector is also projected to continue to expand its role in the economy, with both exports and imports growing faster than GDP. The export (volume) growth rate is set at about 7.5%, while we project a rapid growth of imports for a year or two, to eliminate the present trade surplus, and thereafter growth at about 8%. The strong emphasis on technical modernization in the development strategy is expected to be reflected particularly in higher capital goods imports, which we expect to grow at about 10% a year. Nevertheless, the current account deficit is not expected to exceed 2% of GDP, keeping debt within manageable levels (para. 37).

32. The downside scenario assumes less progress in reform, and a repeat of the stop-go cycles of the 1980s. It is not expected that this would have a very severe impact on the average growth rate -- even in 1989, at the height of the austerity program, GDP grew by 3.9% -- but rather it would be reflected in three things: a higher ICOR, and thus a significantly lower rate of consumption growth; a higher average inflation rate, nearer to 10% per annum on average, because of the high rates during the "booms"; and a lower rate of foreign direct investment, because of the economic instability. This would raise debt ratios slightly, though still not seriously. The downside risk that we have not attempted to model explicitly is that of a serious deterioration in export markets, and specifically the removal of MFN status for China in the United States. This is for two reasons: first, the probability of this occurring is still judged to be relatively low based on the experience of the last two years; second, and more importantly,

we consider that the impact of such a step would be felt primarily through a reduction in the capital goods' import level in China, and thus in the pace of modernization, rather than in creditworthiness indicators, as China would be sure to react to such an event with tightened import restrictions to stabilize the overall external account.

33. The high case assumes a much more aggressive attack on reform issues, commencing in the next year or so. This would have three primary effects: GDP would rise by an average of about 7% a year in response to efficiency gains (experience has shown that reforms launched in periods of macroeconomic stability have a strong growth effect as people respond to the new incentives); more products would become export-competitive, raising average trade levels; and in response to these reforms, foreign direct investment would rise more rapidly, and this would reduce debt service levels.

34. External Financing Requirements. The external financing requirements of the three cases are presented in Annex A-1. The current account position is expected to continue to be a policy variable for the Chinese Government, and thus we do not project very different results under the three scenarios. It is assumed that the 1990 surplus of US$12 billion will be eliminated by the end of 1992. Imports are growing at present at an annual rate of over 20% (with exports at about 14%), and the experience of 1988 suggests that the response to removal of import restraints will be maintained at this sort of pace for some time. We also assume that there will no longer be a desire to continue to build up reserves, and that these will slowly fall in relative terms to about 4 months' imports from the abnormally high present 7.5 months. The deficit is therefore projected to expand gradually over the decade, reaching a level of US$10 billion in 1995 (1.8% of GDP), and US$12 billion in the year 2000 (1.4% of GDP).

35. With only very small additions to the absolute level of reserves, the net external financing requirement would barely exceed this deficit. In the base, about US$3 billion (net) of this amount is expected on average to come from foreign direct investment, which is the present level, and thus the external financing requirement is about US$6 billion per annum on average over the course of the decade. This is lower in real terms than the average level of net borrowing during the 1980s, which was about US$5 billion per annum. The distribution of such borrowing between official and private sources is expected to be slightly more favorable to China than in the last decade, as more and larger sources of official financing are now available, notably already committed additional Japanese credits, and access to ADB ordinary resources, expected to rise to US$1 billion per annum on a commitment basis by 1993. Thus, just over half of the external financing requirement is expected to come from official sources, and the balance from private sources, compared with the 40-60 split to date.

36. The only significant difference between the base case and the alternative scenarios in this regard relates to the level of FDI, since the current account is judged to be about the same in all three cases. In the higher scenario, FDI would rise to about US$4 billion per annum, while in the low case it would be about US$ 2 billion, the lowest it has been in the recent past. The balance would be made up by commercial borrowing, with consequent marginal improvement/worsening of debt ratios. However, given China's expected continued

creditworthiness, such borrowing would all continue to be on a voluntary basis, and debt rescheduling is projected to be neither necessary nor sought by the Government.

37. Creditworthiness. Under all three of our scenarios China would continue to enjoy a strong creditworthiness position, with all indicators remaining very good. Total debt outstanding stood at only 14.4% of GDP in 1990, and under our base scenario, this would **fall** to 13% in the year 2000, and stay between these two levels throughout the decade. Even in the low case, debt would stay well below 20% of GDP, and would be only 12% in the high case. The associated debt service levels also remain healthy, at a peak of 13.2% of export earnings in 1992, falling to 10.4% in 1995 and only 8.4% in the year 2000. However, even with these modest indicators, it should be emphasized that in a different sense they cannot be regarded as conservative, in that the absolute level of debt would double over the decade to US$121 billion in the year 2000, placing China among the ranks of the most highly indebted developing countries in absolute terms, and implying that China would account for a substantial proportion of total new net debt to developing countries over the decade. The exposure of the Bank under alternative scenarios is evaluated in para. 45 below.

D. Bank Assistance Strategy

38. Our overriding mandate in China, as in all borrowing countries, is to support broad-based economic development and to combat poverty. Our previous CSP, processed in 1988, argued that the country was then only beginning to approach its long-term equilibrium status as a leading client of the institution. That process, interrupted in the event by exogenous factors, is now resuming and the arguments then adduced - China's size, income levels, dynamism and creditworthiness - continue to create a prima facie case for a program of effective support at least comparable in absolute size to that provided to any other borrowing member. Even the highest lending scenarios we will present will, however, involve relative (per capita) assistance levels substantially lower than those enjoyed by most other borrowers from the Bank Group.

39. An effective program of development assistance for China must seek to balance needs for help with policy and institutional reform, technological modernization, infrastructural strengthening, environmental protection and poverty alleviation. Our point of departure is that, provided overall and sectoral policies are seen as conducive to development, these needs justify a program which is both substantial in size by our own institutional standards, and also sectorally and geographically broad-based. Even such a program, however, will not be able to meet all possible needs in all parts of China. Building on recent trends, we propose the following broad principles to guide the sectoral and geographic focus of our future work:

(a) Support for industrial and urban reform (including urban environmental lending) will be concentrated primarily along the coast, to the extent that (and as long as) this region continues to be at the frontiers of reform and experimentation in these sectors;

(b) Assistance for social sector development (education, health) will be concentrated primarily in poorer rural areas, mostly in the interior, where achieving and maintaining minimum acceptable standards is most at risk. A substantial share of the agricultural portfolio will also be used to address the interrelated problems of rural poverty and environmental degradation in the most vulnerable areas of the hinterland; and

(c) Selection of investments in basic infrastructure will be based upon increasingly systematic evaluation of strategic priorities on a nation-wide basis.

The principles outlined above - especially (b) - do not always command support among our working level counterparts, whose emphasis is frequently on narrowly-defined repayment considerations. Explicit management support is sought for the proposed poverty/environmental focus in the social sectors and agriculture.

40. We present in Annex D a proposed three-year ESW program which would build upon and deepen the achievements of the past three years. In keeping with the priorities set out in Section B above, the program places significant emphasis on issues of industrial reform and restructuring, as well as on regional integration and relations between different levels of Government. Compared to recent years, it will also involve more explicit focus on trade development issues. Proposed sector-specific studies are reviewed in more detail in the sector strategies outlined below (paras. 46-68).

41. In Annex C we present our proposals for lending. In view of the uncertainties which currently surround the future depth and pace of reform, we propose to link our aggregate lending volume more explicitly than in the previous CSP to the effectiveness with which reform is pursued in the most sensitive sectors, and - to indicate the range of outcomes at present contemplated - have prepared three indicative lending scenarios for the five years FY93-97. These three scenarios, in turn, may be considered roughly comparable to the three macroeconomic outcomes modelled in Section C above. The base scenario assumes that the Government effectively delivers the range of reforms and policy experiments it is currently committed to or has clearly foreshadowed. Inter alia, such a program would, in its early years, include:

(a) measures to strengthen the regulatory, supervisory and accounting environment for the financial sector; the initiation of portfolio audits for the major banks and subsequent effective steps, as needed, to ensure their financial soundness and stability; and progress in addressing issues raised by directed credit;

(b) an environment conducive to national and regional experiments with new forms of corporate governance (e.g. Boards of Directors, joint-stock companies) and the active pursuit of meaningful industrial restructuring;

(c) support for effective reforms to divest provision of social security and housing from productive enterprises; and

(d) reform of producer and consumer pricing and marketing of basic foodstuffs.

42. Meeting these requirements would permit us to provide policy-linked investment support in the four reform-sensitive areas cited above: respectively, finance, industry, housing/social security and grain distribution, in addition to our "core" program of support for agriculture, social sectors, environment and basic infrastructure. On this basis, the base lending program over five years would amount to about 77 operations totalling some US$14.7 billion (of which, an assumed US$4.8 billion equivalent in IDA). Failure to meet the minimum reform conditionality in any one of the four areas would result in that sector dropping out of the program: the resources involved would not be considered fungible to other sectors.

43. The low or "core" program presented assumes much less progress with reform than currently appears foreshadowed - it might correspond to the comparative policy stagnation that has affected the country when past stop-go cycles have got out of hand. This scenario is itself illustrative, rather than a minimum program to be guaranteed under any circumstances - it is possible to conjecture conditions (however unlikely) under which lending would be even below this "core" (e.g. serious deterioration in the financial standing of public utilities, attempted reversal of household production responsibility reforms in agriculture). Under the "core" case, total lending would be cut back to some US$10.2 billion (57 operations), with IDA also cut (though less than proportionately in view of its social emphasis) to US$3.4 billion.

44. The high case assumes a bolder program of reforms than currently envisaged, and - unlike the other two scenarios - introduces the possibility of policy-based lending per se. Examples of the kind of reforms which could unlock lending above the base case would include: an accelerated move towards unified, market-determined pricing for basic commodities; measures to liberalize import restrictions to expand competition in the domestic economy; or moves towards a truly level playing field as between State and non-State enterprises (collective and private firms). Again, this scenario should be considered illustrative rather than an absolute ceiling. It assumes total lending of US$16.8 billion (84 operations) with all of the increase over the base case on IBRD terms.

45. Bank Exposure. The implications of the proposed three lending program scenarios for Bank exposure have been evaluated under the three comparable macroeconomic scenarios presented in Section C above. Under all three scenarios, Bank guidelines would be adhered to, although, under the high scenario, the share of IBRD debt in total public debt would increase substantially. Nevertheless, as the table below indicates, the indicators will all remain well within manageable levels for some time to come.

Table 1: **Creditworthiness Indicators, 1991-2000**
(percent)

	Base			High			Guideline
	91	'95	'00	'91	'95	'00	
IBRD DS/Exports	0.5	0.7	1.2	0.5	0.7	1.2	**5.5**
IBRD DS/Public DS	4.9	8.7	16.2	4.9	8.7	17.5	**20.0**
Prfd Cred DS/Pub DS	13.0	15.8	19.0	13.2	15.8	19.1	**35.0**

DS = Debt service DOD = Debt outstanding and disbursed

Sector Assistance Strategies: Proposed Sector Work and Lending Programs

46. As emphasized in Section B above, we regard industrial reform - and more specifically reform of the SOEs - as the most crucial and difficult challenge now facing China's leadership. The importance and sensitivity of this sector are reflected both in the orientation of our overall ESW program and by our proposal to make further lending for Industry and Finance clearly contingent upon further progress with reform. Key elements of our strategy include helping the State clarify and separate the exercise of ownership functions from its policy role; promoting the development of a conducive regulatory and policy environment and helping develop replicable models for industrial restructuring. Bank assistance to promote domestic competition (including the breakdown of trade and ownership barriers which currently inhibit inter-provincial commerce) will also be necessary. Finally, significant attention to the further deepening of financial sector reform is warranted: despite the progress achieved since 1985, banks still lack significant autonomy, the structure of interest rates remains distorted (reflecting distortions in the overall price regime) and measures designed to strengthen PBC further, including the development of an appropriate supervisory and regulatory framework, will be critical.

47. The detailed design of the next stage of industrial reforms will require targeted and specialized assistance with the articulation of a regulatory framework, State ownership mechanisms and industrial restructuring experiments. Continued focussed sector work in selected areas of enterprise reform and the promotion of competitiveness is therefore indicated. A series of subsector studies, e.g., machine tools, designed to illustrate the application of practical policy and institutional prescriptions and to build on earlier studies of the electronics and automobile sectors is also planned. This will be complemented by a series of operational interventions, targeted at the more progressive coastal provinces, designed to promote experiments and develop practical models which can subsequently be replicated more broadly. To this end major industrial restructuring and enterprise reform projects in Shanghai, Tianjin and Shenyang are planned; if resources permit, similar initiatives will also be pursued in

Guangdong. These industrial restructuring operations will require accompanying elements of welfare and labor market reform, as well as specific conditionality on enterprise, trade and price policies.

48. Provincial projects will be complemented by a limited number of national subsector operations, e.g., fertilizer, electronics and heavy engineering, which would allow us to focus on cross-provincial issues, including the promotion of greater national integration. We also allow for further support to the non-State industrial sector, as a follow-up to our recent Rural Industrial Technology Project. Finally, the planned FY92 Financial Sector Technical Assistance Project, which will build on the sector priorities established in our recent review of Financial Sector Policies and Institutional Development, is intended to play a key role in helping lay the foundation for future financial sector reform by assisting in the development of a sound supervisory, regulatory and accounting framework for the banking system as a whole. Assuming that financial sector policy reform continues at a satisfactory pace (to be assessed during regular annual reviews), we would subsequently plan to proceed with additional targeted assistance designed to promote key financial intermediaries, e.g., strengthening the specialized and comprehensive banks, helping the China Investment Bank (CIB), the recipient of much Bank support in the past, evolve into a more financially autonomous investment bank, and undertaking further work on the broadening of capital markets.

49. The success of our strategy in industry and finance will depend critically on continued and steady progress by the Government in implementing sector reforms. The size of our program of operational assistance and, to a lesser extent, that of sector work, will therefore be determined by the overall pace of the reform process and our counterparts' response to suggested initiatives. While we have to be cognizant of political realities in China, minimum acceptable "reform conditionalities" will have to be clearly articulated for each operation early in the project cycle, and then clearly communicated to our Chinese counterparts. Close monitoring of performance during the project preparation and appraisal process will then be necessary.

50. Urban. China's cities are the forum within which industrial reform must take place - State enterprises are overwhelmingly urban in nature. For many SOEs, State ownership is effectively exercised by bureaus at city level, and thus ownership reform must also be addressed at this level. In addition, if SOEs are to be relieved of responsibility for housing, pensions, medical care and protection against unemployment - to permit the firms to be judged against more rigorous financial standards and allow labor markets to start functioning - it is, in the first instance, primarily city-level agencies that must pick up these social responsibilities. Beyond these direct connections with enterprise reform, the past decade has seen an unprecedented degree of decentralization of responsibility for urban planning and service provision and financing to the city level, and the newly empowered municipalities face a wide range of challenges including breaking down institutional compartmentalization, building up more integrated budget processes and new revenue sources, developing more flexible, market-driven systems of land allocation, working out low-cost approaches to traffic management, encouraging

the evolution of self-sustaining public utilities financed through user charges, experimenting with improved policy approaches to combatting air and water pollution, etc.

51. With our recent sector work on Urban Housing Reform and Reforming Social Security we have a solid intellectual basis for pursuing an active operational dialogue in these sectors. The center now recognizes their crucial connection with enterprise reform and has set generally sound guidelines for pension pooling and creation of unemployment insurance (socialized medical insurance so far lacks strong central guidance). Beijing additionally recognizes that rents must rise very substantially from their present nominal levels if housing is to become financially self-sustaining, and also sees an increased role for home-ownership as part of the longer-term solution. Cities are, however, being given some latitude in the details and timing of implementation - with the expectation that, as usual in China, successful experiments will attract emulation. Experience to date suggests that some cities are aggressively pursuing rent reform (with compensating wage adjustment), cost control and sustainable financial solutions, but others currently favor deeply discounted sales and the use of compulsory savings schemes to fund subsidized mortgages. We are seeking agreement both at national level and with reform-minded cities on a satisfactory policy framework for sustainable reform of housing and social security, including meaningful rent reform, phasing-out of subsidies, establishment of autonomous housing corporations, adoption of more flexible standards on buildings and land use and social security provision consistent with increased labor mobility. Given the extent of rent adjustment that will be needed, housing reform will be far from easy in political terms. Based upon encouraging dialogue at the center (and with some cities), however, we are listing sector lending in support of housing and social security reform in our base case scenario (but allow in the core program for possible slippage in this area).

52. More broadly, we envisage a growing program of operational support for improved urban management in key reform-oriented cities. Our overall policy framework will emphasize divestiture by productive enterprises of social functions, a growing role for market signals, the development of financially self-sufficient public utilities, strengthening the management of existing assets and improved prioritization and planning of new investments. In some cases, as in the recently approved Medium Sized Cities Development Project, it may be feasible to support policy and institutional improvements and investments on a relatively comprehensive, cross-sectoral basis. Such an approach is, however, resource-intensive and probably less well-suited to China's larger cities, where greater selectivity in investment support to target priority subsectors will be called for. We will, however, assure ourselves that our support fits into a rational overall policy strategy and system of investment prioritization at city level: one model, being pioneered in Shanghai, involves agreeing in advance on a multi-year, cross-sectoral Reform Action Plan. In formulating city-specific project designs, we will place heavy emphasis on measures to ameliorate the impact on the Urban Environment of past and continuing industrial and residential development. Improving the supply and utilization of water, the disposal and control of municipal and industrial wastewater and/or solid and gaseous wastes through investments, institution strengthening, tariff reforms and effluent charges and long range, least cost environmental strategies and programs will be among the key features of about

eight core provincial/municipal operations at present under active preparation. We will continue our sector work on urban land markets, and initiate study of municipal finance. In addition, more in-depth work is urgently needed to understand better the implications for urban growth and service provision of large numbers of "temporary" urban residents, to date all but ignored in official planning and policy formation, and we plan to add such work to our current ESW program.

53. The Transport sector has been, together with energy, the classic "bottleneck" sector in China's recent industrial development: the link between the two sectors is close as some 40 percent of the freight tonnage carried by the country's dominant transport mode, the railways, consists of coal, China's main energy source. For both coal and rail the fundamental problem of past underinvestment and inadequate capacity has been compounded by technological insularity and the distorting impact on demand of sub-economic pricing: though for rail transport, at least, major tariff adjustments over the past two years have done much to correct the latter problem. Compared to the railways, all other transport modes are even more seriously underdeveloped, especially the roads. Modal choice is thus heavily distorted - in addition, little has been done to develop modern inter-modal connections (containerization, etc.). The overall capital requirements of the sector are extremely large, as are the scope for and benefits of diffusing international technology and management techniques - and our base case assumes that we will continue to dedicate between a fifth and a quarter of our total lending to transport, with some internal shifts of emphasis as noted below. We also see the need and potential to broaden the terms of our dialogue to place greater emphasis on cost recovery, investment and O & M financing and system planning in the various modes. In addition our ESW program will continue the work on cross-modal transport issues commenced by our recent Guangdong Province Comprehensive Transport Study, with the completion of a multi-modal analysis of the crucial Yangtze Economic Zone surrounding Shanghai and the launching of a new inter-modal study on long-distance passenger transport.

54. In the Railways sector, our early operations focussed on the expansion of capacity on congested key routes, together with modernizing the manufacture of locomotives, rolling stock and equipment, but with relatively limited direct involvement in broader, system-wide modernization and reform issues. Simultaneously, however, we made use of a range of project-supported studies and technical assistance activities to develop a better base of understanding of selected sectoral and institutional questions - including development of a Railway Investment System to help prioritize future capacity expansion investments on a system-wide basis, upgrading of management information systems and a Railway Costing System to serve as a basis for more rational cost-based tariff setting. As these investments mature, together with studies on aspects of system-wide technological modernization (track, locomotive and rolling stock maintenance, telecommunications and electrification), they are strengthening our ability to engage our counterparts in substantive dialogue on policy reform issues (including further tariff reform) and institutional development priorities, and also generating more solidly grounded components for our lending operations - whether in priority capacity expansion or system-wide modernization. The early fruits of this broadened approach were seen in the pilot system-wide components of the recently approved Fifth Railway Project, and we plan to base the investment

components of future operations entirely on output of the Bank-supported system studies, while also pursuing the operationalization of investment selection models and cost-based tariffs. The Government is in principle committed to further enhancing the railways' self-financing of new investments, and has launched a Railway Investment Fund to plow-back resources from recent and projected tariff increases; we therefore feel confident including future railway operations in our base case lending scenario (though we allow in our low case for the contingency that further tariff reform might be impeded e.g. by an upsurge in inflationary pressures). We will continue to broaden the intellectual underpinnings of our operational involvement: future studies are expected to address such aspects as rail-based container transport (currently underdeveloped and a key to strengthening inter-modal links) and the environmental impact of the sector.

55. China's Highways constitute the most seriously underdeveloped of all transport modes by any international comparison: on either a quantitative or qualitative basis. Past underinvestment in roads contributes to the pressure on the railway system while also limiting the scope for intermodal competition and more rational allocation of traffic between modes, and the weakness of the network inhibits regional integration, distorts industrial location and threatens to constrain the transformation of the industrial sector from heavy to light manufactures and further export promotion efforts. While the 8FYP recognizes the need for major expansion and upgrading, central resources are limited and much of the burden for funding even "national" highways (as well as direct responsibility for construction and maintenance) rests with the provinces: it is thus at this level that our operational involvement will continue to be concentrated. Future provincial projects, whose location will be based on a prioritization of road investment requirements (including the need to fill in remaining gaps in the "national" network), will continue to spread to new provinces advances in supervision and quality control of road construction, design and planning. Highways have been among the few projects in China which have lent themselves to the introduction of ICB for construction: upgrading the capacity of the domestic construction sector will continue to be among our principle objectives. In addition, as in the railways sector, we plan to broaden further the range of issues covered in our sector dialogue and our operational activities and plan to experiment with a "one project, one issue" approach to several key sectoral concerns. One of these areas of concentration will be the inadequacies of current systems of highway financing and the appropriate future role of vehicle license fees, earmarked fuel taxes, tolls and bonds - a study supported by an earlier project is currently under review and we plan to pursue these issues at both national and provincial levels. In addition, too little is currently understood about the comparative underdevelopment of the domestic trucking industry (already the focus for significant non-State enterprise involvement) - our work in Guangdong indicates that relative and absolute costs are exceptionally high by international standards, but further sector work (probably supported by project-financed activities) is needed to analyze the respective contributions of such factors as inadequate infrastructure, unsuitable vehicle designs, regulatory issues, management and financing, and to design potential operational interventions to strengthen the sector. A further area for exploration and possible study would be the impact of vehicle emissions on air pollution. Both our provincial operations and selected Municipal Transport projects in major cities will continue to strengthen institutional capacity for planning, traffic management and road safety improvement.

56. Our earlier sector study of Water Transport indicated that the potential of inland waterways and coastal shipping has been under-exploited in recent years: though here too progress with deregulation has allowed a significant increase in private sector participation. The 8FYP indicates that priority will be given inter alia to upgrading facilities along the Yangtze, and we will explore the scope for initiating operational involvement in inland waterways - though indications are that issues of cost recovery will first have to be resolved. By contrast, China's Ports are the one component of the transport sector where most progress has been made in clearing accumulated capacity constraints - in part reflecting our own active lending program to date. Here greater selectivity in further expansion appears called for - and we will initially focus our efforts on studying the strategic issues which should guide future development: multi-modal links to the hinterland, regional sites for concentration of deep-sea facilities and the respective future roles of Hong Kong and other Chinese ports.

57. Energy, as noted earlier, has been together with transport one of the key constraints to industrial growth - reportedly some 20-30 percent of industrial capacity is affected by shortages of power. The Bank has maintained a significant program of commitments in the power sector throughout most of the past decade. Operational involvement in other parts of the energy sector (coal, petroleum) has been less active for reasons discussed below. In Electric Power, in addition to the major role we have played in technology transfer (including introduction of competitive bidding procedures), our primary objective has been the reform of tariffs, to provide both producers and consumers with more realistic incentives. Progress, if uneven, has been demonstrable, and the financial covenants introduced under our projects (to which the borrowers have in large measure adhered) have been a significant factor. China's "new plant new price" policy has resulted in major increases in overall tariff levels, and we now expect that the average level of tariffs will be close to long-run marginal cost by the mid-1990s. While the internal structure of tariffs remains distorted, inconsistent and lacking in transparency, the Government has shown considerable interest in our sector work on this issue and in several follow-up seminars, and we can now anticipate real progress in tariff rationalization; for example, province-wide agreements to improve the structure in Shandong and Henan provinces under the next two thermal projects.

58. In proposing a continued active presence in the power sector as part of our core lending program (and, as a share of the base case, close to its historical 10 percent level) we see additional scope for technology transfer (e.g. in pump storage and large mine mouth generation) and also take account of the new confidence we detect among government officials in tackling reform issues such as tariff restructuring. We also plan to step up still further the attention paid to including state-of-the-art pollution control measures in thermal plants and monitoring resettlement issues in hydro schemes. A study will soon get underway on energy conservation (primarily in industry) which will have important implications for this sector and the environmental impacts, both locally and globally (e.g. acid rain and greenhouse gas emissions) of coal-burning thermal power plants. Technical assistance funds have also been provided for a comprehensive regional air pollution control study of thermal power plants in the coastal regions of China. Beyond this, institution-building objectives are taking on new relevance in the sector: our recent Ertan project was the first to be undertaken by a financially semi-

autonomous enterprise rather than a Government bureau. While there were special circumstances involved, the scope for "enterprise reform" in the power sector is an aspect we will pursue in future operational work - together with the relevance for China of formal public utility regulation as practiced in other countries.

59. The Government has not yet indicated explicitly its attitude to the largest strategic decision in the power sector, the implementation of the possible Three Gorges Project, and no approach for Bank financing has been made. Before we could consider any such request, we would need to understand what was proposed to make the project sustainable on the basis of the international feasibility study which we supervised (key unresolved issues include project scale, environmental impact and resettlement proposals).

60. The Coal sector, likely to continue to supply 70-80 percent of China's primary energy needs for the foreseeable future, is one in which policy issues and, to a lesser degree, institutional constraints have thus far prevented us from playing a major role. The potential benefits from transfer of modern technology and management methods could be enormous - in terms both of efficiency and environmental gains and improvement of the industry's adverse worker safety record. However, the implementation experience of our only previous loan for coal development suggests limited receptivity to such modernization within the State-owned sector of the industry, while the seriously distorted State price of coal (resulting in heavy losses for the producers, as well as perverse incentives for consumers) has remained a fundamental obstacle to follow-up operations. We therefore plan a two-track approach. Building on our recent study on Efficiency and Environmental Impact of Coal Use, we are considering operational intervention targeted at provincial level mines (in Shanxi province), as experience in other sectors suggests that provincial enterprises tend to be more flexible and receptive to new ideas, including transfer of state-of-the-art technology, than their State counterparts - while the pricing of their output has for some time been more flexible and market-determined. Such an operation would also permit us to introduce significant environmental and safety improvements with high potential for replicability. In parallel, we will continue to pursue an active dialogue on coal pricing (a subject on which we have already prepared several reports) in part in the context of a broader work program on energy pricing reform we hope to initiate with the State Planning Commission (SPC). While the projected lending program in Annex C shows no further coal operations after Shanxi, this is a sector where - when the Government does move decisively on price reform - the potential could exist for a major expansion in operational involvement.

61. No new commitments have been made in the Oil sector since FY85, and none are currently proposed. We do, however, plan to lend for the development of Natural Gas: a far cleaner and more efficient fuel and feedstock than coal, whose potential in China has been underdeveloped. We envisage involvement on both the production and consumption sides, which will enable us to contribute to technology transfer, energy efficiency and environmental goals - and will also provide a vehicle for addressing the current under-pricing of gas and rationalizing its allocation across consuming sectors.

62. Although the relative share of Agriculture in the economy has been declining, it continues as the primary source of income for some 60 percent of the workforce. Additionally, most of China's roughly 100 million people still living in absolute poverty are to be found in agricultural households, typically struggling to exploit ecologically fragile and marginally productive hillsides. The well-known earlier reforms of land tenure and product pricing and marketing encompassed within the production responsibility system have achieved impressive results in raising the incomes of many farm families and production especially of higher value commercial crops, livestock and aquatic products (and, more indirectly, the output of an increasingly diversified rural industrial sector). This transformation has received significant support from our own series of rural credit and provincial agricultural operations. The agricultural sector as a whole, however, remains only half-reformed, with a sizeable portion of the grain crop and a few other staples still subject to central planning, production quotas and confiscatory producer pricing - the counterpart to the subsidized supply of such foods to the registered urban population: attempts at introducing fundamental reforms in these areas during 1988-90 under our previous Rural Sector Adjustment Loan suffered from the authorities' overriding emphasis at the time on combatting inflation.

63. We continue to regard grain sector reform as a crucial piece of unfinished business. Our recently published study of Options for Reform in the Grain Sector provides a guide to the main issues involved, which include not merely the need to adjust producer and consumer prices, but also the benefits attainable from radically liberalizing now tightly controlled domestic grain markets (regional experiments indicate present distribution costs can be cut dramatically). Initial Government response has been encouraging: sharp increases in administered urban grain prices earlier in 1991 failed to elicit the feared protests and recent initiatives have included opening regional wholesale markets, earmarking of reserve stocks for market regulation and steps to create semi-autonomous trading enterprises, as well as announcement of a 24 percent rise in the producer price for wheat effective next year. Continued moves to increase the role of market forces could lead to significant shifts in regional patterns of production and consumption - as well as raising incomes of rural producers - and would also likely require major investments in distribution infrastructure. We have indicated to the Government that, given satisfactory agreements on further market liberalization and completion of the price reform process, we would be ready to commence a possible series of large operations to help finance the necessary infrastructure investments and assist in the associated institutional development.

64. Reflecting recent exchanges with central authorities, our base case scenario assumes that the above agreements will be attainable (and also that overall progress in financial sector reform will permit us to resume lending to strengthen the rural financial sector): the share of agriculture in our total lending under the base case would remain close to its historical level of 30 percent. Our core program is projected to include operations to raise farm family incomes and spread sustainable production practices in three of the most impoverished regions of the country - as noted earlier, these are also some of the most environmentally sensitive zones (the red soils of southern China, the loess plateau of the northwest and the mountainous southwest) - we will, however, face the need to overcome pressure from central agencies to concentrate more heavily on commercial activities in advanced provinces they perceive as having better

repayment capacity. We plan, in addition, to build on the provincial Forest Management Plans being prepared under our ongoing National Afforestation Project to develop more comprehensive forestry sector lending, which would improve the underlying capacity for policy analysis in the sector and also encompass the sustainable management of China's natural forests.

65. Effective agricultural support services and water management remain of fundamental importance to Chinese agriculture and we will continue to be engaged in both areas. Preparation is now at an advanced stage for our first cross-provincial operation to focus exclusively on upgrading the full range of farm support services: achieving replicability will be a major aim. Involvement in irrigation will continue to target cost-recovery and improved sector planning. Our long-running support through sector work and technical assistance for water use planning along the Yellow River - the crucial source for much of China's arid north - will yield fruit by way of operational assistance in completing the final major structure required for the river's control and management. Beyond this, the next strategic question in this region will concern the feasibility of long-distance transfers of water from the south: extensive study will be required prior to any possible operational involvement. Our sector work program is also expected to include studies on agricultural production and marketing issues for non-grain crops and on the livestock feed grain subsector - the shape of any possible lending support here will be determined following the sector studies. Finally, this year's dramatic floods have demonstrated serious weaknesses in flood control in several regions of the country, including the Yangtze basin and parts of the northeast: at least one and possibly up to three operations over FY93-95 are expected to provide urgently needed assistance in remedying such deficiencies.

66. Social Sectors. The PRC's commitment, from the outset, to the broadest possible access to basic education and health has earned widespread international recognition and continues to be reflected in average indices of literacy, infant mortality and life expectancy normally associated with much higher income levels. China first looked to the Bank primarily for lending operations to help the tertiary education sector recover from the effects of decades of isolation capped by the ravages of the Cultural Revolution: over the years, key Chinese institutions significantly improved their capacity to absorb technology and their knowledge base. Meanwhile, however, new challenges were emerging as fiscal decentralization gave the provinces and lower levels increasing responsibility for both planning and implementing social sector policies and programs, while the dissolution of the rural communes weakened structures of collective social service provision in the countryside. Our own role has changed in response, with both sector work and operational interventions increasingly focussed on the choices facing provincial and lower-level decisionmakers as they strive to achieve quality, efficiency and equity in the provision of basic education and health services (including the supply of safe drinking water) - with special emphasis on the problems of the poorest rural counties, on whom the burden of fiscal decentralization is hardest. In both sectors, though our lending volume is constrained by Government preferences, one of the most important contributions we can make is to bring to bear on Chinese problems the lessons of international experience, which are in general little understood in the country.

67. Education. Our recent study of Provincial Education and Finance crystallizes the range of policy issues emerging from our work over the past few years. We consider China's aim to universalize nine years of basic education by 2010, which we strongly endorse, to be feasible provided greater attention is given to efficiency of resource use in the sector (better utilization of teachers and facilities, a more critical approach to expensive and narrowly based vocational programs at secondary level, rationalization of the fragmented and costly tertiary sector) and to more equitable funding mechanisms (i.e. targeted budgetary support from higher levels of Government for basic education in poor rural counties). Building on this analysis, we plan to present shortly an operation to implement reforms in some of these key areas in small towns and rural areas of six poor provinces (where access for girls is a particular concern), and to follow this by further assistance at provincial level for the effective training of junior secondary teachers. Subsequent involvement will continue the emphasis on poor regions and on assistance in improving efficiency in resource mobilization and utilization, as well as technical assistance and institution building.

68. Health. Our 1990 report Long-Term Issues and Options in the Health Transition posed a powerful challenge to many aspects of current sector policy and practice and has stimulated widespread discussion. While not disputing that most indicators of health status remained highly favorable by international standards, it argued that constrained public health funding over the 1980s and the new emphasis on payment-for-service threatened, especially in poorer rural areas, to erode some of the previous decades' achievements against communicable diseases, and could also miss the chance to put prevention first in the battle against now increasing chronic diseases (cancer, heart disease, etc.). Some of the report's recommendations, on strengthening community-based disease prevention programs and rural primary health care, are already being implemented under the Integrated Regional Health Project and are attracting emulation; proposals for fundamental changes in health financing, however, face more of an uphill struggle. While there is no powerful constituency at central level for large-scale international financing in this sector, we will continue to use the leverage IDA gives us to maintain a regular operational program for the strengthening of public health services, especially in poorer rural areas. Project concepts which are maturing include one to reinstate free treatment of two major communicable diseases (TB and schistosomiasis) - a principle which has now been accepted - and one to upgrade the training (and improve the public funding) of health workers in poor rural counties. Maternal and child health care, so far supported indirectly through our overall sector and lending work, will also receive more explicit focus in the future. Additionally, we plan to undertake further sector work on the financing of health services, including the scope for broadening the coverage of medical insurance schemes while enhancing incentives for cost-consciousness.

Responsiveness to Major Program Objective Categories

69. Poverty Alleviation. The China Poverty Study, currently under preparation, will confirm that absolute poverty in China is overwhelmingly a rural phenomenon, and heavily concentrated in remote, resource-poor regions. Our agricultural portfolio, as discussed above,

is planned to include at least three operations specifically targeted at enhancing productivity and achieving sustainability in some of the poorest regions of the country, while the recent refocussing of our operational program in education and health is also consistent with the recommendations of the study. More work is still needed on the policy implications of greater internal labor mobility for poverty alleviation - we hope to address such issues, inter alia, with TA followup to the poverty study and within the Yangtze Economic Zone study in our ESW program. A proposed study on Center-Provincial Policy Linkages (Phase II) will focus directly on the effectiveness of budgetary transfers in reaching the poor.

70. Environment. Environmental conditions in China present a number of serious challenges, the foremost being: (a) water resource management, including water quality; (b) air quality management; (c) solid and liquid waste management, including hazardous and toxic wastes; (d) energy conservation and industrial efficiency and pollution control; (e) natural resource management and conservation (especially forest resources); and (f) sustainable agriculture practices on marginal lands. The operational program outlined in this paper conforms closely to the strategy spelled out in more detail in our forthcoming Environmental Strategy Paper. China's policies, programs and institutions in the environment sector are among the most comprehensive of any Bank member country (and conform substantially to the IDA Environmental Action Plan requirement): support to strengthen them further will be an important objective in many of our operations. Environmental aspects will be uppermost in the three marginal lands agricultural projects discussed above, the proposed forestry sector operation, the provincial coal project, and the series of provincial/urban environmental projects. We are processing a GEF operation for ships' waste disposal and marine pollution control, while GEF-financed studies on greenhouse gas emissions and biodiversity (with expected operational follow-up) are also underway. Studies on ozone-depleting substances (ODS) are in preparation with support from UNDP and the Montreal Protocol Interim Fund (MPIF), and will result in one of the largest ODS projects to be funded by the MPIF. Following our recent pilot program of technical assistance to the National Environmental Protection Agency (NEPA), funded under JGF, we plan to undertake a substantial program of technical assistance for China's environmental protection agencies (both national and local), either as a stand-alone project or as a national component attached to one of our provincial environmental projects: this assistance would be supplemented by additional resources mobilized from Technical Cooperation Credits and trust funds to help in carrying out further sector studies to develop policy, regulatory and institutional development action plans and formulate additional investment programs. We also plan to raise, at our next round of ESW consultations, a study of provincial and urban environmental management issues, inter alia to provide policy input to the series of provincial/urban environment projects. As also noted above, additional emphasis will be given to environmental issues within our energy and transport portfolios.

71. Public Sector Reform and Private Sector Development. China's commitment to the primacy of public ownership in industry and public utilities does not preclude experimentation with new models of more dispersed ownership for SOEs (e.g. joint stock companies) or with the expansion of public listings on nascent domestic stock exchanges, and such experiments will be actively supported under our future industrial operations. Nor has it inhibited the rapid growth

of non-State (private or collective) enterprises in industry, transport, construction and other service sectors. Much of our rural credit lending has long gone to private or collective end-users, and our dialogue with CIB during the preparation of the recently-approved Rural Industrial Technology Project resulted in a policy decision to diversify away from its previous exclusive focus on lending to State enterprises: possible follow-up to these initiatives will be conditioned upon satisfactory progress in our overall financial sector dialogue. Non-State enterprise development in the transport sector will be supported through our provincial highways program (most specifically the trucking industry work) and through possible inland waterways lending. We also hope to find additional vehicles to advance the analysis in our forthcoming CEM of the role that non-State firms can play in further service sector development. It is unlikely that the Bank can explicitly influence China's on-going redefinition of the role of Government. But selected intervention in sectors and provinces where reforms are progressing quickly, and denial of lending in areas where the authorities seem reluctant to advance fast enough in the required direction, will signal our interest in seeing China move faster. Infrastructure and urban development projects will aim to improve public institutions' efficiency in planning, implementing and providing public goods, and emphasis on cost-recovery and introduction of appropriate pricing will move to the center of our dialogue on irrigation, railways, energy, water supply and municipal services.

Relationship with Other Donors

72. Strategies of IFC, MIGA. Strategy statements by IFC and MIGA are presented in Annexes E and F respectively. IFC's three objectives in China are: (a) to promote a more favorable climate for foreign direct investment (FDI) through FIAS advisory services, (b) to act as a catalyst for private sector investment through participation primarily in international joint ventures, and (c) to help accelerate development of capital markets, including stock exchanges. FIAS has recently completed preparation, at Government request, of a report on impediments to FDI and is currently working with the Chinese authorities on measures to implement some of the report's recommendations. On the lending side, after about two years of relatively limited activity, IFC is programming a renewed effort of project promotion and is considering opening an office in China: a project pipeline is under active preparation. Finally IFC sees recent measures of financial sector liberalization (including the establishment of stock exchanges in Shanghai and Shenzhen) as opening the opportunity for its Capital Markets Department to play an active role in capital market development in China. MIGA, which provides long term political risk insurance to investors, is prepared to guarantee projects in China which meet its general eligibility criteria. Preliminary applications for guarantees have been received for some ten projects in different sectors, though to date no Contract of Guarantee has been issued for a project in China.

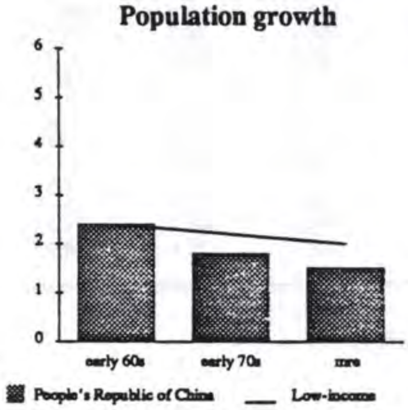
73. Prospects of Co-financing. Though the Ministry of Finance (MOF) has expressed some interest in co-financing prospects, institutional responsibility within the Government remains fragmented and inimical to straightforward implementation - SPC generally allocates responsibility for obtaining foreign funding of a project to either MOF, PBC or the Ministry of Foreign Economic Relations and Trade (MOFERT), each of which has ties to different groups

of multilateral or bilateral donors. In addition, due to lack of experience internally, the basic procedures remain poorly understood, despite efforts to explain and promote them. Recent attempts at ECO promotion yielded disappointing results, while the Government perceives more traditional instruments as subject to uncertainty and delay and is reluctant to consider them. Current limitations on access to US financial markets would also stand in the way of using the new instruments, unless China were willing to increase its exposure in Yen. We will, nonetheless, continue to pursue opportunities to encourage greater use of co-financing: there are early expressions of interest in possible collaboration in the railways sector from the Japanese authorities.

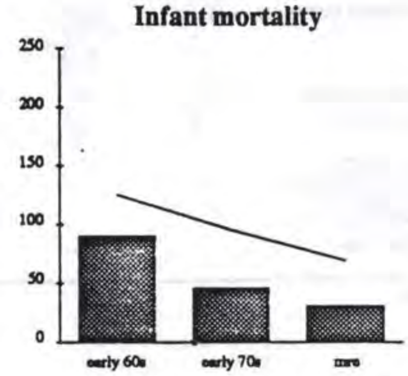
CHINA - Social Indicators, 1990

	Unit of measure	25-30 years ago	15-20 years ago	Most recent estimate (mre)	Same region / income group: Asia	Same region / income group: Low-income	Next higher income group
HUMAN RESOURCES							
Size, growth, structure of population							
Total population (mre = 1989)	millions	715	916	1,105	2,593	2,945	667
14 and under	% of pop.	40.2	39.5	27.1	32.9	35.3	37.9
15-64	"	55.4	56.1	67.2	62.2	60.1	57.6
Age dependency ratio	unit	0.80	0.78	0.48	0.60	0.65	0.73
Percentage in urban areas	% of pop.	18.2	17.3	52.8	41.7	37.4	59.2
Females per 100 males							
Urban	number	..	..	91	..	..	..
Rural	"	..	..	96	..	..	..
Population growth rate	annual %	2.4	1.8	1.5	1.8	2.0	2.1
Urban	"	5.7	2.3	7.8	5.3	5.6	3.0
Urban/rural growth differential	difference	4.1	0.7	12.7	6.1	5.8	1.9
Projected population: 2000	millions	..	..	1,275	3,080	3,620	831
Stationary population	"	..	..	1,835	..	..	..
Determinants of population growth							
Fertility							
Crude birth rate	per thou. pop.	37.9	23.0	20.8	26.0	29.8	30.0
Total fertility rate	births per woman	6.36	3.39	2.36	3.20	3.80	3.87
Contraceptive prevalence	% of women 15-49	..	..	74.0	57.0	56.2	..
Child (0-4) / woman (15-49) ratios							
Urban	per 100 women	..	..	28	..	..	..
Rural	"	..	..	41	..	..	..
Mortality							
Crude death rate	per thou. pop.	9.5	7.3	6.6	8.6	9.9	8.1
Infant mortality rate	per thou. live births	90.0	46.0	30.3	58.1	69.3	52.7
Under 5 mortality rate	"	..	..	33.4	83.1	161.0	81.5
Life expectancy at birth: overall	years	57.4	64.8	69.9	64.4	61.9	65.2
female	"	59.0	65.6	71.0	65.2	62.7	67.6
Labor force (15-64)							
Total labor force	millions	381	482	668	1,250	1,371	244
Agriculture	% of labor force	80.8	76.3	..	..	..	..
Industry	"	8.2	12.1	..	..	..	..
Female	"	41.1	42.4	43.2	36.5	35.9	30.2
Females per 100 males							
Urban	number	..	..	88	..	..	..
Rural	"	..	..	95	..	..	..
Participation rate: overall	% of labor force	52.3	52.0	60.1	50.8	49.5	38.8
female	"	44.3	45.4	53.5	36.7	35.0	22.6
Educational attainment of labor force							
School years completed: overall	years	..	..	4.5	..	..	..
male	"	..	..	..	..	..	..
NATURAL RESOURCES							
Area	thou. sq. km	9,561	9,561	9,561	18,406	36,997	21,088
Density	pop. per sq. km	75	96	112	136	76	30
Agricultural land	% of land area	44.2	43.8	43.4	38.4	36.1	36.9
Agricultural density	pop. per sq. km	169	219	258	354	212	82
Forests and woodland	thou. sq. km	1,057	1,129	1,150	4,831	9,154	6,084
Deforestation rate (net)	annual %	0.7	0.7	-0.2	-0.2	-0.3	-0.7
Access to safe water	% of pop.	..	..	..	..	..	63.5
Urban	"	..	..	81.0	72.5	73.4	77.2
Rural	"	..	..	..	..	..	46.8

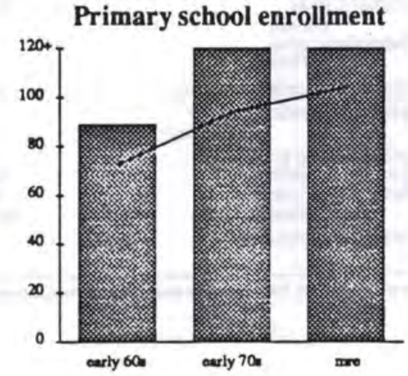
Population growth



Infant mortality



Primary school enrollment



CHINA - Social Indicators, 1990

	Unit of measure	25-30 years ago	15-20 years ago	Most recent estimate (mre)	Same region / income group: Asia	Same region / income group: Low-income	Next higher income group
INCOME AND POVERTY							
Income							
GNP per capita (mre = 1989)	US$	90	180	360	540	330	1,320
Total household income							
Share to top 10% of households	% of income	..	..	..	..	..	..
Share to top 20% of households	"	..	..	..	..	..	..
Share to bottom 40% of households	"	..	..	..	..	..	..
Share to bottom 20% of households	"	..	..	..	..	..	..
Poverty							
Absolute poverty income: urban	US$ per person	..	..	..	..	..	..
rural	"	..	..	..	..	..	..
Pop. in absolute poverty: urban	% of pop.	..	..	..	..	..	..
rural	"	..	..	..	..	..	..
Prevalence of malnutrition (under 5)	% of age group	..	..	..	..	..	..
EXPENDITURE							
Food	% of GDP	..	..	43.1	..	..	..
Staples	"	..	..	..	..	..	..
Meat, fish, milk, cheese, eggs	"	..	..	..	..	..	..
Cereal imports	thou. metric tonnes	6,424	3,718	15,897	40,773	27,738	40,386
Food aid in cereals	"	..	..	347	3,501	7,122	7,767
Food production per capita	1979-81=100	83.1	90.3	128.8	120.8	117.8	99.9
Share of agriculture in GDP	% of GDP	44.1	36.9	32.4	23.3	32.8	15.2
Daily calorie supply	calories per person	1,931	2,074	2,632	2,412	2,342	2,741
Daily protein supply	grams per person	48	49	63	58	56	71
Housing	% of GDP	..	..	5.5	..	..	..
Average household size	persons per household	..	..	5	..	..	..
Urban	"	..	..	4	..	..	..
Fixed investment: housing	% of GDP	..	..	..	..	..	..
Fuel and power	% of GDP	..	..	1.8	..	..	..
Energy consumption per capita	kg of oil equivalent	186.7	366.8	570.4	405.5	323.8	843.7
Households with electricity							
Urban	% of households	..	..	..	..	..	..
Rural	"	..	..	..	..	..	..
Transport and communication	% of GDP	..	..	0.9	..	..	..
Population per passenger car	persons	..	8,124	4,319	..	..	30
Fixed investment: transport equipment	% of GDP	..	..	..	..	..	..
Total road length	km	..	..	915,100	..	..	..
Population per telephone	persons	..	269	148	..	..	17
INVESTMENT IN HUMAN CAPITAL							
Medical care	% of GDP	..	..	1.0	..	..	..
Population per: physician	persons	1,600	1,400	1,004	1,423	1,463	1,551
nurse	"	3,000	2,400	1,393	1,674	1,747	..
hospital bed	"	900	600	502	729	755	..
Access to health care	% of pop.	..	..	..	..	..	..
Immunized (under 12 months): measles	% of age group	..	..	77.0	44.8	43.5	62.9
DPT	"	..	..	75.0	52.0	41.3	65.2
Oral Rehydration Therapy use (under 5)	% of cases	..	..	5.0	27.9	21.6	27.5
Education	% of GDP	..	..	0.5	..	..	..
Gross enrollment ratios							
Primary: total	% of school-age group	89.0	126.0	132.0	112.7	104.3	102.0
female	"	..	115.0	124.0	102.4	94.7	101.1
Secondary: total	"	..	47.0	43.0	41.8	37.2	51.1
female	"	..	38.0	37.0	33.5	28.0	52.4
Tertiary: science/engineering	% of tertiary students	53.0	43.9	40.9	..	..	..
Pupil-teacher ratio: primary	pupils per teacher	30	29	24	30	29	26
secondary	"	0	21	18	19	18	17
Pupils reaching grade 4	% of cohort	..	..	76.8	68.6	67.8	..
Repeater rate: primary	% of total enrollment	..	..	..	..	..	8.6
Illiteracy rate: overall	% of pop. (age 15+)	..	..	30.7	39.5	43.4	25.4
female	% of females (age 15+)	..	..	44.5	52.2	56.5	31.6
Newspaper circulation	per thou. pop.	..	..	52.8	26.4	20.4	78.9

Source: World Bank International Economics Department, September 1990.

CHINA -- Key Indicators

ASECASE

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Real Growth Rates:										
Gross Domestic Product (GDP)			10.8%	3.9%	4.9%	5.0%	5.5%	6.0%	6.0%	6.5%
Gross Domestic Income (GDY)			10.7%	4.1%	5.1%	4.9%	5.4%	6.0%	6.0%	6.5%
Real per Capita Growth Rates:										
Gross Domestic Product (GDP)			9.5%	2.6%	3.6%	3.8%	4.2%	4.7%	4.7%	5.2%
Total Consumption			10.5%	3.7%	-3.0%	7.7%	8.2%	6.4%	6.4%	5.0%
Private Consumption			10.4%	4.2%	-0.9%	5.7%	8.8%	6.7%	6.6%	5.0%
Debt and Debt Service(LT+IMF+ST): /1										
Total DOD (US$M) /2		35304	42407	41624	52549	54971	61952	68769	75048	114839
DOD/GDP		11.6%	11.3%	9.9%	14.4%	14.1%	14.8%	15.2%	13.5%	12.3%
Debt Service (US$M)		3812	4627	5683	7006	7917	8197	8028	8263	10990
Debt Service/Exports		8.7%	8.9%	10.1%	10.6%	10.8%	10.4%	9.4%	8.3%	7.4%
Debt Service/GDP		1.3%	1.2%	1.3%	1.9%	2.0%	2.0%	1.8%	1.5%	1.2%
Interest Burden (LT+IMF+ST):										
Interest Paid (US$M)		1815	2195	1928	2564	3131	2956	2680	2287	1854
Interest/Exports		4.1%	4.2%	3.4%	3.9%	4.3%	3.8%	3.1%	2.3%	1.2%
Interest/GDP		0.6%	0.6%	0.5%	0.7%	0.8%	0.7%	0.6%	0.4%	0.2%
Gross Investment/GDP		39.1%	39.6%	39.0%	39.1%	39.6%	39.5%	38.9%	37.5%	36.1%
ICORs (5 years ending year shown)/3			3.6	5.5	6.2	6.5	6.6	7.6	6.7	5.5
Domestic Savings/GDP		39.3%	38.7%	38.4%	42.6%	41.3%	38.7%	37.7%	35.7%	35.1%
BOP Resource Balance/GDP /4		0.2%	-0.9%	-0.7%	3.5%	1.7%	-0.8%	-1.2%	-1.8%	-1.0%
National Savings/GDP		38.8%	38.2%	38.0%	42.0%	40.6%	38.1%	37.2%	35.3%	34.9%
BOP Current Account Balance/GDP /5		0.0%	-1.0%	-1.1%	3.3%	1.4%	-1.0%	-1.3%	-1.7%	-0.9%
Marginal Domestic Savings Rate			32.3%	28.4%	127.1%	-6.6%	-4.7%	20.4%	18.4%	36.4%
Marginal National Savings Rate			33.0%	33.1%	135.3%	12.1%	-9.7%	21.5%	21.1%	38.4%
Government Investment/GDP		3.9%	4.0%	3.9%	3.9%	4.0%	4.0%	4.0%	4.0%	4.0%
Government Savings/GDP		4.8%	3.2%	2.7%	2.7%	2.3%	2.1%	2.0%	2.3%	2.2%
Private Investment/GDP		35.2%	35.7%	35.1%	35.2%	35.6%	35.5%	34.9%	33.5%	32.1%
Private Savings/GDP		30.7%	36.4%	37.1%	40.6%	37.7%	35.5%	34.7%	32.4%	32.0%
Government Revenues/GDP		22.7%	20.0%	20.8%	19.9%	20.6%	20.6%	20.6%	20.6%	20.6%
Government Expenditures/GDP		18.2%	17.3%	18.2%	17.6%	18.8%	18.9%	19.0%	18.7%	18.8%
Budget Deficit(-) or Surplus/GDP		1.7%	3.7%	5.6%	4.5%	5.9%	6.1%	6.2%	5.8%	6.1%
Primary Deficit(-) or Surplus/GDP		1.3%	3.3%	5.3%	4.1%	5.0%	5.1%	5.1%	5.0%	5.1%
Consumer Price Index(% growth rate)			12.8%	7.7%	0.9%	4.6%	6.7%	6.1%	5.9%	5.9%
GDP Deflator (% growth rate)			11.6%	9.0%	4.9%	3.0%	6.0%	6.0%	6.0%	6.0%
Real Exchange Rate (1987=100)		3.7	3.6	3.3	4.2	4.4	4.4	4.4	4.4	4.4
Terms of Trade Index (1987=100)		100.0	100.1	101.0	102.4	100.8	100.5	100.6	100.9	101.7
Export (GNFS) Volume Growth Rate /6			14.8%	7.8%	12.6%	4.4%	6.5%	6.8%	7.0%	7.4%
Exports (GNFS)/GDP		14.4%	13.7%	13.4%	18.2%	18.7%	18.7%	18.8%	17.9%	16.0%
Import (GNFS) Volume Growth Rate			23.4%	7.8%	-12.8%	16.8%	21.7%	9.2%	8.2%	6.5%
Imports (GNFS)/GDP		14.2%	14.7%	14.0%	14.6%	17.0%	19.5%	20.0%	19.6%	17.0%
BOP Current Account Balance(US$M)/7		66	-3805	-4460	11935	5335	-4333	-6054	-9707	-8127
Net Reserves (US$M)		22453	23751	23053	34476	43747	46484	49148	44838	56092
Gross Reserves (months imports)		6.0	5.0	4.5	7.4	7.5	6.6	6.3	4.8	4.2

Note: All ratios are calculated from data in current prices and exchange rates.
ICOR and growth rates are based on constant price data.
Marginal savings rates are based on current price data deflated by expenditures deflator.

/1."LT" denotes "logn-term debt"; "ST" denotes "short-term debt."
/2.Debt outstanding and disbursed.
/3.Incremental capital-output ratios with a 5-year period.
/4."BOP" denotes "Balance of Payments".
/5.Current account balance as defined in line F.1. in Annex B3.
/6.Goods and nonfactor services.
/7.For the definition, see footnote 5.

CHINA -- National Accounts

Part A: Current Price Data

(billions of Yuan)

BASECASE Projection
Per Capita GNP in 1990: $
Midyear Population (millions):

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Gross Domestic Product		1133	1401	1586	1745	1888	2111	2372	2994	5490
Net Indirect Taxes		99	114	127	132	151	169	190	240	439
GDP at Factor Cost		1035	1287	1459	1614	1737	1942	2182	2755	5051
Imports (GNFS) /1		161	206	223	255	321	412	474	587	932
Exports (GNFS)		163	193	212	317	353	396	445	535	876
Resource Balance		2	-13	-11	62	32	-16	-28	-52	-56
Total Expenditures		1131	1414	1597	1684	1855	2127	2400	3047	5546
Total Consumption:		688	859	978	1002	1107	1293	1477	1925	3563
Government		95	112	129	143	147	166	186	235	429
Private		593	747	849	858	960	1127	1291	1690	3134
Gross Domestic Investment:		443	555	619	682	748	834	923	1122	1983
Government /2		44	56	62	68	76	84	95	120	220
Private /3		399	500	557	614	672	750	828	1002	1764
Memorandum Items:										
Domestic Savings--		445	542	608	744	780	818	895	1069	1927
Net Factor Income		-7	-8	-7	-12	-15	-15	-14	-12	-11
Net Current Transfers /4		1	2	1	1	1	1	1	1	1
National Savings		439	535	602	732	766	804	882	1058	1918
Optional details for RMSM-X:										
Net Indirect Taxes--		99	114	127	132	151	169	190	240	439
Indirect Taxes		166	190	224	228	245	274	308	389	714
Subsidies		67	76	97	96	94	106	119	150	275

PART B: Constant Price Data

(billions of Yuan, 1987=100)

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Gross Domestic Product		1133	1256	1304	1368	1436	1515	1606	1804	2472
Imports (GNFS)		161	198	214	187	218	265	290	342	475
Exports (GNFS)		163	187	202	227	237	253	270	308	438
Resource Balance		607	-3033	-3272	10898	6405	-2048	-4031	-7936	-8646
Total Expenditures		1131	1267	1316	1327	1417	1528	1626	1839	2509
Total Consumption Expenditures:		688	769	807	793	864	946	1019	1182	1642
Government		95	107	109	92	115	121	128	144	198
Private		593	662	699	701	749	825	890	1038	1444
Total Investment Expenditures:		443	498	509	534	553	582	607	657	868
Government /5		44	50	51	53	56	59	62	70	96
Private /6		399	448	458	481	497	523	545	587	772
Terms of Trade (TT) Effect		0	-1	2	4	3	2	3	4	9
Gross Domestic Income		1133	1254	1306	1372	1439	1517	1609	1808	2481
Domestic Savings (TT Adjusted)		445	485	499	579	575	571	590	626	839

/1.Goods and nonfactor services.
/2.Gross domestic fixed capital formation only.
/3.Derived as a residual; includes increase in stocks.
/4.Total net unrequited transfers excluding official capital grants.
/5.For the definition, see footnote 2.
/6.For the definition,see footnote 3.

CHINA -- National Accounts

PART C: Value Added by Sector
(sectoral shares in percent)

BASECASE

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Agriculture		28.4%	27.4%	26.8%	27.5%	27.9%	27.4%	26.7%	25.5%	22.1%
Industry, of which:		40.6%	41.3%	41.6%	41.6%	42.8%	42.6%	42.2%	41.4%	38.6%
Mining		3.8%	4.5%	3.8%	4.1%	4.2%	4.2%	4.1%	4.1%	3.8%
Manufacturing		36.8%	36.8%	37.8%	37.5%	38.6%	38.4%	38.1%	37.4%	34.8%
Services		31.0%	31.3%	31.6%	30.9%	29.3%	30.0%	31.1%	33.1%	39.3%
Total		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Note: Historical shares are calculated from current price data.
Projected shares are from current price data if available; otherwise, from constant price data.

PART D: Long-Term Growth Rates

(Average annual growth rates are calculated from constant price data.)

	Actual			Estimated	Projected	
	1965-73	1973-80	1980-90	1990	1990-95	1995-20 00
Gross Domestic Product at Market Prices:	8.5%	5.6%	6.2%	4.9%	5.7%	6.5%
Agriculture	2.8%	2.1%	4.3%	6.9%	3.5%	3.5%
Industry of which--	12.1%	8.7%	11.6%	8.3%	5.0%	5.0%
Manufacturing	9.4%	9.9%	11.7%	7.5%	5.0%	5.0%
Mining	..	..	11.1%	16.6%	5.0%	5.0%
Services	19.5%	6.8%	0.1%	-2.7%	9.1%	10.6%
Imports of GNFS	1.6%	11.6%	5.4%	-12.8%	12.9%	6.7%
Exports of GNFS	2.1%	4.1%	11.3%	12.6%	6.4%	7.3%
Total Expenditures	8.6%	6.4%	5.3%	0.8%	6.8%	6.4%
Total Consumption:	7.3%	5.3%	4.9%	-1.8%	8.3%	6.8%
Government /7	7.0%	7.3%	-0.8%	-15.3%	8.4%	6.5%
Private /8	7.3%	5.1%	5.7%	0.3%	8.3%	6.8%
Gross Domestic Investment:	12.9%	8.9%	6.0%	5.0%	4.3%	5.7%
Government	..	..	6.0%	5.0%	5.7%	6.5%
Private	..	..	6.0%	5.0%	4.2%	5.6%
Memorandum Items:						
Capacity to Import	2.8%	9.5%	12.1%	13.8%	6.2%	7.4%
Gross National Income	8.6%	6.2%	6.3%	4.8%	5.8%	6.6%
Gross National Product	8.5%	5.6%	6.2%	4.6%	5.8%	6.5%
Gross Domestic Income	8.6%	6.2%	6.3%	5.1%	5.7%	6.5%
Gross Domestic Savings	12.4%	8.1%	8.5%	16.2%	1.7%	6.0%
Gross National Savings	12.4%	8.4%	8.9%	16.3%	2.0%	6.3%
Population	..	..	1.2%	1.2%	1.2%	1.2%
Labor Force	..	..	2.4%	2.6%		
Gross Domestic Product per Capita	..	..	4.9%	3.6%	4.5%	5.2%

/7.For the definition, see footnote 2.
/8.For the definition, see footnote 3.

CHINA -- National Accounts

PART E: Annual Growth Rate

(Annual growth rates are calculated from constant price data.)

BASECASE

	Actual					Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Gross Domestic Product (Market Prices)			10.8%	3.9%	4.9%	5.0%	5.5%	6.0%	6.0%	6.5%
Agriculture			3.2%	3.3%	6.9%	3.5%	3.5%	3.5%	3.5%	3.5%
Industry			20.7%	7.6%	8.3%	5.0%	5.0%	5.0%	5.0%	5.0%
Services			4.9%	-1.3%	-2.7%	6.6%	8.4%	10.1%	9.7%	10.2%
Gross Domestic Income										
Total Investment			12.3%	2.3%	5.0%	3.5%	5.2%	4.3%	3.7%	6.5%
Total Consumption			11.9%	4.9%	-1.8%	9.0%	9.5%	7.7%	7.7%	6.3%
Population			1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%
Per Capita:										
Gross Domestic Product(Market Prices)			9.5%	2.6%	3.6%	3.8%	4.2%	4.7%	4.7%	5.2%
Total Consumption			10.5%	3.7%	-3.0%	7.7%	8.2%	6.4%	6.4%	5.0%
Private Consumption			10.4%	4.2%	-0.9%	5.7%	8.8%	6.7%	6.6%	5.0%

Part F: Price Indices

(national accounts deflators;1987=100)

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
GDP Deflator		100.00	111.58	121.61	127.62	131.45	139.34	147.70	165.95	222.08
Import (GNFS)		100.00	103.66	103.99	136.68	146.98	155.20	163.35	171.52	196.23
Export (GNFS)		100.00	102.91	104.94	139.38	148.82	156.57	164.95	173.74	200.07
Total Expenditures		100.00	111.62	121.30	126.88	130.93	139.24	147.62	165.69	221.03
Consumption		100.00	112.81	121.48	122.53	128.15	136.68	145.01	162.85	217.05
Investment		100.00	111.58	121.60	127.63	135.29	143.40	152.01	170.80	228.57
Agriculture		100.00	115.60	123.89	130.89	138.74	147.07	155.89	175.16	234.40
Industry, of which:		100.00	104.21	110.42	112.22	118.95	126.09	133.66	150.18	200.97
Mining		100.00	104.21	110.42	112.22	118.95	126.09	133.66	150.18	200.97
Manufacturing		100.00	104.21	110.42	112.22	118.95	126.09	133.66	150.18	200.97
Services		100.00	119.07	137.82	152.39	146.62	155.02	163.65	182.56	239.70

Part G: Other Economic Indicators

	1973-80	1980-90	1990-95	1995-200	1973	1980	1990
Import Elasticity based on							
Imports (GNFS)							-3.14
Marginal Saving Rates:							
Gross Domestic Saving							
Gross National Saving							
ICOR (period averages)							7.10
Labor Force(%):							
Agriculture							
Industry							
Services							
Total							

CHINA -- External Trade

A: Volume, Value, and Prices

BASECASE

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1994	2000
Volume Indices 1987=100										
Merchandise Exports										
Food		100	112	124	155	162	170	179	188	252
Petroleum		100	118	107	105	103	101	99	97	86
Manufactures		100	118	134	156	168	181	194	209	330
Other		100	123	121	107	115	124	134	145	230
Total Merchandise Exports (FOB)		100	118	122	131	137	144	151	160	224
Value Current Prices (US$ millions)										
Merchandise Exports:										
Food		5037	6200	6544	7094	6952	7568	8228	8491	12812
Petroleum		4544	3950	4321	5225	4068	3808	3916	3919	4444
Manufactures		26206	33110	37460	46206	53695	58242	63174	68523	114211
Other		3650	4257	4212	3537	3581	3812	4117	4439	7816
Total Merchandise Exports (FOB)		39437	47518	52537	62063	68297	73430	79435	85371	139284
Volume Indices 1987=100										
Merchandise Imports:										
Food		100	124	165	161	169	178	189	200	290
Other Consumer goods		100	97	104	109	116	123	132	142	221
POL and Other Energy /1		100	198	344	215	226	238	252	267	388
Intermediate Goods n.e.i-- /2		100	134	135	101	127	161	177	194	291
Primary Goods										
Manufactured Goods										
Capital Goods		100	115	124	119	137	168	184	201	303
Total Merchandise Imports CIF		100	134	174	141	155	174	187	201	299
Value Current Prices (US$ millions)										
Merchandise Imports:										
Food		3055	4191	5269	4474	4385	4796	5263	5484	8967
Other Consumer goods		1743	1757	1866	2051	2350	2528	2734	2957	4870
POL and Other Energy		539	787	1650	1272	1061	1070	1190	1288	2394
Intermediate Goods n.e.i--		16769	23391	23415	18327	24764	31859	35231	38961	61805
Primary Goods										
Manufactured Goods										
Capital Goods		21110	25150	26940	27225	33845	41663	46073	50951	80824
Total Merchandise Imports CIF		43216	55275	59140	53350	66405	81914	90491	99640	158861
US$ Prices Indices 1987=100										
Merchandise Export Prices		100.00	103.75	103.91	108.84	114.21	115.38	116.87	117.94	126.57
Merchandise Import Prices		100.00	103.66	102.83	106.33	113.28	114.85	116.20	117.16	124.50
Merchandise Terms of Trade		100.00	100.08	101.04	102.37	100.82	100.46	100.58	100.66	101.66

/1.Crude and derivatives.
/2."n.e.i" denotes "not elsewhere included."

CHINA -- External Trade

B: Shares of Total, and Growth Rates

BASECASE

	Share of Merchandise Exports and imports(in current prices)				Export and Import Volume Growth Rates (from constant price data)			
	Actual	Estimate	Projected		Actual	Estimate	Projected	
	1980	1990	1995	2000	1980-90	1990	1990-95	95-2000
Merchandise Exports (%,% p.a):								
Food		11.4%	9.8%	9.2%				
Petroleum		8.4%	4.2%	3.2%				
Manufactures		74.5%	80.4%	82.0%				
Other		5.7%	5.5%	5.6%				
Total Merchandise Exports (FOB)		100.0%	100.0%	100.0%				
Merchandise Imports (%,% p.a.):								
Food		8.4%	5.5%	5.6%				
Other Consumer goods		3.8%	2.9%	3.1%				
POL and Other Energy		2.4%	1.3%	1.5%				
Intermediate Goods n.e.i.:		34.4%	39.1%	38.9%				
Primary Goods								
Manufactured Goods								
Capital Goods		51.0%	51.2%	50.9%				
Total Merchandise Imports (CIF)		100.0%	100.0%	100.0%				

C: Trends in Nonfactor Services

BASECASE

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Volume Indices 1987=100										
Exports of NonFactor Services		100.00	90.00	80.28	84.00	90.30	97.08	104.36	120.60	173.13
Imports of NonFactor Services		100.00	123.39	133.08	116.10	135.65	165.04	180.21	212.83	295.27
US$ Price Indices 1987=100										
Exports of NFS		100.00	107.28	106.50	112.83	121.96	123.06	124.17	126.41	132.21
Imports of NFS		100.00	103.66	102.80	106.43	113.28	114.85	116.20	118.36	124.50

CHINA -- Balance of Payments

(US$ millions at current prices)

BASECASE

		Actual			Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
A. Exports of GNFS: /1		43823	51753	56287	66220	73128	78670	85118	99146	149323
1.Merchandise (FOB)		39437	47518	52537	62063	68297	73430	79435	92460	139284
2.Non-Factor Services		4386	4235	3750	4157	4831	5240	5683	6687	10039
B. Imports of GNFS:		43216	55275	59140	53350	66405	81914	90491	108864	158861
1.Merchandise (FOB)		39629	50687	54231	48922	60894	75115	82981	99828	145675
2.Non-Factor Services		3587	4588	4909	4428	5512	6799	7511	9036	13185
C. Resource Balance		607	-3522	-2853	12870	6722	-3244	-5374	-9717	-9538
D. Net Factor Income		-790	-699	-3120	-1712	-1584	-1543	-1708	-1962	-3940
1.Factor Receips		1027	1504	1362	1551	1676	1810	1954	2280	3349
2.Factor Payments--		1817	2203	4482	3263	3259	3353	3663	4242	7290
a.Total Interest Paid(DRS)/2		1815	2195	3203	3146	3131	3211	3507	4054	6987
b.Interest Arrears										
c.Other Factor Payments		0	0	0	0	0	0	0	0	0
E. Net Current Transfers:		249	416	238	. 195	197	199	201	206	218
1.Current Receipts--		260	428	247	200	202	204	206	211	223
a. Workers remittances		166	129	76	108	110	112	114	119	131
b. Other current Transfers		94	299	171	92	92	92	92	92	92
2.Current Payments		11	12	9	5	5	5	5	5	5
F. Current Account Balance:										
1.Before Official Capital Grants		66	-3805	-4460	11935	5335	-4333	-6054	-9707	-8127
2.Official Capital Grants		-25	3	143	65	65	65	65	65	65
3.After Official Capital Grants		41	-3802	-4317	12001	5401	-4267	-5988	-9642	-8061
. Long Term Capital Inflows n.e.i.:/3		5815	7053	3212	3900	4340	7004	8653	9235	12032
1.Direct Investment		1669	2344	2613	2660	2660	2820	2989	3358	4494
2.Net Long-Term (LT) Borrowing (DRS)--		6131	6781	4501	3290	1680	4185	5664	5876	7538
a.Disbursements										
b.Repayments										
3.Other LT Inflows (net)		-1985	-2072	-3902	-2050	0	0	0	0	0
H. Total Other Items (net):		-1630	-1588	-625	-4330	0	0	0	0	0
1.Net Short-Term (ST) Capital n.e.i.--		-180	-494	-670	-2000	0	0	0	0	0
a.Interest Arrears										
b.Other Net ST Capital										
2.Capital Flows n.e.i.		0	0	0	0	0	0	0	0	0
3.Errors and omissions		-1450	-1094	45	-2330	0	0	0	0	0
I. Change in Net Reserves: [-indicates increase]		-4226	-1663	1730	-11700	-9740	-2737	-2665	408	-3971
1. Net Credit from the IMF		-81	-83	-79	-490	-469	0	0	0	0
2. Reserves Changes n.e.i.		-4145	-1580	1809	-11210	-9271	-2737	-2665	408	-3971
3. Escrow account	0	0	0	0	0	0	0	0	0	0

/1.Goods and nonfactor services.
/2."DRS" denotes "Debtor Reporting System."
/3."n.e.i." denotes "not elsewhere included."

CHINA -- Balance of Payments

(US$ millions at current prices)

BASECASE

		Actual			Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
J. As Shares of GDP (current US$):										
1.Resource Balance		0.2%	-0.9%	-0.7%	3.5%	1.7%	-0.8%	-1.2%	-1.8%	-1.0%
2.Interest Payments (LT+IMF+ST)		0.6%	0.6%	0.5%	0.7%	0.8%	0.7%	0.6%	0.4%	0.2%
3.Current Account Balance (See F.1)		0.0%	-1.0%	-1.1%	3.3%	1.4%	-1.0%	-1.3%	-1.7%	-0.9%
4.LT capital Inflow (See F.2+G.)		2.6%	2.4%	2.1%	2.5%	0.5%	0.1%	0.1%	0.4%	0.5%
5.Net Credit from the IMF		0.0%	0.0%	0.0%	-0.1%	-0.1%	0.0%	0.0%	0.0%	0.0%
K. Foreign Exchange Reserves:										
1.Gross Reserves (excluding gold)		22453	23751	19333	29826	35997	39354	41708	35848	56092
2.Gold (end-year London price)				3720	4650	7750	7130	7440	8990	
3.Gross Reserves (including gold)		22453	23751	23053	34476	43747	46484	49148	44838	56092
4.Gross Reserves (in months imports)		6.0	5.0	4.5	7.4	7.5	6.6	6.3	4.8	4.2
L. Exchange Rates:										
1.In Nominal Terms (Yuan/US$): /4		100.00	100.00	101.12	128.54	129.75	135.13	140.59	144.92	157.62
a.Primary (Official) Rate--										
Annual Average		3.72	3.72	3.76	4.78	4.83	5.03	5.23	5.39	5.87
End-of-Year		3.72	3.72	4.72	5.22	4.93	5.13	5.28	5.44	5.91
b.GNP Conversion Factor		3.72	3.72	3.76	4.78	4.83	5.03	5.23	5.39	5.87
2.In Real Terms (base 1987=100):										
a.MUV (PAC estimates) /5 /6		100.00	107.28	106.50	112.82	118.48	120.58	122.86	133.92	164.77
b.Index Real Exchange Rate /7 (US$/Yuan)		3.72	3.58	3.30	4.23	4.35	4.35	4.35	4.35	4.35
M. Memorandumn Item:										
GDP (current US$M)		304417	376416	421348	364813	390861	419698	453288	555162	935840
N. Optional Details for RMSM-X:										
1.Total Factor Payments--										
a.Government Interest		419	449	363	544	603	579	485	459	3[illegible]
b.Private Sector Interest		1217	1554	1409	1787	2269	2128	1987	1631	1344
c.Profit on Direct Foreign Investment		0	0	0	0	0	0	0	0	0
2.Official Capital Grants--		-25	3	143	65	65	65	65	65	65
a.For Budgetary Financing		-25	3	143	65	65	65	65	65	65
b.To Extra-Budgetary Entities (OPS) /8										
3.Government Net LT Borrowing		1738	777	841	1293	648	444	673	1432	1392
a.Disbursements										
b.Repayments										
4.Private Net LT Borrowing		9076	5992	-1984	9078	754	3551	4703	3830	5550
a.Disbursements										
b.Repayments										

/4."LCU" denotes "local currency units."
/5."MUV" denotes the unit value index of manufactured exports from selected industrialized countries (France, Germany, Japan, U.K., and U.S.) to developing country markets expressed in U.S. dollars.
/6."PAC" refers to the Bank's "Planning Assumptions Committee."
/7.An increase in US$/Yuan denotes appreciation.
/8."OPS" denotes "Other Public Sector Entities." These entities are included in the "Private Sector Account (see Annex B8).

CHINA -- Government Budget
(billions of Yuan at current prices)

BASECASE

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Direct Taxes		67	68	69	72	87	97	109	138	253
Indirect Taxes		166	190	224	228	245	274	308	389	714
NonTax Receipts		25	23	38	47	57	63	71	90	165
Total Current Revenues		257	280	330	347	389	435	489	617	1131
Interest on External Debt										
Interest on Domestic Debt										
Other Current Transfers		0	0	0	0	0	0	0	0	0
Subsidies		67	76	97	96	94	106	119	150	275
Consumption		95	112	129	143	147	166	186	235	429
Total Current Expenditures		207	242	289	307	354	399	452	560	1031
Budgetary Savings		55	44	42	47	44	45	48	70	119
Capital Revenues		22	17	-1	22	8	7	9	14	18
Capital Transfers		0	0	0	0	0	0	0	0	0
Budgetary Investment		44	56	62	68	76	84	95	120	220
Total Capital Expenditures		96	113	130	148	162	181	204	257	472
Total Deficit Financing		19	52	89	79	111	129	147	173	335
External Capital Grants		0	0	0	0	0	0	0	0	0
External Borrowing (net)		7	8	5	5	3	2	4	8	8
Monetary System Credit (net)		15	10	-6	17	4	5	5	6	10
Other Domestic Borrowing (net)		-18	1	32	12	33	42	50	51	111
Debt (at end of the year)										
External Debt										
(in millions of Yuan)		27	30	42	53	53	58	63	79	132
(in millions of US$)		7215	7992	8833	10126	10774	11218	11891	14475	22387
Domestic Debt										
To Monetary System		21	31	25	42	46	51	56	68	109
Other Domestic Debt		43	68	92	99	132	175	225	321	736
Memorandum Item										
Primary Deficit		15	46	84	72	94	108	120	149	283

CHINA -- Money and Credit

(billions of Yuan at current prices)

BASECASE

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
A. Annual Flows										
Net International Reserves		22	5	20	71	36	23	21	1	28
Net Domestic Credit		144	168	179	279	70	135	235	310	568
To Goverment Budget		15	10	-6	17	4	5	5	6	10
To Other Official Entities	0	0	0	0	0	0	0	0	0	0
To Private Sector		129	158	185	261	66	131	230	304	558
Total Assets and Liabilities		166	172	200	350	106	158	257	311	596
Money and Quasimoney			166	189	338	99	148	245	296	567
Net Other Liabilities		-14	-10	-2	-1	10	27	28	32	66
B. End of Year Stocks										
Net International Reserves		84	88	109	180	216	239	260	244	332
Net Domestic Credit		812	980	1159	1437	1507	1643	1878	2407	4689
To Goverment Budget		21	31	25	42	46	51	56	68	109
To Other Official Entities										
To Private Sector		791	949	1134	1395	1461	1592	1822	2339	4580
Total Assets and Liabilities		896	1068	1268	1617	1723	1881	2138	2651	5021
Money and Quasimoney		844	1010	1199	1537	1636	1784	2029	2513	4769
Net Other Liabilities		-2	-12	-15	-16	-5	22	49	109	366
C. Offsets to Expansion of MQM /1										
Increase in Money+Quasimoney(in %)			100.2%	99.9%	99.8%	97.8%	102.7%	101.2%	102.3%	101.8%
Net Foreign Assets			2.2%	8.1%	19.6%	35.9%	14.2%	7.8%	-0.9%	4.2%
Net Domestic Credit			95.7%	96.4%	83.3%	79.0%	113.7%	109.6%	119.0%	114.4%
Credit to Governmnet Budget			5.5%	-3.1%	5.2%	4.8%	3.9%	2.4%	2.4%	2.0%
Credit to Official Entities			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Credit to Private Sector			90.2%	99.5%	78.1%	74.2%	109.8%	107.2%	116.6%	112.4%
Net Other Liabilities			2.4%	-4.6%	-3.1%	-17.1%	-25.2%	-16.2%	-15.8%	-16.8%
D. Memorandum Items										
Net International Reserves (in millions of US$)										
Change during the year		-4145	-1580	1809	-11210	-9271	-2737	-2665	408	-3971
Stock at the End of Year		22453	23751	23053	34476	43747	46484	49148	44838	56092

/1."MQM" denotes "money and quasimoney."

CHINA -- Private Sector Account

(includes Other Public Sector [OPS] activities)

(billions of Yuan at current prices)

BASECASE

	Actual				Estimated	Projected				
	1980	1987	1988	1989	1990	1991	1992	1993	1995	2000
Current Account										
Factor Income		1035	1287	1459	1614	1737	1942	2182	2755	5051
Interest Transfers from Budget		2	3	3	3	14	18	24	22	50
Other Transfers from Budget		40	49	58	62	94	106	119	150	275
Factor Income from ROW /1		0	0	0	0	0	0	0	0	0
Workers' Remittances from ROW		1	0	0	1	1	1	1	1	1
Current Transfers from ROW		0	1	1	0	0	0	0	0	1
Less Direct Taxes		67	68	69	72	87	97	109	138	253
Less Nontax Budgetary Receips		25	23	38	47	57	63	71	90	165
Less Interest Paid to ROW		5	6	5	9	11	11	10	9	8
Less DFI Profits Paid to ROW /2		0	0	0	0	0	0	0	0	0
Less Current Transfers to ROW		0	0	0	0	0	0	0	0	0
Total Disposable Income		940	1257	1436	1567	1672	1876	2113	2661	4888
Uses of Disposable Income:										
Private Consumption		593	747	849	858	960	1127	1291	1690	3134
Private Savings		348	510	588	709	712	749	822	971	1755
Capital Account										
Total Capital Sources:										
Private Saving		348	510	588	709	712	749	822	971	1755
Capital Grants (ROW to OPS)			0	0	0	0	0	0	0	
Direct Foreign Investment		6	9	10	13	13	14	16	18	26
LT Borrowing from ROW (net) /3		11	13	8	8	4	18	25	21	33
Other LT Inflows from ROW (net)			0	0	0	0	0	0	0	
ST Borrowing from ROW (net) /4		-1	-2	-3	-10	0	0	0	0	0
Capital Transfers from Government		0	0	0	0	0	0	0	0	0
Monetary System Net Borrowing		129	158	185	261	66	131	230	304	558
Total Capital Uses:										
Gross Domestic Investment		399	500	557	614	672	750	828	1002	1764
BOP Capital Flows n.e.i. /5		0	0	0	0	0	0	0	0	0
Budgetary Capital Revenues		22	17	-1	22	8	7	9	14	18
Loans to Government		-18	1	32	12	33	42	50	51	111
Money and Quasimoney			166	189	338	99	148	245	296	567
Other Monetary System Liabilities										

/1."ROW" denotes "rest of the world."
/2."DFI" denotes "direct foreign investment."
/3."LT" denotes "long-term."
/4."ST" denotes "short-term."
/5."n.e.i." denotes "net elsewhere included."

CHINA: COUNTRY STRATEGY PAPER

PROPOSED LENDING OPERATIONS (FY93-97)

SUMMARY TABLE

Sector/Division	LOW CASE Bank --$ Million--	LOW CASE IDA	BASE CASE Bank --$ Million--	BASE CASE IDA	HIGH CASE Bank --$ Million--	HIGH CASE IDA
COD-managed Policy Lending (CO)	-	-	-	-	1,100	-
Agriculture (AG)	1,180	2,163	1,515	2,898	1,515	2,898
Industry & Energy (IE)	1,825	-	3,775	-	4,775	-
Transport (TP)	2,870	-	3,560	-	3,560	-
Environment, Human Resources & Urban Development (EH)	880	1,260	1,050	1,920	1,050	1,920
All Sectors	6,755	3,423	9,900	4,818	12,000	4,818
# OF OPERATIONS	57		77		84	
TOTAL	10,178		14,718		16,818	
IBRD/IDA BLEND	66:34		67:33		71:29	

CHINA - FY93 LENDING PROPOSALS

23-Oct-91
12:42 PM
FY93: JW

LOW CASE

Div.	Project	Bank	IDA
		--$ Million---	
AG	SICHUAN ADP		143.0
AG	AG. SUPPORT SERVICES		110.0
AG	XIAOLANGDI MULTIPURP.	140.0	160.0
	SUBTOTAL (AG)	140.0	413.0
IE	SHUIKOU II	140.0	
IE	SICHUAN GAS	150.0	
IE	ZOUXIAN	250.0	
	SUBTOTAL (IE)	540.0	0.0
TP	GUANGDONG PROV. TRANS.	270.0	
TP	SHANGHAI PORT II	200.0	
TP	HENAN PROV. TRANSPORT	120.0	
	SUBTOTAL (TP)	590.0	0.0
EH	ZHEJIANG URBAN		150.0
EH	CHANGCHUN WATER		120.0
EH	TIANJIN URB DEV & ENV		100.0
	SUBTOTAL (EH)	0.0	370.0
	TOTAL (LOW) (# OF OPERATIONS: 12)	1,270.0	783.0
	TOTAL:	2,053.0	
	IBRD/IDA BLEND:	62:38	

BASE CASE

Div.	Project	Bank	IDA
		----$ Million----	
AG	GRAIN DISTRIBUTION	240.0	160.0
AG	SICHUAN ADP		143.0
AG	AG. SUPPORT SERVICES		110.0
AG	XIAOLANGDI MULTIPURP.	140.0	160.0
	SUBTOTAL (AG)	380.0	573.0
IE	SHUIKOU II	140.0	
IE	SICHUAN GAS	150.0	
IE	TIANJIN IND. II	100.0	
IE	SHENYANG IND.	100.0	
IE	ZOUXIAN	250.0	
	SUBTOTAL (IE)	740.0	0.0
TP	GUANGDONG PROV. TRANS.	270.0	
TP	SHANGHAI PORT II	200.0	
TP	HENAN PROV. TRANSPORT	110.0	
	SUBTOTAL (TP)	580.0	0.0
EH	ZHEJIANG URBAN		150.0
EH	CHANGCHUN WATER		120.0
EH	TIANJIN URB DEV & ENV		100.0
	SUBTOTAL (EH)	0.0	370.0
	TOTAL (BASE) (# OF OPERATIONS: 15)	1,700.0	943.0
	TOTAL:	2,643.0	
	IBRD/IDA BLEND:	64:36	

HIGH CASE

Div.	Project	Bank	IDA
		----$ Million----	
AG	GRAIN DISTRIBUTION	240.0	160.0
AG	SICHUAN ADP		143.0
AG	AG. SUPPORT SERVICES		110.0
AG	XIAOLANGDI MULTIPURP.	140.0	160.0
	SUBTOTAL (AG)	380.0	573.0
IE	SHUIKOU II	140.0	
IE	SICHUAN GAS	150.0	
IE	TIANJIN IND. II	100.0	
IE	SHENYANG IND.	100.0	
IE	ZOUXIAN	250.0	
	SUBTOTAL (IE)	740.0	0.0
TP	GUANGDONG PROV. TRANS.	270.0	
TP	SHANGHAI PORT II	200.0	
TP	HENAN PROV. TRANSPORT	120.0	
	SUBTOTAL (TP)	590.0	0.0
EH	ZHEJIANG URBAN		150.0
EH	CHANGCHUN WATER		120.0
EH	TIANJIN URB DEV & ENV		100.0
	SUBTOTAL (EH)	0.0	370.0
	TOTAL (HIGH) (# OF OPERATIONS: 15)	1,710.0	943.0
	TOTAL:	2,653.0	
	IBRD/IDA BLEND:	64:36	

CHINA - FY94 LENDING PROPOSALS

LOW CASE

Div.	Project	Bank ----$ Million----	IDA
AG	FLOODS		200.0
AG	SONGLIAO PLAIN ADP		190.0
AG	RED SOILS II		185.0
	SUBTOTAL (AG)	0.0	575.0
IE	TIANHUANGPING	250.0	
	SUBTOTAL (IE)	250.0	0.0
TP	SHANGHAI MTP II	200.0	
TP	FUJIAN HWY	150.0	
TP	NATIONAL HIGHWAY	200.0	
	SUBTOTAL (TP)	550.0	0.0
EH	SCIENCE & TECH.	150.0	
EH	HUMAN RESOURCES		150.0
EH	SHANGHAI ENVIRONMENT	125.0	25.0
	SUBTOTAL (EH)	275.0	175.0
	TOTAL (LOW) (# OF OPERATIONS: 10)	1,075.0	750.0
	TOTAL:	1,825.0	
	IBRD/IDA BLEND:	59:41	

BASE CASE

Div.	Project	Bank ----$ Million----	IDA
AG	FLOODS		200.0
AG	SONGLIAO PLAIN ADP		190.0
AG	RED SOILS II		185.0
	SUBTOTAL (AG)	0.0	575.0
IE	ELECTRONICS I	150.0	
IE	SHANGHAI IND. EFF.	150.0	
IE	FINAN DEV LOAN	250.0	
IE	TIANHUANGPING	250.0	
	SUBTOTAL (IE)	800.0	0.0
TP	SHANGHAI MTP II	200.0	
TP	RAILWAYS VI	350.0	
TP	FUJIAN HWY	150.0	
TP	NATIONAL HIGHWAY	200.0	
	SUBTOTAL (TP)	900.0	0.0
EH	SCIENCE & TECH.	100.0	50.0
EH	HUMAN RESOURCES		150.0
EH	HOUSING/SOC. SEC. REFORM	200.0	150.0
EH	SHANGHAI ENVIRONMENT	50.0	100.0
	SUBTOTAL (EH)	350.0	450.0
	TOTAL (BASE) (# OF OPERATIONS: 15)	2,050.0	1,025.0
	TOTAL:	3,075.0	
	IBRD/IDA BLEND:	67:33	

HIGH CASE

Div.	Project	Bank ----$ Million----	IDA
CO	PRICE REFORM	400.0	
AG	FLOODS		200.0
AG	SONGLIAO PLAIN ADP		190.0
AG	RED SOILS II		185.0
	SUBTOTAL (AG)	0.0	575.0
IE	ELECTRONICS I	150.0	
IE	SHANGHAI IND. EFF.	150.0	
IE	FINAN DEV LOAN	250.0	
IE	TIANHUANGPING	250.0	
	SUBTOTAL (IE)	800.0	0.0
TP	SHANGHAI MTP II	200.0	
TP	RAILWAYS VI	350.0	
TP	FUJIAN HWY	150.0	
TP	NATIONAL HIGHWAY	200.0	
	SUBTOTAL (TP)	900.0	0.0
EH	SCIENCE & TECH.	100.0	50.0
EH	HUMAN RESOURCES		150.0
EH	HOUSING/SOC. SEC. REFORM	200.0	150.0
EH	SHANGHAI ENVIRONMENT	50.0	100.0
	SUBTOTAL (EH)	350.0	450.0
	TOTAL (HIGH) (# OF OPERATIONS: 16)	2,450.0	1,025.0
	TOTAL:	3,475.0	
	IBRD/IDA BLEND:	71:29	

CHINA - FY95 LENDING PROPOSALS

LOW CASE

Div.	Project	Bank ($ Million)	IDA ($ Million)
AG	FORESTRY SECTOR II	100.0	200.0
AG	IAIL III	200.0	
AG	ANIMAL FEED & NUTR.	70.0	100.0
AG	LOESS PLATEAU		150.0
	SUBTOTAL (AG)	370.0	450.0
IE	SHANXI COAL CONS. & ENV.	200.0	
IE	SO. JIANGSU ENV.	150.0	
	SUBTOTAL (IE)	350.0	0.0
TP	H'WAY VIII	150.0	
TP	URBAN TRANSPORT iii	150.0	
TP	INLAND WATERWAYS	150.0	
	SUBTOTAL (TP)	450.0	0.0
EH	LIAONING ENVIRONMENT	150.0	
EH	ZHEJIANG ENVIRONMENT	150.0	
EH	HEALTH IV		180.0
	SUBTOTAL (EH)	300.0	180.0
	TOTAL (LOW) (# OF OPERATIONS: 12)	1,470.0	630.0

TOTAL: 2,100.0

IBRD/IDA BLEND: 70:30

BASE CASE

Div.	Project	Bank ($ Million)	IDA ($ Million)
AG	FORESTRY SECTOR II	100.0	200.0
AG	RURAL FINANCIAL SECTOR	200.0	200.0
AG	IAIL III	200.0	
AG	ANIMAL FEED & NUTR.		170.0
AG	LOESS PLATEAU		150.0
	SUBTOTAL (AG)	500.0	720.0
IE	SHANXI COAL CONS. & ENV.	200.0	
IE	FERT. & PROCESS EQUIP.	150.0	
IE	SO. JIANGSU ENV.	150.0	
IE	GUANGDONG/MED.SCALE FERT.	300.0	
	SUBTOTAL (IE)	800.0	0.0
TP	H'WAY VIII	200.0	
TP	URBAN TRANSPORT III	150.0	
TP	INLAND WATERWAYS	150.0	
	SUBTOTAL (TP)	500.0	0.0
EH	LIAONING ENVIRONMENT	125.0	25.0
EH	ZHEJIANG ENVIRONMENT	125.0	25.0
EH	HEALTH IV		180.0
	SUBTOTAL (EH)	250.0	230.0
	TOTAL (BASE) (# OF OPERATIONS: 15)	2,050.0	950.0

TOTAL: 3,000.0

IBRD/IDA BLEND: 68:32

HIGH CASE

Div.	Project	Bank ($ Million)	IDA ($ Million)
AG	FORESTRY SECTOR II	100.0	200.0
AG	RURAL FINANCIAL SECTOR	200.0	200.0
AG	IAIL III	200.0	
AG	ANIMAL FEED & NUTR.		170.0
AG	LOESS PLATEAU		150.0
	SUBTOTAL (AG)	500.0	720.0
IE	SHANXI COAL CONS. & ENV.	200.0	
IE	FERT. & PROCESS EQUIP.	150.0	
IE	SO. JIANGSU ENV.	150.0	
IE	GUANGDONG/MED.SCALE FERT.	300.0	
IE	RURAL INDUSTRY II (SPARK)	300.0	
IE	FIDL II	300.0	
	SUBTOTAL (IE)	1,400.0	0.0
TP	H'WAY VIII	150.0	
TP	PORTS VIII	150.0	
TP	INLAND WATERWAYS	150.0	
	SUBTOTAL (TP)	450.0	0.0
EH	LIAONING ENVIRONMENT	125.0	25.0
EH	ZHEJIANG ENVIRONMENT	125.0	25.0
EH	HEALTH IV		180.0
	SUBTOTAL (EH)	250.0	230.0
	TOTAL (HIGH) (# OF OPERATIONS: 17)	2,600.0	950.0

TOTAL: 3,550.0

IBRD/IDA BLEND: 73:27

CHINA - FY96 LENDING PROPOSALS

LOW CASE

Div.	Project	Bank	IDA
		--$ Million--	
AG	State Farms Commercialization	250.0	
AG	Oilseed Sector	195.0	
AG	Poor Areas Dev.		180.0
AG	Ag. Supp. Serv. 2		150.0
	SUBTOTAL (AG)	445.0	330.0
IE	Ertan 2	200.0	
IE	Longtan Hydro	200.0	
	SUBTOTAL (IE)	400.0	0.0
TP	Metropolitan Trans. (N/S)	130.0	
TP	Prov. Trans. (N/S)	150.0	
TP	National Highways 2	200.0	
	SUBTOTAL (TP)	480.0	0.0
EH	Prov. Education 2		200.0
EH	Rural Water Supply 3		100.0
EH	Environment (N/S)	145.0	
	SUBTOTAL (EH)	145.0	300.0
TOTAL (LOW) (# OF OPERATIONS: 12)		1,470.0	630.0
	TOTALS:	2,100.0	
	IBRD/IDA BLEND:	70:30	

BASE CASE

Div.	Project	Bank	IDA
		--$ Million--	
AG	State Farms Commercialization	150.0	100.0
AG	Oilseed Sector	150.0	45.0
AG	Poor Areas Dev.		180.0
AG	Ag. Supp. Serv. 2		150.0
	SUBTOTAL (AG)	300.0	475.0
IE	Ertan 2	200.0	
IE	Longtan Hydro	200.0	
IE	Shenyang Ind. 2	100.0	
IE	Finance (N/S)	300.0	
	SUBTOTAL (IE)	800.0	0.0
TP	Ports VIII	130.0	
TP	Prov. Trans. (N/S)	150.0	
TP	National Highways 2	200.0	
TP	Railways VII	300.0	
	SUBTOTAL (TP)	780.0	0.0
EH	City Manangement (N/S)	100.0	100.0
EH	Prov. Education 2		200.0
EH	Rural Water Supply 3		100.0
EH	Environment (N/S)	70.0	75.0
	SUBTOTAL (EH)	170.0	475.0
TOTAL (BASE) (# OF OPERATIONS: 16)		2,050.0	950.0
	TOTAL:	3,000.0	
	IBRD/IDA BLEND:	68:32	

HIGH CASE

Div.	Project	Bank	IDA
		--$ Million--	
CO	Trade Reform	350.0	
	SUBTOTAL (CO)	350.0	
AG	State Farms Commercialization	150.0	100.0
AG	Oilseed Sector	150.0	45.0
AG	Poor Areas Dev.		180.0
AG	Ag. Supp. Serv. 2		150.0
	SUBTOTALS (AG)	300.0	475.0
IE	Ertan 2	200.0	
IE	Longtan Hydro	200.0	
IE	Shenyang Ind. 2	100.0	
IE	Finance (N/S)	300.0	
IE	Nonstate Ent. Dev.	200.0	
	SUBTOTAL (IE)	1,000.0	0.0
TP	Metropolitan Trans. (N/S)	130.0	
TP	Prov. Trans. (N/S)	150.0	
TP	National Highways 2	200.0	
TP	Railways VII	300.0	
	SUBTOTAL (TP)	780.0	0.0
EH	City Management (N/S)	100.0	100.0
EH	Prov. Education 2		200.0
EH	Rural Water Supply 3		100.0
EH	Environment (N/S)	70.0	75.0
	SUBTOTAL (EH)	170.0	475.0
TOTAL (HIGH) (# OF OPERATIONS: 18)		2,600.0	950.0
	TOTAL:	3,550.0	
	IBRD/IDA BLEND:	73:27	

CHINA - FY97 LENDING PROPOSALS

LOW CASE

Div.	Project	Bank (--$ Million--)	IDA
AG	S-N Water	100.0	100.0
AG	Forestry 3	100.0	200.0
AG	Prov. Ag. (N/S)	25.0	95.0
	SUBTOTAL (AG)	225.0	395.0
IE	Power (N/S)	285.0	
	SUBTOTAL (IE)	285.0	0.0
TP	Ports (N/S)	225.0	
TP	Inland Waterways 2	225.0	
TP	Prov. Transport (N/S)	150.0	
TP	Highway (N/S)	200.0	
	SUBTOTAL (TP)	800.0	0.0
EH	Environment (N/S)	60.0	75.0
EH	Health (N/S)		110.0
EH	Science and Technology 2	100.0	50.0
	SUBTOTAL (EH)	160.0	235.0
TOTAL (LOW) (# OF OPERATIONS: 12)		1,470.0	630.0

TOTALS: 2,100.0

IBRD/IDA BLEND: 70:30

BASE CASE

Div.	Project	Bank (--$ Million--)	IDA
AG	Grain Dist. 2	110.0	160.0
AG	S-N Water	100.0	100.0
AG	Forestry 3	100.0	200.0
AG	Prov. Ag. (N/S)	25.0	95.0
	SUBTOTAL (AG)	335.0	555.0
IE	Power (N/S)	285.0	
IE	Guangdong Ind. Reform	110.0	
IE	Jiangsu Ind. 2	110.0	
IE	Fert. (N/S)	130.0	
	SUBTOTAL (IE)	635.0	0.0
TP	Ports (N/S)	225.0	
TP	Inland Waterways 2	225.0	
TP	Prov. Transport (N/S)	150.0	
TP	Highway (N/S)	200.0	
	SUBTOTAL (TP)	800.0	0.0
EH	Housing 2	120.0	160.0
EH	Environment (N/S)	60.0	75.0
EH	Health (N/S)		110.0
EH	Science and Technology 2	100.0	50.0
	SUBTOTAL (EH)	280.0	395.0
TOTAL (BASE) (# OF OPERATIONS: 16)		2,050.0	950.0

TOTAL: 3,000.0

IBRD/IDA BLEND: 68:32

HIGH CASE

Div.	Project	Bank (--$ Million--)	IDA
CO	Trade Reform	350.0	
	SUBTOTAL (CO)	350.0	
AG	Grain Dist. 2	110.0	160.0
AG	S-N Water	100.0	100.0
AG	Forestry 3	100.0	200.0
AG	Prov. Ag. (N/S)	25.0	95.0
	SUBTOTALS (AG)	335.0	555.0
IE	Power (N/S)	285.0	
IE	Guangdong Ind. Reform	110.0	
IE	Jiangsu Ind. 2	110.0	
IE	Fert. (N/S)	130.0	
IE	Nonstate Ent. Dev.	200.0	
	SUBTOTAL (IE)	835.0	0.0
TP	Ports (N/S)	225.0	
TP	Inland Waterways 2	225.0	
TP	Prov. Transport (N/S)	150.0	
TP	Highway (N/S)	200.0	
	SUBTOTAL (TP)	800.0	0.0
EH	Housing 2	120.0	160.0
EH	Environment (N/S)	60.0	75.0
EH	Health (N/S)		110.0
EH	Science and Technology 2	100.0	50.0
	SUBTOTAL (EH)	280.0	395.0
TOTAL (HIGH) (# OF OPERATIONS: 18)		2,600.0	950.0

TOTAL: 3,550.0

IBRD/IDA BLEND: 73:27

CHINA: COUNTRY STRATEGY PAPER

ANNEX D: SUMMARY OF ECONOMIC AND SECTOR WORK

D1. Since 1987, representatives of the Bank and the Government have met annually to agree on a rolling three year program of economic and sector work (ESW). The proposed ESW program for 1992-94, as discussed below and summarized in Attachment 1, reflects the results of discussions held in July 1991.

Underlying Concerns

D2. The Department's current and future ESW is motivated by a related set of short and long term concerns regarding the Chinese economy. The principal short term objectives we perceive are to maintain the economy on a non-inflationary growth path; to narrow the budget deficit; and to maintain healthy external accounts. The major goal for the longer run is to maximize productive efficiency by strengthening mechanisms that enhance allocative efficiency and technological advancement. Four concerns straddle both periods: making sure that China's capital and human resources are put to the best possible use through industrial restructuring, with a start being made in this area through reforms in such spheres as housing and social security; sustaining resource mobilization and ensuring that an adequate volume of funds flows into the appropriate fiscal channels (central, provincial and local); institutional reforms promoting market competition together with the freer flow of goods as well as factors, and increased reliance on market determined prices; and attaining a degree of interprovincial market integration so as to take better advantage of China's natural economies of scale and keep regional income inequality within acceptable bounds. There are other important areas of concern, including for example infrastructure bottlenecks and the reform of agricultural marketing, but those listed above may be considered paramount.

D3. There is no dispute that the government's fiscal difficulties pose a potential threat to macro stability. In addition, closer monitoring of credit expansion at the provincial level is necessary to keep inflation in the low single digit range. But it is also apparent that the elasticity of government revenues will be restored and the burden of subsidies reduced, only if housing, social security and enterprise reforms can trigger meaningful industrial restructuring, especially critical within the still-dominant State enterprise sector. For tax yields to improve and subsidies to be cut, industrial productivity must rise and lossmakers be weeded out. At the same time, while not discounting the scope for further improvements in agriculture - or the potential and need for an increase in the tertiary sector's role - China's overall pace of development will continue to depend crucially on the achievement of efficiency gains and improved dynamism within industry.

D4. To be successful, industrial restructuring calls for analysis as well as policy action at many levels:

(a) The initial steps, as indicated above, could be in housing and social security, on which experimentation has begun to yield useful clues for action.

(b) The decentralization of economic management, so significant a facet of reform in China, requires further analysis. A better balance needs to be struck between provincial and lower level administrative agencies, that have accumulated wide powers, and enterprise management and market forces. This would remove some of the worrisome industrial rigidities. It would also facilitate tax reform and the sectoral apportionment of revenues.

(c) Industrial restructuring will inevitably entail a major rethinking of China's urban development and associated transport strategies. This is not just a matter of raising the level of investment but also of deciding on the future direction of urban growth and allocating resources to support a concentration of industry and population in those regions with the greatest promise.

(d) Industrial development, to be both efficient and in accordance with regional comparative advantage, will require labor and capital markets of greater breadth and flexibility. Gradually, as urban absorptive capacity is nurtured through housing and other reforms, intra along with inter provincial labor mobility must be encouraged so that capital can circulate throughout the economy and thereby bolster regional industrial strategies. Such mobility will also make a major contribution to eliminating China's remaining (largely region-specific) pockets of absolute poverty.

(e) Changing the composition of industry, the relocation of plant, consolidation of enterprises and a solution to the fiscal problem posed by chronic lossmakers, will require guidance from central as well as provincial economic agencies. However, its success will depend in at least equal part on the ability of the authorities to create a competitive market environment by freeing prices, and by setting up institutions that will work to promote labor mobility, lower barriers to trade, and discourage the formation of regional monopolies or cartels.

(f) An enduring solution to China's macroeconomic and industrial problems calls for a further rationalization of trade strategy. To sustain export growth, while progressively scaling back the subsidy outlay, China will have to build the production and marketing apparatus capable of dealing in increasingly sophisticated goods of higher quality. During the nineties, in fact, China will have to start the process of graduating from a variety of assembled or processed items aimed at the low priced end of the international market. Industrial restructuring and associated enterprise reform can yield some of the gains in productivity and product quality. But the trade strategy must also embrace at least four other areas: a deepening of marketing skills; a liberalization of imports within prudent limits, to provide industry with inputs plus embodied technology while at the same time minimizing tensions with trading partners; a supportive exchange rate policy along with measures to integrate domestic foreign exchange markets; and continuing hospitality towards direct foreign investment, especially in high technology industries.

D5. These objectives and concerns have guided the design of our economic and sector work over the recent past and strongly influence the program proposed for FY92-94. While the sectoral coverage remains broad, there is a central focus: industrial restructuring and its enabling social environment, because it impinges on so many of the economic issues China will face in the nineties. Our hope is that by framing our ESW in this fashion, we can provide analytical support to the new wave of reforms which the Government has begun implementing since mid 1990.

Studies Ongoing from FY91

D6. The FY92 Country Economic Memorandum, as well as analyzing recent trends in macroeconomic policy and reform, will provide an overall review of the Government's recently issued development and reform plans for the next five years and the balance of the decade. In addition, as a case study of development issues raised by the plans, the report will include a more detailed examination of the Government's proposals for the transport sector. Also ongoing are a study of policy developments and reform issues in Urban Labor Markets, whose improved efficiency will be one of the keys to raising industrial productivity, and an examination of the economic potential and restructuring requirements of China's Automobile Sector.

D7. Two broad sector-wide studies, on issues of fundamental institutional concern, are also at an advanced stage of preparation. The Environment Strategy paper presents a comprehensive survey of issues relating to environmental pollution and damage or destruction of natural resource systems, and makes recommendations both for Government policy measures and institutional development and for a future program of Bank environmental assistance. The Poverty Strategy paper examines recent evidence on the incidence and determinants of absolute poverty, and devotes special attention to the options for addressing the problems of the remote and backward rural areas where most of China's impoverished population is now concentrated: this study may also have potential links to future lending for regional development.

D8. To build on our recently published report on Options for Reform in the Grain Sector, we are commencing a more detailed study of Animal Feedgrains, an area of increasing importance with the progressive diversification of the Chinese diet, and one which raises significant issues of regional comparative advantage, internal distribution and transport and the appropriate role of international trade. This study would also help us determine whether a policy framework conducive to operational involvement in this subsector can be expected, and if so what form such involvement might take.

D9. In addition to the agreed program of formal ESW, the Department continues to maintain an ongoing program of collaborative research work in co-operation with Chinese agencies such as the Chinese Academy of Social Sciences (CASS) and the Development Research Center (DRC). Two years ago, we joined forces with CASS to conduct an empirical study of Industrial Efficiency. This has already yielded a number of valuable papers and we are aiming for completion of the project by next year. The initial phase of a second study on the effects of price adjustments on the rate of inflation and fiscal revenues, being undertaken in collaboration with the DRC, is approaching completion and we have also begun the groundwork on a third study which will attempt to explain the factors responsible for the success of export industries in the dynamic southern provinces of Guangdong and Fujian. This, too, is being carried out in collaboration with the DRC. The Department has also recently launched a new series of informal sector studies: seeking to provide concise pieces of policy-oriented analysis of key areas with lower resource requirements and a shorter turnaround time than formal ESW. Among the first topics targeted are Direct Foreign Investment and Strategic Issues for Price Reform, as well as Coal Pricing, Sino-Japanese Economic Relations and Rural Industrialization. A study of Intergovernmental Economic Relations is also well underway.

FY92-94 Program

D10. To extend and deepen our previous work on the fiscal system and intergovernmental relations, we will carry out a new study of Center-Provincial Policy Interlinkages. The purpose of this would be to analyze the evolving relations between different levels of government regarding credit supply and its distribution as well as the allocation of fiscal resources for the purposes of fixed investment.

D11. On industrial restructuring and the associated reforms of the financial sector, housing and social security, we are proceeding beyond our recently completed sector studies in each of these areas, by initiating one on Reform in Three Cities. This study will appraise, in an integrated fashion, the process of industrial reform and modernization in Shanghai, Tianjin and

Guangzhou. It will provide guidance on longer term reform strategy, as well as concrete suggestions on next steps. A closely related exercise on Market Development and Regional Integration will explore development in the Yangtze Basin and attempt to define policies to accelerate the integration of labor, capital and product markets, thereby injecting much needed competition into one of China's major regional subeconomies.

D12. Complementing the analysis of industrial restructuring, which we will conduct through our project on three major urban centers, will be three other industrial studies: on Machine Tools, the Marketing of Basic Materials and Energy Conservation. The former follows on the heels of our work on Electronics and Automobiles, and will permit us to include another key subsector in our industrial dialogue. The study of Basic Materials will allow us to examine the emergence of markets for key commodities, institutional changes and pricing policies. The third study will enable us to develop a significant dimension of industrial policy, an area we have touched upon through our work on Electricity Pricing and Coal Utilization, but without the degree of industrial sector specificity which is desirable. Both the machine tool study and that on energy conservation may also help generate new prospects for operational involvement.

D13. Our work on industrial reform in the major urban centers should also derive valuable reinforcement from our planned studies on Urban Land Issues, which will examine factors influencing current and future land utilization and progress and prospects in developing more active land markets in China's cities. The study of Teacher Training will contribute indirectly, though no less importantly, to the understanding of the causal mechanisms mediating successful industrial modernization. Without adequate supplies of suitably educated manpower, industrial progress will be constained. How China can produce teachers of the desired quality at least cost will be the objective of this exercise.

D14. Although reform and urban-industrial concerns are at the heart of our future ESW, we have no intention of neglecting the development of agriculture, transport and energy infrastructure. Once we have completed our work on Animal Feedgrain, we expect to commence, later in FY92, a study of Rural Expenditure and its Financing, which will analyze the pattern of rural expenditures with special emphasis on farm and irrigation infrastructure and inputs so as to determine how existing bottlenecks might be eased and the role that financial policies might play. A more geographically focussed study on water management issues--the Yellow River Investment Program--has been under preparation for some time and we expect to complete much of the work during FY92 although the final phases are likely to extend into FY93. We expect this exercise to enlarge the understanding of water availability and its use in China's northern grain producing areas. The study will also evaluate the capital requirements of this vast undertaking.

D15. Market integration, industrial restructuring and steady growth require the progressive expansion of China's still relatively backward transport facilities. As a part of our ESW for FY92, we would like to bring three ongoing activities to completion and start one new task. The principal findings and policy implications of the Railway Investment Study, under which technical assistance (TA) has been provided to the Ministry of Railways to develop new modelling techniques for screening and prioritizing investments in capacity expansion, will be crystallized in a short Bank report to be completed this year. We also intend to prepare short formal reports based on two other TA financed exercises. One of these, called Strategic Issues in Ports and Shipping, will identifiy problems affecting China's major ports and suggest remedial actions. The other will provide a farreaching, integrated, multimodal assessment of Transport Needs in the Yangtze Economic Zone. It refines and extends work we carried out two years ago on transport in

Guangdong province and will provide important inputs to the study of Regional Market Development (para. D10).

D16. Road transport, in particular the Trucking Industry, remains backward in China. If the country is to lessen the burden of intercity traffic in goods and passengers on the railway system and if it is to create the capacity for intra-urban door to door delivering, the trucking business will require sustained attention. The scale of the effort needed and policy directions would be mapped by our proposed study to start in late FY92 and end in the following year. A study which straddles the transport and energy sectors, and which also seeks to distill the lessons of accumulated TA, is that on Coal Transport: actual and potential flows of coal between producers and consumers will be examined in the context of a comprehensive energy sector planning model. Our other proposed study on the energy sector will focus on Power Distribution. The efficient use of power, especially in the urban areas, and the future provision of electricity to households are the two important topics which will be covered by this exercise.

D17. Although the main focus of our ESW will be on the domestic economy, the direction taken by China's Trade Strategy and the degree of economic openness will have significant bearing on industrial efficiency, technology transfer, foreign borrowing and the ability to sustain rapid growth. We therefore propose to start a new study in late FY92 to examine the reforms and institutional developments that may be necessary for China to maintain the momentum of its export drive during the rest of the 1990s, as the pattern of exports inevitably changes and diversifies. This would involve not only examining export issues, but the appropriate pace and pattern for import liberalization, and the future role of joint ventures and the special economic zones in modernizing the economy and in generating exports. This exercise would build on the work done in the recent past, especially in connection with the FY90 CEM, as well as the collaborative research on Export Industry in Southern China.

D18. Studies due to commence from FY93 onwards are inevitably less well-defined at this stage and more subject to modification and change. However, to follow-up our work both on center-provincial relations and on poverty, we anticipate that Center Provincial Relations (II) will examine the trends in fiscal transfers to China's poorer, interior provinces, the distribution of these funds across various expenditure categories and the implications of changes in such transfers on industrial restructuring together with the incomes of the poor. A study on Industrial Efficiency will draw upon our accumulated research in this area together with additional fieldwork to evaluate the gains from reforms over the previous seven years and define policies for promoting further productivity growth. Reform and Restructuring of State Enterprises to expose them to market discipline, increase efficiency and permit the majority to achieve financial viability will be the topic of a third study in FY93. In late FY93, we would also hope to begin work on a new CEM for 1994 that would provide a midcourse assessment of China's reform effort during the Eighth Plan and the success in shifting from a stabilization-oriented strategy to one focussed on reform-propelled growth. Last year we issued a Financial Sector Review which offered guidelines for institutional and policy reforms in the first half of the nineties. As financial reform is likely to remain critical to the success of industrial restructuring and the dispersion of ownership, it would be timely to initiate a study that concentrates on the Development of Capital and Money Markets towards the end of FY93. In FY93, we would also plan to conduct a fourth study of an Industrial Subsector so as to deepen further our policy analysis of the micro implication of reforms and restructuring: tentatively we have identified the basic metals industry.

D19. To expand our agricultural sector work beyond the grain sector, we plan in FY93 to commence a study concentrated on Agricultural Marketing and

Trade of Non-Grain Food Items, which are the most rapidly expanding segments of the farm sector. In FY94, we would expect to launch a closely related study to explore Opportunities for Agricultural Diversification, so that the vigor of agricultural growth can be sustained in the second half of the nineties. In the transport sector, meanwhile, we plan a Multimodal Review of Intercity Passenger Movement to map out trends in intercity travel as the level of urbanization increases and discuss various options for meeting demand, particularly along the Eastern corridor.

D20. Finally, two studies are planned on the decentralized financing of public services. Work on Health Finance will build on our recently completed Long-Term Issues and Options in the Health Transition to examine in greater depth financial strategies to meet the challenges posed by the changing epidemiological profile (increase in chronic diseases), the weakening of earlier communal health schemes and the rising cost of curative health care. Urban Finance will take a cross-sectoral view of issues related to the financing of urban infrastructure and services through local taxation, user charges and inter-governmental transfers, in the light of anticipated changes in the overall tax structure and local responsibility system.

D21. While the above constitutes the three-year program formally agreed in July 1991, preparation of forward-looking ESW programs is an iterative process, and new concepts for future work are constantly being generated within the Department. Among the ideas which we expect to propose for approval in the future would be work on developing appropriate regulatory structures for increasingly autonomous public utility enterprises (e.g. in the power sector), and more explicit examination of urban safety net issues (and provision, more broadly, of social services and infrastructure) for the temporary or "floating" urban population. Given the importance of the service sector in the Government's plans for further employment creation (one of the themes of the forthcoming CEM), we also need to find appropriate vehicles for more in-depth analysis of the relevant issues.

China: Proposed Rolling Three Year ESW Program, FY92-94

The abbreviations that have been used in the tables are as follows:

MOF	=	Ministry of Finance
CASS	=	Chinese Academy of Social Sciences
PBC	=	People's Bank of China
SRC	=	Systems Reform Commission
DRC	=	Development Research Center of the State Council
SPC	=	State Planning Commission
ERC	=	SPC's Economic Research Center
CNAIC	=	China National Auto Industry Corporation
PLG	=	Poor Areas Leading Group
SEdC	=	State Education Commission
MOL	=	Ministry of Labor
MOR	=	Ministry of Railways
MOC	=	Ministry of Communications
MOA	=	Ministry of Agriculture
NEPA	=	National Environmental Protection Agency
MOCI	=	Ministry of Coal Industry
SPB	=	State Price Bureau
MOE	=	Ministry of Energy
MEMB	=	Ministry of Electronics and Machine Building
SLA	=	State Lands Administration
MWR	=	Ministry of Water Resources
YRCC	=	Yellow River Commission
MOFERT	=	Ministry of Foreign Economic Relations and Trade
SLA	=	State Lands Administration
MME	=	Ministry of Materials and Equipment
MMET	=	Ministry of Metallurgy
CTRI	=	Comprehensive Transport Research Institute (SPC)
MOPH	=	Ministry of Public Health
MCOM	=	Ministry of Commerce

China: Proposed Rolling Three Year ESW Program, FY92-94

FY92

Name of Study	Lead Agency	Other Agencies
New Starts		
1. Center-Provin Finan.	MOF	ERC, SRC
2. Market Dev. & Reg	DRC	MCOM
3. Three Cities	MOF	SRC
4. Export Strategy	CASS	MOFT, DRC
5. Machine Tool Industry	MEMB	DRC
6. Energy Conservation	MOE	ERC
7. Urban Land Mngmt	SLA, MOF	-
8. Teacher's Training	SEdc	-
9. Rural Expendi. & Finan.	DRC	MOA, MOF
10. Trucking Industry	MOC	CTRI
11. Power Distribution	MOE	SPC
12. Yellow River Resources	YRCC	MWR
Ongoing from FY91		
1. CEM 92	MOF	SSPC, SRC, DRC
2. Urban Labor Markets	MOL	SRC
3. Poverty Strategy	PLG	-
4. Environment Strategy	NEPA	-
5. Auto Sector	CNAIC	DRC
6. Railway Sect. Invest.	MOR	SPC
7. Coal Transport	ERC	MOCI
8. Ports and Shipping	MOC	-
9. Yangtze Economic Zone	SPC	-
10. Animal Feedgrains	MOA	-
Research Studies		
1. Industrial Efficiency	CASS	
2. Price Reform	DRC	
3. Export Ind. in Fujian	DRC	

FY93

Name of Study	Lead Agency	Other Agencies
New Starts		
1. Center-Provincial II	MOF	ERC, SRC
2. CEM FY94	MOF	SPC, SRC
3. Finance	PBC/SRC	-
4. Agri. Mkting & Trade	DRC	MOA
5. Basic Materials Mktg	MME	SPC
6. Industrial Efficiency	CASS	SPC
7. Passenger Movements	CTRI	MOR
8. Health Finance	MOPH	MOF
Ongoing from FY92		
1. Market Development	DRC	MCOM
2. Export Strategy	CASS	MOFT, DRC
3. Yellow River Resources	YRCC	MWR
4. Rural Expend. & Fin.	DRC	DRC, MOF
5. Yangtze Economic Zone	SPC	-
6. Ports and Shipping	MOC	-
7. Trucking Industry	MOC	CTRI

FY94

Name of Study	Lead Agency	Other Agencies
New Starts		
1. Opport. for Agri. Divers.	MOA	DRC
2. Urban Finance	MOF	SRC
3. State Enterprise Reform	ERC	SRC
Ongoing from FY93		
1. CEM FY94	MOF	SPC, SRC
2. Finance	PBC/SRC	-
3. Industrial Efficiency	CASS	SPC
4. Passenger Movements	CTRI	MOR

CHINA COUNTRY STRATEGY PAPER

ANNEX E: IFC STRATEGY AND OBJECTIVES

E1. IFC has three principal objectives in China:

(i) to promote a more favorable investment climate to attract foreign direct investment through FIAS advisory activities;

(ii) to serve as a catalyst to private sector investment, primarily joint ventures, where IFC's presence provides comfort to foreign partners and assures Chinese partners of project quality; and

(iii) to accelerate development of a private capital market including stock markets.

E2. To date, IFC has invested in five projects with total commitments of $38.7 million. Two of these, China Bicycles (exclusively for export) and Guangzhou Peugeot Automobile Co. (commercial vehicle manufacturing with Automobile Peugeot as partner) are considered by the Chinese Government as two of the top three successful joint ventures to date. IFC's most recent investment in China was a $1.3 million rights subscription in GPAC in July 1991.

E3. After about two years of little activity in China, IFC is programming a renewed effort of project promotion and is considering opening a China office. IFC's focus will continue to be on foreign/Chinese joint venture projects in the coastal areas and special economic zones. The present project pipeline includes a propylene oxide joint venture sponsored by Dow Chemical, expansion of Guangzhou Automobile and a joint venture commercial bank.

E4. Recent developments indicate the government's recognition and willingness to liberalize the financial sector for private sector participation. These include the establishment of the Shanghai and Shenzhen stock exchanges, licensing of some joint venture banks and allowing branch operation of foreign banks. These developments should open the opportunity for IFC to play an active role in capital market development.

E5. To date, foreign joint ventures have contributed to growth in China's industrial output and exports (and have enabled living standards in the Special Economic Zones of Southern China to rise at a much faster rate than in other parts of China). Maintaining the momentum of open door initiatives will require further reforms on several fronts. A study carried out by FIAS has highlighted a range of impediments to foreign joint ventures (see also Annex F). These include improving the system of foreign exchange allocation, strengthening management control over labor costs and employment conditions, removing biases which favor state owned enterprises in procurement of raw materials and other inputs, and bringing greater transparency to laws and regulations governing foreign direct investment. While the existing impediments have not prevented small joint ventures principally from overseas Chinese sources, the improvements in the business environment noted above may be necessary to attract larger investments with more advanced technology transfer.

E6. In light of the evolving policies in China towards overall Private Sector Development, IFC's project selection criteria will focus on structuring individual transactions to serve as examples of mechanisms to further the process of private investments, both local and foreign, in the economy.

CHINA COUNTRY STRATEGY PAPER

ANNEX F: THE MULTILATERAL INVESTMENT GUARANTEE AGENCY

F1. The Multilateral Investment Guarantee Agency, "MIGA", the newest member of the World Bank Group, has as its primary objective the promotion of private foreign investment in developing member countries. To fulfill its objective, the Agency provides long term political risk investment insurance to investors, and, through the Foreign Investment Advisory Services (FIAS), advisory services to member governments seeking to promote foreign investment. MIGA was formed in the summer of 1988, with an authorized capital of US$1,080 million. Presently 107 countries are signatories to the MIGA Convention, and 82 countries have ratified the Convention. Subscribed capital totals US$792 million.

F2. MIGA's insurance program provides insurance against political risks for companies considering investments in developing member countries. The types of risk MIGA will cover include Currency Transfer restrictions, Expropriation, War and Civil Disturbance, and Breach of Contract. The insurance program is typically available for a 15-year term. Investments that are eligible for coverage include equity, shareholder loans and loan guarantees and certain forms of "non-direct equity investments", e.g. management contracts, licensing and franchising arrangements.

F3. With respect to MIGA's activities in China, the Agency is prepared to guarantee projects in China that meet its general eligibility criteria. Although Preliminary Applications for Guarantees for some 10 projects in different sectors (including manufacturing, food, and exploration) have been received from potential investors, MIGA has thus far not issued any Contract of Guarantee for a project in China.

F4. Since the mid 1980s, FIAS has completed five advisory projects in China. First, a high-level seminar was conducted in Beijing to discuss global foreign direct investment (FDI) policies and trends, and their implications for the development of China's own FDI policy framework.

F5. Second, FIAS made recommendations aimed at easing up the foreign exchange balance requirements for joint ventures (this requirement has been a major impediment to attracting FDI, especially in high technology sectors).

F6. Third, at the request of the World Bank, FIAS reviewed the FDI climate in China, which was reflected in the red cover report "China: External Trade and Capital" (1988). The report included a brief historical and statistical survey of FDI in China, and an overview of the forces driving FDI and the benefits it could potentially bring to China, and identified policy problems or inconsistencies between China's goals and policies.

F7. Fourth, in 1987 FIAS provided assistance in the preparation of the new contractual joint venture law.

F8. Finally, most recently FIAS carried out a project to identify impediments to China's FDI environment and to propose follow-up advisory projects to address them. Over 50 companies, located in five economies and representing 11 nationalities, and 17 government agencies at the central and local levels were interviewed for the project. The final report was submitted to the Government in August 1991.

F9. The report stated that China faces a suboptimal FDI regime due to its economic policies and the slow pace of economic reform. Such a regime allows economically unfeasible FDI projects, has reduced the country's ability to benefit from FDI, and needs significant adjustment, the scope of which is outside the range of FIAS's current assistance.

F10. Based on other key impediments noted by FIAS, we submitted to the Government for its consideration seven project proposal ideas to enhance China's FDI environment.

1. to overhaul administrative procedures facing foreign investors;
2. to develop investor services centers in China;
3. to improve the operations and administration of the foreign exchange adjustment centers;
4. to alleviate labor-related problems;
5. to alleviate procurement-related problems;
6. to review and overhaul FDI-related laws and regulations; and
7. to develop the business information service industry.

FIAS is now working with the Government to develop an approach to implementing some of the proposed projects.

›rld Bank/IFC/MIGA
O . I C E   M E M O R A N D U M

DATE: 20-Jul-1991 05:05am

TO: David Pearce (DAVID PEARCE)
TO: Paul M. Cadario (PAUL M. CADARIO)

FROM: Gerardo Sicat, EAS (GERARDO SICAT)

EXT.: 81943

SUBJECT: CHINA CSP -- Initiating Memo

The I.M. provides a good overview of developments in China and describes the reform issues very well. It also points out the relative degrees of uncertainties faced by China. I will focus only on the missing central part in the I.M., the need for articulating the alternative scenarios (and possibly their components in terms of events, not only policies).

Despite its pioneering reforms of the last decade, China today appears as the most conservative country in a sea of revolutionary changes sweeping the socialist economies. Being one decade ahead has given it a lead in establishing a track record in overall growth and industrial and agricultural reform. A most important question with respect to the CSP is how the problems of reform -- both political and economic -- are likely to be resolved and what scenarios would likely manifest themselves as competing possibilities.

Unfortunately, the scenarios are not discussed in the I.M. The issues linked with the MFN debate in the US represents a manifestabion of one type of scenario, with its dangerous implications on the status of China as a source of exports in the developing world. Are we to shy away from describing the sets of events that would likely produce a low case or a high case? And the middle case?

With respect to the assistance scenarios, it would be useful to know what sets of actions by the government, both in in particular sectors or spheres of macroeconomic action, would trigger either a slide to the low case assistance program or an acceleration of the lending program.

The I.M. does not at this stage give us the proposed magnitudes of the assistance program, but it "will recommend ... a growing lending program ... at a hardening blend..." (para. 12). I think a prior question is the establishment of the base case program. Surely, on the basis of at least last year's program, we can establish a benchmark number. Is this to be set only at the final writing stage? It would be useful to focus on the relative magnitudes each scenario would hope to bring.

Having said the above, perhaps the I.M. is not expected to say a lot, but in order to provide a drift of where we are headed, it would nonetheless be useful to put the above issue fully at this stage. Otherwise, I find that the coverage of the I.M. on issues of relevance is comprehensive: identifying appropriate sequencing of policy reforms, support of country program with strong ESW, issues of risks, aid coordination, etc.

(I will not attend the meeting on the CSP memo, since I will by then be on home leave.)

CC: Shahid Javed Burki (SHAHID JAVED BURKI)
CC: Enzo Grilli (ENZO GRILLI)

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: June 28, 1991

TO: Distribution

FROM: for David Pearce, Chief, AS3CO

EXTENSION: 82350

Chin CSP
prepare EM

SUBJECT: CHINA - 1991 Country Strategy Paper Initiating Memorandum

Mr. Burki will chair a meeting on **Tuesday, July 23** at 10:00 am in Room A8063 to discuss the attached Initiating Memorandum.

If you are not able to attend the meeting, please convey your comments to Paul Cadario (A8041, ext. 82343) or Anthony Ody (A8029, ext. 82340).

Distribution:

Attila Karaosmanoglu, Ram Agarwala, Frida Johansen, Loretta Schaeffer, Inder Sud (ASIVP), Kabir Ahmed (ASICA), Shahid Javed Burki, Yo Kimura (AS3DR), Joseph Goldberg, Richard Stern, Daud Ahmad, Zafer Ecevit, Attila Sonmez, Joy Walsh (AS3), Daniel Ritchie (ASTDR), Gloria Davis (ASTEN), Enzo Grilli, F.J. Lysy (EAS), Hans Wyss (COD), Koji Kashiwaya (3) (CFSVP), Wilfried Thalwitz, Francis Colaco (PRESV), Paul Isenman, Robert Liebenthal (PRD), Dennis de Tray (DECVP), D.C. Rao (IEC), Joseph Wood (FPRVP), Everardus Stoutjesdijk, Frederick Kilby (FRS), Guy Pfeffermann (CEI), Pro Ba Quan, Sakdiyian Kupasrimonkol (IFC), Dale Weigel (FIAS), Leigh Hollywood, Ghassan El-Rifai (MIGA), Andrew Vorkink (LEGAS), Nancy Hwang (LOAAS), Martin Featherstone (IMF)
AS3CO HL Staff
Asia Information Centre

CHINA: 1991 COUNTRY STRATEGY PAPER

Initiating Memorandum

This memorandum, which initiates preparation of the 1991 CSP, sets out the key country assistance strategy issues to be addressed during the next 18-24 months (FY92-93). Section I summarizes developments in China since the last full CSP was reviewed in September 1988. Taking these into account, Section II outlines the main issues to be addressed in the 1991 CSP. Section III describes the topics to be covered and the analysis to be carried out.

I. DEVELOPMENTS SINCE THE LAST CSP

1. In mid-1988, China had to contend with a period of macroeconomic instability more severe than the two experienced earlier during its decade of reform. This period was characterized by urban inflation close to 90% on an annualized basis and declining rates of investment in agriculture and other economic infrastructure. Plans to decontrol the prices of most major commodities in 1989 were almost immediately shelved and, by November 1988, replaced by an economic retrenchment and stabilization program. With the benefit of hindsight, this was probably a critical stage for the upheaval that culminated in the events of June 3-4, 1989 in Beijing. Since then, China's leaders have been almost wholly preoccupied with efforts to restore and maintain economic, political and social stability, an imperative that was complicated by adverse reaction and (until 1990) sanctions by most Western nations.

XX

X

2. By early 1990, the economy had largely stabilized, thanks to the dramatic effectiveness of the steps taken, mainly administrative measures accompanied by higher interest rates and efforts by China's central Bank, People's Bank of China, to use indirect levers for macroeconomic management. China's decade-long commitment to overall reform, not seriously in doubt until 1988, has been re-affirmed on many occasions over the last two years. However, the authorities were obliged to delay the implementation of some reforms in the interests of macroeconomic and political stability. Although on the surface, and taking a short-term perspective, economic performance over the last three years has been satisfactory, deep-seated structural problems remain and 1991 economic performance gives some cause for concern. There are signs that the economy may be overheating again, thus heading toward another stop-and-go cycle. This situation again raises questions about the sustainability of the stabilization effort and the potential to recover higher rates of growth with price stability. In the circumstances, the continued priority being given to stability suggests that, despite recent movement on several fronts, concerns about the pace of reform may continue for some time.

stop-go cycle

country assistance perspective has changed

3. China's Relations with the Bank. Because of the events of 1989, including an eight-month hiatus in Bank/IDA lending, the principal objectives of the Bank's country assistance strategy have changed significantly. As discussed below, the Bank has begun to address explicitly reform issues not only its sectoral dialogue but also in formulating individual investment operations. Continuing uncertainty over the economic and political situation has raised questions among the Bank's major shareholders about the composition and level of Bank/IDA lending and, more broadly, whether the growth in Bank/IDA assistance expected by the authorities can be achieved. There is no doubt about China's continued interest in a significant Bank role in its development efforts. Indeed, the authorities' anxiety about the delayed resumption of normal lending is evidence of the Bank's standing in the country, not only as a source of economic advice and concessional funds but also as the implicit leader among commercial bank and official aid

avoiding inflationary growth →
to ~~avo~~ avoid "stop-go cycles"

why =

go → inflation + growth → "overheat"
stop → deflationary policy

agencies involved in China. Accordingly, for the first time since it resumed its membership in the institution in 1980, China's demand for Bank/IDA resources may exceed our ability to supply them.

II. ISSUES FOR THE 1991 CSP

4. China's long-term development strategy remains to increase the role of the market for resource allocation purposes while maintaining public ownership as the dominant form of asset control. Also in place is the goal of doubling per capita income again by 2000 and achieving middle-income status by the middle of the 21st century. Despite impressive progress over the last decade in moving toward market management, China's structural problems are the result of state control over industrial assets and over basic infrastructure. The challenge for China is to make further progress toward market management without slipping on social development. This is important since China remains a poor country, with an annual per capita income of $350 and pockets of hard-core poverty covering 70-100 million people, generally in remote and resource-poor areas. In order to absorb surplus labor from rural areas, and assuming some slippage in China's population program, sustained, broad-based economic growth will be needed over the Eighth and Ninth Five Year Plan periods (1991-95 and 1996-2000) to generate productive employment for a growing, increasingly urban workforce. Building on the lessons of the 1980s, China will need to develop strategies to encourage non-inflationary growth while avoiding the stop-go cycles of the last decade. To achieve this, China will have to make continuous progress in a number of areas. In addressing these issues, the CSP will pull together the three strands of thought correctly underlying China's 8th Five Year Plan: stability, development and reform.

5. Structural Adjustment. Three policy areas subsume the factors for encouraging stability, development and reform: fiscal and financial reforms, price reform and trade reform. All three would, in particular, have one pre-eminent goal: the structural adjustment of the industrial sector and, in particular, of the large- and medium-sized state-owned enterprises, which remain as the key challenges of the 8th Five-Year Plan. While investments in technical transformation projects, improvements in the contract system, promotion of enterprise groups and use of the shareholding system are important, no real success can be achieved without improvements in the performance of SOEs both at the central and provincial levels and changes in the environment in which they operate. This means addressing the pricing and planning systems they face, the burden of social welfare services they currently provide, the rigor of financial discipline exerted by banks, and competition from non-state enterprises and imports. If these reforms can be promoted within the context of a sound macroeconomic environment, a reasonably optimistic view of the future of China's economy in the next decade can be adopted.

state enterprises at state / provincial levels

→ pricing / planning syst

6. Fiscal and Financial Reforms. Measures adopted in 1990 to contain fiscal the deficit only partially addressed the underlying causes, and shifted the bulk of these obligations to the banking system. These problems cannot be addressed without major and comprehensive tax reform, dealing with the underlying structural weaknesses in China's public finances. These include an inelastic revenue system (tax contracting) and the heavy burden of enterprise and consumer subsidies, together with rapidly rising welfare and administrative expenditures. The stabilization program, which relied mainly on administrative measures, did not advance enough the development of mechanisms and institutions of indirect macroeconomic management and the emergence of more autonomous financial institutions. The need for strengthened capacity to manage the economy via indirect means has been stated many times and in many ways in China, but bears

repeating, not least because of the present economic situation. In particular, money supply growth must be brought under control, and kept at more reasonable levels if inflation is to be avoided.

7. Price Reform. China had begun to address the question of price reform in a serious way before the heating up of the economy in 1988 and Tiananmen Square. Since then, the move toward price liberalization slowed down but recent changes in grain and edible oil prices and upward adjustments in railway freight charges and fares suggest that price reform is back on the leadership's agenda. Price reform is called for by the need to improve economic efficiency and to contain the budget deficit. Until market signals are clearly established, the scope for resource misallocation and corruption will remain significant. Price reform must mean more than adjusting present administered prices, necessary as this may be as a first step. It should also include new methods of price formulation via the market, and the creation of appropriate market infrastructure. This is an area where more urgent attention is needed. If price reform can be combined with sound macroeconomic policies, excessive inflation can be avoided, although compensation for some of the losers in such reforms may be needed.

How [illegible] in [illegible] agenda needed to be done?

8. Trade Reform. Recent adjustments in the exchange rate (China is now operating a quasi-crawling peg arrangement) and reduction in export subsidies are bound to improve the long-term efficiency of the sectors of the economy with strong external links. A liberalization of the trade regime, by removal of current administrative restrictions on imports, could contribute to sustaining macroeconomic balance in the domestic economy and mitigate the stop-go swings in demand management. More importantly, over the long-run the stimulus of competition from imports--an element rarely mentioned in the government's strategy--has the potential to spur greater efficiency in China's industrial sector and to promote the higher product quality increasingly needed for continued growth in export value. Should China move along these lines, of course, its current very positive balance of payments and reserve situation could weaken as a side effect of the use of trade policy to improve the quality of growth.

III. APPROACH AND COVERAGE

9. The main theme of the CSP will be to examine the impact on China's current economic situation of the gradualist approach toward economic liberalization. It will also investigate the long-term viability of such an approach. It will draw on the economic analysis of the CEM, now under preparation, as well as recent ESW reports on agricultural prices and markets, education, provincial development, housing and the environment. The balance between stability and reform, between incentives and a reasonably egalitarian income distribution, between state and non-state enterprises and private entrepreneurs in production, and between individual responsibility and collective provision of social goods, are all difficult issues. However, it is too simple to view all policy options as choices between "reform" on the one hand, and "reaction" or "central planning" on the other. The real issues have to do with achieving appropriate balances of authority between central agencies, provincial and local governments and economic units (industrial enterprises, banks and other financial institutions, family farms, etc.) and--related to this--between administrative measures and market signals in a very large and complex economy in transition. Just as these complexities underlie China's economic choices, they will determine the Bank's strategy. Our basic approach--supporting the implementation of reforms, helping productive sector modernization and rationalization and infrastructure development, and analyzing policy options and helping deal with their

"China - is [illegible] consolidation - how workable is the concept in the midst of rapid change [illegible]?

what is the base case scenario?

consequences--remains valid, but the CSP will consider what adjustments may be necessary, depending on China's overall economic performance and pace and direction of reform. It will also assess how the size and composition of the lending and ESW programs should be tailored according to developments on the stability and reform fronts.

what will determine high case? core?

10. Reform Sequences and Linkages. Maintaining stability and public support for the next steps of reform will require greater attention to the relationships between actions in various sectors. The key nexus seems to be enterprise reform, including housing and social security, and liberalization of factor markets, including land and labor. Financial sector development remains pivotal to improving China's macroeconomic management and to deepening enterprise, housing and rural sector reforms. The CSP will consider these linkages, and how the Bank's ESW and lending can address them in a coherent, timely and pragmatic way.

10, 11 critical to sustained performance

11. A Strong ESW Program. Our CESW is inspired by a number of objectives and concerns that we share with the Chinese authorities. Success at achieving short-term goals--to maintain the economy on a non-inflationary growth path, narrow the budget deficit and preserve healthy external accounts--will contribute to China's longer term objective of maximizing productive efficiency by strengthening mechanisms that enhance allocative efficiency and technological advancement. These goals establish four concerns that are central to our ESW program. These are: 1 industrial restructuring to see that China's capital and human resources are put to the best possible use; 2 sustaining resource mobilization and an adequate flow of funds through fiscal channels at all levels; 3 institutional reforms promoting market competition through a freer flow of goods and factors, and greater reliance on market-determined prices; 4 and increasing interprovincial market integration to contain regional income inequality.

4 goals of ESW

12. Focus of Future Bank Group Assistance. Consistent with its Eighth Plan development priorities, China is expected to continue to turn to the Bank for intellectual and financial support for its economic reforms, for infrastructure development (transport and energy), for modernization of its agriculture, for alleviating its bad environmental situation and for helping it sustain its past remarkable performance in the social sectors. More specific ESW advice will be needed. Large sector investment operations to support country-wide reforms, in some cases after projects that confirm the validity of the proposed physical and policy designs, may become possible. The argument for a continued strong Bank presence in agriculture is sustained both by important sector-wide issues that the authorities now seem willing to address and by possibilities for institutional strengthening, poverty alleviation and environmental protection. China's interest in continued Bank lending for industry will challenge us to find appropriate subsectors and locations where reforms can be pressed forward. It will depend on the development of more autonomous financial intermediaries, and on China's taking steps toward a more enabling environment for services and for non-state domestic and foreign investment in sectors where Bank lending is unlikely. Transport and energy projects, supporting system reform improvements in sector planning and pricing, will help remove infrastructure bottlenecks. Bank attempts to increase the reform content and influence project design in the urban, water supply and industrial sectors to focus on environmental concerns are paying off.

13. Lending Commitments and the Structure of the Lending Program. The CSP will recommend that a growing lending program incorporating balanced sectoral allocation of Bank/IDA lending, at a hardening blend, remains broadly appropriate in helping China's transition from a planned economy to one based on greater

lending profile for different scenarios should include —

market competition. Specific investment operations with increasing reform content will remain the main lending instrument, with occasional sector investment operations where policy reforms, pricing and investment planning develop satisfactorily. The CSP will examine burden-sharing questions in light of likely expanded Japanese official lending, alternatives for growth of DFI and China's external situation.

14. External Capital Requirements. China's recent stabilization program showed the continued ability of its planners to control the level of imports and exports when faced with an uncertain trade environment. The results of the MFN debate in the United States could have important short-term implications, not only for trade and for direct foreign investment (DFI), but also in determining US attitudes to Bank lending. The CSP will review China's needs for concessional assistance, commercial and official borrowing and, assuming improvements in its investment climate, private capital flows. It will also consider cofinancing prospects with Japan and potential private lenders, and the scope for using new IBRD cofinancing instruments.

15. Creditworthiness and Country Risk. Although China's external trade is subject to some uncertainty, its prudent past level of borrowing and improving debt management and control make it unlikely that the country poses any creditworthiness or exposure concerns to the Bank, or imposes related constraints to the growth of China's IBRD borrowing.

AS3CO June 28, 1991

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 1, 1990

TO: Mr. Shahid Javed Burki, Director, AS3

FROM: Vinod Dubey, Director, EAS

EXTENSION: 78061/2

SUBJECT: CHINA: Creditworthiness Issues in CEM FY90

1. China's long-term debt increased sevenfold between 1980 and 1988; and, in spite of a quite remarkable export and growth performance, all the traditional debt indicators worsened. However, China's creditworthiness remained good. We see few reasons why this situation would change in the medium term.

2. The CEM projects that long term debt--in real terms--over the 1989-95 period is assumed to remain virtually unchanged. The debt indicators are expected to show quite dramatic improvements under both the base and low scenarios. The key assumptions in both cases appear somewhat on the optimistic side, which might reduce the credibility of the analysis.

3. Over the 1980-88 period, nominal imports (13.9% p.a. in US$ terms) grew somewhat more rapidly than exports (12.7% p.a.). In the base scenario, however, real export growth is assumed to outpace import growth with a significant margin (6.7% versus 5.8% p.a.). This implies an elasticity of imports to GDP which is less than one. An annual growth rate for imports of 7.5%--which is more in tune with the historical experience--would probably give a debt service ratio of around 12% rather than 5.7% projected for 1995 in Table 5.1. A figure in the low teens would hardly create concern among China's creditors.

4. The low case scenario looks more like a debt work-out scenario than a "worst case" or a "high risk" scenario. The reason is that import growth is assumed to be significantly curtailed and be well below the rate of export growth. It seems unlikely that an import elasticity of 0.86 can be sustained for a prolonged period.

5. Given the fact that even under more realistic assumptions, China's creditworthiness will remain quite good, we think that the present analysis should be modified.

6. We have no problems with the discussion of China's debt management.

cc: Mr. Sicat (o/r)

PLjong:vl

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: April 29, 1991

TO: Mr. David Pearce, AS3CO

FROM: Fred Kilby, FRSCR

EXTENSION: 80554

SUBJECT: **Risk Assessment Note - CHINA**

Please find attached for your final review and comment the country risk note for China, which we intend to include in this year's IBRD Portfolio Review.

Again, thank you very much for your cooperation in last year's Unified Survey and in the drafting of this note.

Attachments

Cleared with and cc: Mr. Stoutjesdijk
cc: Mr. Burki
Mr. Grilli

CHINA

DOD/GDP (1989): 10.7%		Population (1989, m): 1105			
Interest/GDP (1989): 0.8%		GNP per capita (1989): $360			
Proportion of Public Debt (1989)		Inflation (CPI - 1990): 17.8%			
Concessional:	18.4%	Secondary Price of Debt: par			
Private Creditor:	70.5%				
Variable Interest Rate:	37.8%				

	1985	1990	1991	1995	1999
IBRD Debt Service/Exports (%)	0.1	0.6	0.5	0.8	0.9
IBRD DOD ($ billion, end FY)	0.3	2.5	3.1	5.4	9.9

Adjustment Operations	Amount	Board Date	Status
Rural Sector Adjustment	$200 m	Jun 1988	100% disb.

IMF Status: No Stand-by operations.
Outstanding Purchases (Jan 1991): SDR 330.0 million (13.8% of quota)

Growth Rates (%)	1984-89	1989-94	1994-99
GDP	8.5	5.4	6.6
Exports GNFS	14.8	6.2	7.6
Imports GNFS	13.0	7.6	7.2
Per Capita Consumption	5.6	5.0	5.2

Shares of GDP (%)	1985-89	1990-94	1995-99
Investment	38.5	35.6	35.2
Gross National Savings	36.6	36.1	35.6
Current Account Balance	-1.9	+0.2	-0.7
ICOR	4.5	6.4	5.2
Import Elasticity	1.9	1.2	1.1

External Vulnerability - 1995	Terms of Trade	Export Growth	Interest Rates	Total
(months of imports)	?	?	?	?

Overall Assessment

1. China's creditworthiness remains sound but was shaken by the political events of 1989. The forcible suspension of political unrest put the country's reform strategy in jeopardy and strained relations with external creditors. Relations improved in 1990, however, with a gradual resumption of lending by multilateral agencies (IBRD, ADB) and commercial banks while foreign investment has substantially recovered. The challenge for the Government now is to return the economy to a long-term path of rapid economic growth while maintaining macroeconomic and political stability. The balance of payments is expected to remain strong in the medium term and require only modest net

flows. Reserves are high at seven months of imports and external vulnerability is low. Bank exposure is currently quite low but projected to rise gradually as project approvals return to pre-June 1989 levels. Portfolio share would increase from 3 percent towards 8 percent by the end of the decade.

Economic Outlook

2. The major long-term structural task facing China is to effect the transition from fairly authoritarian central planning to decentralized market socialism within a stable macroeconomic and political framework. The program of economic reforms initiated during the 1980s led to impressive GDP growth rates, increases in agricultural and industrial productivity and output, and rapid diversification and growth of exports. However, the path toward decentralization has also been marked by periodic episodes of macroeconomic instability and political disruption, most recently in the rising inflationary problems that began in 1988 and persisted into the early part of 1989. Restoring and maintaining a long-term high growth rate of 6-7 percent per annum will require renewed efforts to resolve issues related to enterprise reform, wage and price policies and an improved efficiency of investment in the context of continued public ownership of significant amounts of the means of production. The successful implementation of reforms will depend on China's ability to maintain stable macroeconomic and political conditions, on access to foreign capital markets, and on the trade environment.

3. Overall, the Chinese economy has performed better on the external front than on the domestic side during 1989-90. The overheated economy had a current account deficit of $4.3 billion (1.1 percent of GDP) in 1989, but import restrictions, a 26 percent devaluation in December 1989, tightening of demand and continued export growth reversed this, producing a surplus of about $9 billion in 1990. China's foreign exchange reserves increased by over $11 billion in 1990 to $29 billion, equivalent to 5.8 months of imports, while exchange and gold reserves together total $34 billion. A further 11 percent devaluation in November 1990 is expected to allow China to continue to maintain a trade surplus and reduce export subsidies. Inflation was reduced from 18 percent in 1988 to 2 percent in 1990, but at the cost of more than halving the rate of growth from 10.9 percent in 1988 to 4.9 percent in 1990. To maintain a desirable balance between inflation and a return to higher rates of GDP growth, the authorities will have to continue strengthening macro-management, and in particular reduce the rapid expansion of domestic credit observed in 1990 (25 percent), and move forward with reforms to enhance efficiency.

4. China's foreign debt is thought to have increased only slightly and the debt service ratio is expected to remain in the 9 to 10 percent range. The capital account strengthened considerably in the later part of 1989 and 1990, and the resources generated by exports and foreign capital inflows will allow China's foreign exchange reserves (including gold) to remain within the range of 6 months of imports. These trends are likely to produce a current account surplus in 1991, an approximate balance in 1992 (under the assumption that imports will grow by more than 10 per cent per annum), and deficits of

less than one percent of GDP through the decade. The level of borrowing is likely to remain low as long as the Government proceeds slowly with the reform program.

5. Domestically, there is some evidence of recovery, but the number of loss making state enterprises, inventory build up and sluggish retail sales warrant attention. The fiscal situation also remains worrisome since Central Government revenue is inelastic, reflecting three to five year tax contracting with provinces and state-owned enterprises, while expenditures have expanded under the pressure of financing enterprise losses, procurement of a record grain harvest, and price subsidies. China still needs to reform fundamental distortions and imbalances in the system, but medium- and long-term economic policy has still to be clearly defined and the detailed reform agenda for the next few years is a subject of considerable internal debate. The Eighth Five Year Plan (1991-95), suggests that reforms will follow an incremental approach and will proceed after experiments are carried out in selected cities and regions. The "retrenchment program" will be maintained over the first two years of the Plan, while in the period 1993-95, the authorities intend to extend more broadly the successful experiments. Items uppermost on the agenda are housing, social security, finance and trade reform, as well as adjustment in prices of agricultural and basic industry products.

6. The Unified Survey projections call for growth of 5.5 percent per annum in 1991-92, rising to 7 percent in later years. Assuming continued growth in world trade of 6 percent per year and a continuation of the most-favored nation (MFN) status for China, export growth of 10 percent per annum is feasible through the nineties, given appropriate exchange rate policy and an early tightening of financial policies.

Downside Risks

7. Policy Slippage. The authorities have demonstrated a good record of correcting macroeconomic and financial imbalances once they emerge, usually following expansionary credit policies and decentralization measures. However, to correct these imbalances the authorities have tended to rely on a greater use of central administrative control of credit and investment rather than indirect instruments. Furthermore, the policy of reserving available credit expansion for priority sectors in accordance with industrial policies misallocates resources, weakens financial discipline in the state-owned enterprises and worsens the quality of loan portfolios of commercial banks.

8. A second source of policy slippage is the continuing fiscal problem of the Central Government. It is estimated that one-third of the budget (equivalent to 5.5 percent of GDP), covers enterprise losses and consumer subsidies. Meanwhile, the ratio of total revenues to GNP has declined from 22.6 percent in 1987 to an estimated 21.4 percent in 1990, forcing the Government to step up borrowing in the domestic market. As a result, the Treasury has mandatorily placed increasing amounts of bonds with shorter maturities, making it increasingly difficult for the Government to refinance its domestic debt and honor redemptions by enterprises. Action in this area

is called for, to avoid increased reliance on central banking financing and commercial bank credits.

9. **External Environment**. China's overall vulnerability to external factors is relatively low. For instance the PAC downside could be financed from reserves for 3-4 years before policy adjustment become essential. The main source of vulnerability lies in mounting trade tensions with the U.S. China's trade balance soared from a $6 billion deficit in 1989 to a surplus of $13 billion in 1990, even without taking into account re-exports through Hong Kong. The size of this surplus may become a factor when the question of renewing China's status comes up before the U.S. Congress in the summer of 1991. The export growth projections are also predicated on technology transfers through joint ventures and direct foreign investment. A loss of confidence on the part of foreign investors could thus damage export growth prospects.

10. **Financing Plan**. Following the events of June 1989, there was a sharp drop in foreign exchange earnings from tourism, new direct investment and remittances from overseas Chinese. Earnings from tourism in 1990 ($2.2 billion) regained the level of 1988, while direct foreign investment ($3.4 billion) continued its upward trend. In the medium term, slower economic growth or renewed political turmoil could damage the prospects for foreign direct investment and jeopardize the confidence of external creditors. Such a drop in foreign investment or reduced lending from commercial sources would lead to the need for import compression which in turn could influence the growth of both exports and GDP.

Relations with External Creditors

11. China's relations with its creditors have been good, and its servicing record punctilious. Although not in serious doubt, China's creditworthiness since mid-1989 has been the subject of much foreign media speculation and, for the first time in a decade, there was significant political uncertainty, at least through the first half of 1990. Isolated and minor incidents of payments arrears have also raised concerns. This relate to two systemic factors that have not been addressed by the authorities as they should be: (i) the fact that China's domestic foreign exchange allocation system is fragmented and to a large degree pre-allocated, depriving some borrowing entities of flexibility in access to foreign exchange; and (ii) some ambiguities over what constitute China's sovereign debt. Since both of these considerations are common sources of payments delays in other countries, they will need to be corrected to avoid a possible arrears problem with the IBRD as large amounts of amortization begin to fall due.

Bank Exposure and Risk Management

12. The base case lending program assumes continued modest reforms in the next two years while the austerity program continues, with more significant reforms leading to increased dynamism in the economy in the later years.

At the level of debt accumulation implied in the Region's base case, and assuming significant direct foreign investment, China's overall debt indicators remain within prudent limits, with borrowing from private sources between 1991-93 remaining at moderate levels. With IBRD lending of $5.4 billion over the FY92-94 period (all projects) and growing in line with overall lending thereafter, net flows would average $600 million per annum over the next five years and $1,100 million per annum in the later part of the decade. Portfolio share would increase from 3 percent to 5 percent by 1995 and to 8 percent by 2000, while exposure ratios would remain within guideline limits through the end of the decade.

April 24, 1991

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~~2 A.D.~~ 4/30

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: April 27, 1990

TO: Messrs. J. Wood, FPRVP, and V. Dubey, EAS

FROM: Shahid Javed Burki, AS3

EXTENSION: 72571

SUBJECT: China CEM FY90: Creditworthiness Issues

At Mr. Qureshi's request, I am attaching for your review the section of the China CEM that deals with external borrowing and creditworthiness.

I would appreciate having your comments by c.o.b. April 30.

Attachment

cc: Mr. M. Qureshi

SYusuf:hk

ER 026 TOC/CHA ER/Yusuf/25-APR-90/mjd

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Report No. 8440-CHA

CHINA: COUNTRY ECONOMIC MEMORANDUM

BETWEEN PLAN AND MARKET

May 1, 1990

Country Operations Division
China Department
Asia Region

market-based exchange rate determination system. Further, recent experience in China demonstrates clearly that the economic system is responsive to exchange rate movements, and it is the effective exchange rate which is the most important of all export incentives, even in China. The maintenance of a competitive exchange rate is an issue of critical importance to the achievement of China's export targets, and, as the Minister of MOFERT put it, "to the scale and program for (China's) domestic economic construction".

External Borrowing and Creditworthiness

5.48 Future Trends in Debt Indicators. China's trade performance has contributed significantly to the country's creditworthiness. Other factors that have helped maintain access to international capital markets are the country's impressive growth rate that has kept the ratio of debt outstanding and disbursed to GDP to a modest 8 percent; and the high rate of national savings that holds down the current account deficit, insulates the economy from external shocks and supports the expansion of exports. In the medium term, the economy is projected to grow by between 3 and 6 percent with longer-term growth falling in the 6.0-7.0 percent range. The increasing share of manufactures in exports will also help to sustain export trends. Exports are projected to rise by about 7 percent in the first half of the 1990s, with manufactures growing by 8-9.0 percent per annum. As savings propensities are likely to remain strong and the share of investment in GDP should decline somewhat (counterbalanced by increased efficiency as reforms unfold), the resource gap should remain fairly small, moderating China's net borrowing needs. The continuation of relatively contractionary policies during the first half of 1990 and modest reflation in the second half of the year will limit the growth rate to 3-4 percent and possibly give rise to a small surplus on the BOP current account. Thereafter, as the economy picks up speed the current account deficit may reappear, but should be less than 1 percent of GDP in 1995.

5.49 This pattern of growth and external borrowing will keep the debt servicing burden down to manageable levels and sustain China's creditworthiness. Table 5.1 present the external accounts and the various indicators which measure the burden of indebtedness under the base scenario which is predicated on continuing reforms and openness. The principal assumptions underlying these projections are given in Table 5.3. The ratio of debt outstanding and disbursed to GDP in 1990 will be about 8.5 percent and the total debt service ratio 9.2 percent. Total repayments of public and publicly guaranteed medium- and long-term debt (including interest) will rise from $4.38 billion in 1989 to $5.81 billion in 1990 and then decline somewhat by 1994, followed by another upturn in 1995. The debt service ratio, however, should fall steadily to 5.7 percent in 1995 with total debt outstanding and disbursed to GDP reaching 6.3 percent. China's credit standing should remain satisfactory even if growth of GDP and of exports is substantially lower--4.7 percent and 5.8 percent respectively (average 1990-95)--and the implementation of reforms proceeds at a much slower pace than currently foreseen. Scenario 2 (Table 5.2) provides some illustrative projections for the various debt indicators were China, for external as well as domestic reasons, to pursue a much more conservative economic strategy. The significant but plausible assumptions underlying this scenario (Table 5.3) are that (i) savings behavior will not change markedly; and (ii) that the authorities will be in a position to regulate the trade and capital accounts as they have during 1989/90.

Table 5.1: CHINA: Creditworthiness Ratios: BASE CASE

	1988	1989	1990	1991	1992	1993	1994	1995
	11.4	17.9	17.1	17.2	18.6	17.1	14.8	14.8
Interest Payments/XGS	3.0	3.9	3.8	3.3	3.0	2.6	2.3	2.1
Total debt service/XGS	6.9	7.6	9.2	8.6	8.4	7.1	5.8	5.7
DOD/XGS	60.3	59.1	53.9	50.0	45.1	41.4	39.3	38.6
DOD/GDP	8.6	8.1	8.5	7.9	7.3	6.9	6.5	6.3
Repayments (Amortization+Interest) (in millions of US$)	3690	4384	5812	5973	6489	6049	5566	6105

15.8

REF: RAPARLA\CEM\GREY\ASSUMPTI.WK1 04/25/90

Table 5.2: CHINA: Creditworthiness Ratios: LOW CASE

	1988	1989	1990	1991	1992	1993	1994	1995
Interest Payments/XGS	3.0	3.9	3.8	3.3	2.8	2.3	2.0	1.7
Total debt service/XGS	6.9	7.6	9.2	8.5	8.3	6.9	5.5	5.3
DOD/XGS	60.3	59.1	52.5	46.8	41.2	36.5	32.7	28.9
DOD/GNP	8.6	8.1	8.3	7.4	6.6	6.1	5.5	4.9
Repayments (Amortization+Interest) (in millions of US$)	3690	4384	5812	5897	6296	5773	5127	5392

REF: RAPARLA\CEM\GREY\ASSUMPTI.WK1 04/25/90
NOTE: XGS: Exports of goods and services.
DOD: MLT Debt outstanding and disbursed.

Table 5.3: CHINA: ASSUMPTIONS

	1988	1989	Base Case AVERAGE 1990-5	Low Case AVERAGE 1990-5
EXOGENOUS				
Export Growth Rates (%)				
XGNFS_GR Total GNFS (endogenous)	17.46	8.95	6.71	6.03
of which XMANUF_GR Manufacture	17.79	13.53	8.50	7.58
Import Growth Rates (%)				
Total cif Imports growth rate (MGNFS) (endogenous)	18.98	8.19	5.77	4.02
Other Ratios & Growth Rates (%)				
AI0 Investment/GDP	37.59	36.50	33.92	33.92
ENDOGENOUS				
GDPGR GDP growth rate (%)	11.20	3.89	5.84	4.66
Current account balance/GDPCUR (%)	-1.02	-1.08	-0.46	-0.13

5.50 External Debt Management. As the opening of the economy multiplied the range and complexity of foreign contacts, earlier regulatory procedures were found to be inadequate. Since the mid-eighties, the government has moved to centralize and systematize external borrowing in order to contain the risks inherent in economic liberalization. The State Planning Commission formulates the overall borrowing plan, in consultation with the People's Bank and the Ministry of Finance, but ratification is still required by the State Council. Bilateral lending is managed by MOFERT and the MOF is responsible for borrowing from the World Bank. However, the activity of data gathering, and the supervision of commercial borrowing is the task of the State Administration for Exchange Control (SAEC). Created in 1985 as an entity within the People's Bank with branches throughout the country, the SAEC has, after an uncertain start, gained in administrative capacity and technical skills. These qualities, which seemed somewhat tentative in 1988, were put to the test in late 1988 and 1989, when the authorities acted first to increase the scale of imports to dampen domestic demand pressures, and followed this up with a policy of tight restraint on all commercial foreign transactions, starting in the third quarter of 1989. By and large, the framework for assigning quotas, reporting, cross-checking and enforcing that has been put in place, appears serviceable although more experience and the accumulation of trained manpower, will certainly improve matters. The situation that prevailed during 1984-88, when not just the ten officially designated borrowing windows 8/ but also a few hundred provincial financial entities, were raising funds overseas has been checked for the most part, through the rigorous use of administrative pressure. No doubt the lack of receptivity in international capital markets, during the latter part of 1989, has eased the SAEC's task, but as an organization it has apparently gained in strength and credibility.

5.51 Administrative capability to manage external borrowing is one facet of creditworthiness and the changes introduced, seem to be bearing fruits. The reporting net is still far from watertight--some borrowing by Chinese entities with operations in Hong Kong is probably not captured by the statistics--but the leaks are few. Another equally important facet is the composition and management of the existing debt portfolio.

5.52 China has shown considerable bargaining skill in overseas markets, fully exploiting the attractions of its market, its low exposure and the strength of its economic performance, to extract the most favorable possible terms from lenders--especially Japanese banks. Borrowing from Japanese institutions has been at 15 points below LIBOR and from others, the rates have averaged 25 points over LIBOR. Concessional funds have been sought where possible. From 1.1 percent of the total in 1981, concessional borrowing rose to a peak of 22.7 percent in 1985 before settling at just under 20 percent in 1988. Average interest paid on such borrowing has declined from 5.9 percent in 1984 to 4.3 percent in 1988. For the entire portfolio, average interest charges were 7.1 percent in 1988, close to par for the eighties although maturity on both concessional and overall borrowing is down to 22.7 years and 12.74 years, respectively. About 40 percent of the borrowing is at variable

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8/ These are: The Bank of China, the Communication Bank of China, the China Investment Bank, the China International Trust and Investment Company, and the Guangdong, Fujian, Hainan, Shanghai, Tianjin, Dalian international trust and investment companies.

rates which is close to the norm under current market conditions and does not expose China to unusual risks (Table A5.3).

5.53 The ratio of short-term to total debt is another index of portfolio quality. When China was a newcomer to the international capital market, much of its borrowing was for purposes of trade and tended to be of short maturities--41 percent in 1983. Such lopsidedness, that would be highly unwelcome in the event of a crisis, has been quickly corrected. The share of short-term borrowing was under 26 percent in 1986 and down to 21 percent in 1988--about normal for an economy with a trade to GNP ratio of nearly 30 percent (Table 2.1).

5.54 As Japan has been the principal net supplier of capital in the international market and Japanese banks have sought close relations with China, much of the borrowing in the mid-eighties was Yen-denominated and at quite low rates. The appreciation of the Yen in 1986/87 triggered a change in portfolio composition, the percentage of dollars being increased to 40 percent by 1989 and the Yen share brought down to 34.3 percent. In hindsight, the shift may not have been wisely timed given the strength of the dollar during 1987-89, but future trends for the dollar and the proportion of China's trade denominated in that currency favor the maintenance of the current ratios.

5.55 A third determinant of credit standing is the size of a country's liquid reserves that can enable it to ride out an emergency. By the internationally accepted rule of thumb, reserves equivalent to three months of imports are adequate. China has allowed itself a more comfortable margin: reserves amounted to $12 billion in 1986 (4 months of imports), rising to $19.6 billion (5.3 months) in 1988 (Table 1.1). The need to finance debt servicing obligations and other claims in 1989, when MLT credit became unavailable, forced China to dip into its reserves which fell to a low of $14.8 billion in the middle of the year. However, the recovery of trade brought about some relief and at the end of 1989, total reserves were estimated at $17.5 billion--about a third with PBC and the balance held by the Bank of China. These were equivalent to 3.5 months of imports. In actual fact, China's reserve position may be stronger than the published statistics indicate. The country may now be the sixth largest producer of gold. In 1988 output was estimated to be 60 tons, rising to about 80 tons in 1989.d/ This could be used to augment gold reserves that have remained constant at 12.67 million ounces for several years. It is believed that substantial sales and forward transactions in gold during June-August 1989 were a source of additional liquidity at a time when overseas branches of the Bank of China were faced with mounting withdrawals.

5.56 By economic indices, China's credit standing looks firm and the country compares very favorably with other developing countries in South and

Southeast Asia, not to mention the Latin American region.9/ However, the problems that arose in mid-1989 have aroused fears regarding future political stability. These concerns, that have been stilled somewhat with the return of normality, have led credit rating agencies such as Moody's to mark China's creditworthiness from A3 to BAA. They have also induced lenders to reexamine their exposure in China and future plans for acquiring Chinese paper.

5.57 Future Actions. Some improvements in debt management merit attention in the coming years. External borrowing decisions still remain dispersed over several agencies. The SAEC has begun filling its role in a fairly short space of time, but there are gaps in its coverage and lingering uncertainties about the volume of debt contracted in the 1984-86 period, before reporting rules were tightened. The amounts involved are probably a few hundred million dollars. Nevertheless, these must be made precise and the obligations of the state specified. Essentially, this is a matter of perfecting the information feedback system and verifying what is received. The regulatory powers of the SAEC might also be put on a more formal basis so that it is able to police borrowing and impose order among borrowers, when rectification imperatives are succeeded by normal times.

5.58 There remains some confusion over what is China's sovereign debt, and what rests on the creditworthiness of the borrower alone. Sovereign liabilities include, potentially, all borrowing and guarantees by Chinese borrowers and obligations of joint ventures and borrowing by overseas Chinese enterprises. Creditors' behavior suggests that they consider the bulk of China's

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9/ China's record in servicing its debt has been good but certainly not flawless and in recent months problems have been reported, particularly in connection with lending in the mid-1980s. At that time, foreign banks were aggressive in seeking business, skimped on documentation and did not look too closely at the guarantees mobilized by the many provincial agencies that trawled East Asian financial markets for funds. Now some of these guarantees are being called, there is a concern that a few of these might have been "improper" and may not be eligible for repayment. In the past twelve months, cases have been brought against Chinese entities by First Chicago Bank, Lloyds Bank, the Hong Kong and Shanghai Banking Corporation, and Security Pacific. The latter concerns bankers acceptances guaranteed by the PCBC branch in Shenzhen. Lloyds Bank is suing the CITIC Industrial Bank branch of Shenzhen for nonpayment of $1 million in letters of credit. The Hong Kong and Shanghai bank is involved in lawsuits with three Chinese guarantors for a total sum of $81.3 million. Finally, the First National Bank of Chicago has brought a suit against the China National Machinery and Equipment Corporation to claim $14.65 million that were guaranteed by its Guangdong branch on behalf of Carroway Enterprises, Ltd., registered in Hong Kong. The decline of tourism in 1989 has clouded the future of several hotel projects and two in Guilin may have to be rescheduled. Other complaints refer to small delays in the repayment of loans and trade credit, which in the current atmosphere are causing irritation. But Hong Kong bankers, who are among the most sensitive, admit that, by and large, Chinese borrowers have been quite scrupulous in servicing their loans at least thus far and that delays may affect 3-5 percent of loans.

external debt to be sovereign. The Chinese authorities argue that this is not so, and that even the BOC borrowing on behalf of the government is only an organ of the state, not the state itself. As a practical matter, however, it appears that most debt in the event of difficulties, would come to be sovereign if China places a high premium on its future credit standing. Thus, BOC's borrowing must be considered sovereign debt; in addition, any borrowing by the nine other institutions is also fairly clearly sovereign borrowing.

5.59 The distinction between sovereign and nonsovereign debt, and between sovereign and debt and guarantees and nonsovereign debt and guarantees, could be accomplished by the dissemination of a State Council pronouncement expressly, forcefully, and publicly disclaiming responsibility, legally and in fact, for the debt of all but a narrowly defined (preferably expressly named) group of borrowers. This disclaimer could be made by a carefully drafted letter, delivered to, say, the 500 largest foreign commercial and investment banks. In addition to the general disclaimer, the letter should specifically state that any "comfort letters" or other representations made by any ministry or other organ of government are without effect.

5.60 This approach is consistent with the effort to decentralize enterprise accountability and management, since it would make clear that enterprises must be financed on their own merits. It will make it difficult or impossible for foreign banks to justify credits to these enterprises on the basis of implicit sovereign guarantee and can be expected to dramatically reduce the availability, and raise the cost, of foreign credit to these enterprises. Meanwhile, with expressly guaranteed borrowers enjoying substantially cheaper access to foreign borrowing, they will become the most attractive source of foreign exchange for enterprises, thus providing an incentive for the development of a viable internal intermediation system.

5.61 It is quite likely that, for borrowing activities in 1990, terms may be harder and lenders less inclined to shave margins for the sake of future business with China.e/ In these circumstances, the borrowing strategy might have to be better orchestrated so as to keep costs down. This will require using China's most creditworthy institutions in the proper sequence; avoiding market saturation through appropriate spacing and dispersion of markets; and choosing the borrowing instrument, e.g., syndicated loans or bonds, with an eye to receptivity.10/ There is, at the moment, no problems of excess but neither is there much of a secondary market for Chinese paper that would serve to enhance absorptivity.

5.62 It would be useful for China to consider advice given to Korea a few years ago which is to develop correlations between China's terms of trade and various exchange rates and use these expected exchange rates to guide the choice of currency in future borrowing.f/ China's pattern of external trade is an important determinant of the currency composition of its foreign exchange. External liabilities and assets should be managed in an integrated fashion because what really needs to be managed are net liabilities, that is, external liabilities minus external assets such as foreign exchange reserves.

5.63 Because of China's relatively high ratio of exports to GDP, variations in export earnings should be reflected to the extent possible in the time profile of debt service payments. A variable maturity loan may suit this purpose; it reduces uncertainty and permits the earmarking of funds for future debt service. A lengthening of loan maturity would only be justified when China's ability to pay deteriorated. Extending of maturity, say through postponement of amortization, would have been appropriate for China in the mid-1980s.

10/ The increase in bond issuance is one of the most prominent current trends in international capital markets. Gross issues of international bonds have increased from US$75.5 billion in 1982 to almost US$168 billion in 1985. Although OECD countries and international organizations dominate the market, China has recently increased its activity in this market. A recent World Bank report describes a number of trends in this market having implications for future external financing in Korea--implications that apply to China just as well. These trends are: (a) the resurgence of fixed-interest bonds after a substantial decline in their popularity following the high inflation and high interest rates in the late 1970s and early 1980s. With low inflation in key industrial countries in the foreseeable future, investors have been drawn back to fixed-interest bonds. Longer maturities, together with the option to issue callable debt, which prevents issuers being locked into high interest rates, are attractive to borrowers who need to reduce their exposure to future high interest rates while at the same time reducing their use of short-term debt; (b) the recent easing of regulations in a number of countries, including Japan and Germany, which should improve the prospects of currency diversification inn this market; (c) the increasing popularity of equity-related bond instruments such as convertible debentures and warrant issues. Issuing equity-related debt can be an attractive option for certain types of enterprises, such as joint ventures. It can be a cheap form of finance for an enterprise with high earnings potential.

March 16, 1990

Mr. Moeen A. Qureshi

China: Country Strategy Issues

Moeen,

1. I do not have major difficulties with the approach presented in Mr. Burki's note, and would only stress the uncertainty regarding future developments. These are perhaps inadequately recognized in para 3.

2. The proposal to think in terms of an alternative "base case" and a "low case" lending scenario on the basis in progress of two areas of primary focus - macro-economic stability, with emphasis on strengthening the institutional aspects of macro management and continued price and marketing reforms - is sound. However, one can question whether a low case lending level of 2/3 of the volume of the base case reflects enough of a response to policy regression and drift.

3. A flexible approach to the sectoral composition of lending depending on the progress in sector specific areas of reform (para 11) is also an appropriate one.

4. The issue in para 20 regarding the disposition of IDA8 resources and of China's share in IDA9 seems to be discussed in isolation from the rest of the note. I believe that it cannot be resolved without taking account of whether we are in the low case or the base case situation in China. A poor performance should not mean that the low case lending level should mean that IDA lending remains unchanged and only Bank funds are reduced. Claims on IDA funds should reflect performance. This point is strengthened by the fact that as demonstrated in Annex 1 creditworthiness issues are not important in China.

5. We have not had the time to check the projections summarized in Annex 1. However, the story hangs together.

6. There is something curious about Annex 2. I do not understand why the total of the low and base case is presented in the table.

Vinod

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THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: March 16, 1990

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MAR 17 2017
WBG ARCHIVES

TO: Mr. Moeen A. Qureshi
THROUGH: Mr. Shinji Asanuma, Acting Vice President, ASI
FROM: Shahid Javed Burki, AS3DR

EXTENSION: 72571

SUBJECT: China: Country Strategy Issues

1. In his memorandum of January 9, 1990, recording the outcome of the President's Council's review of FY91-93 country lending allocations, Mr. Conable noted inter alia that he was concerned about the realism of underlying assessments of country performance prospects for four countries, including China; and that, in the case of China, the lending levels proposed should be considered provisional until we had resumed lending and he had reviewed a new Country Strategy Paper (CSP).

2. With the approval of the North China Earthquake Reconstruction and Jiangxi Agricultural Development credits on February 8 and 27 respectively, we have now formally resumed lending. Meanwhile, there are several practical issues that require an early decision, including the re-phasing of our FY90/91 lending operations and the preparations for your upcoming visit to Beijing. Accordingly, the purpose of this memorandum is: (a) to summarize recent macroeconomic trends in China, including the prospects for continued economic reform (based on the draft CEM now under preparation); (b) to assess the implications for our country assistance strategy in general, and for the scope, size and content of our current FY91-93 Business Plan, in particular; and (c) to recommend a plan of action for managing the continuing uncertainties surrounding our FY90/91 lending and operations programs during the next 18 months.

Background

3. The events of June 3-4, 1989 in Beijing and the recent eight-month hiatus in Bank/IDA lending have changed the climate for Bank Group activities in China significantly. Until last year, China's decade-long commitment to economic reform was not seriously in doubt; nor was the size, content or planned rate of growth in the Bank's China program. Both assumptions are now being questioned, by public opinion, foreign investors, and the Bank's principal shareholders. Related to this, the Bank's role in China, including the standards by which its effectiveness is judged, will probably be subjected to closer, more public scrutiny in the immediate future. Second, although the worst fears of last summer concerning a possible major reversal of overall reform have receded (and, in retrospect, were exaggerated), the political situation in China remains uncertain. It is unclear whether the leadership's recent efforts

to regain public confidence, during a period of economic austerity, will ultimately be successful; nor, whether the inevitable transition from the old guard of senior leaders to a new generation will be orderly, and what this may portend for economic policy. Third, although we have initiated the resumption of lending, the current FY90 lending plan, formally comprising the remaining 6 delayed FY89 operations totalling $720 million and 12 FY90 operations totalling about $1.7 billion is no longer feasible in practice, and both the FY90 and FY91 operations and lending programs will have to be adjusted to current and foreseeable realities - within the Bank, including the attitudes of G-7 Executive Directors, and in China.

4. It is against this background - namely, the changed environment for the Bank's China program, the continuing political uncertainties in China in the short-term, and the need to adjust our current FY90 lending plan - that the issues below are discussed.

Macroeconomic Trends and Reform Prospects

5. Regarding recent economic developments, the draft CEM, now scheduled for discussion with the authorities later this month, re-affirms the preliminary judgements made in the paper distributed to the Executive Directors last December and in my statement to the Board on February 8. It endorses the priority being given to stabilization in the short term and draws attention to the need for improving the management of the economy through institutional and policy reforms. However, we have two major concerns about the outcome of the 5th Plenum of the 13th Central Committee last November: first, the authorities' reliance on direct control measures to achieve macroeconomic stability, and their apparent effectiveness in the short term, may discourage them from proceeding with the difficult but increasingly urgent actions required to strengthen longer-term macroeconomic management through institutional reforms; second, the fragile political consensus, as well as latent disenchantment with the consequences of macro-stabilization, could erode popular support for the important reforms that are still needed.

6. Looking ahead, China's growth during the next two years of stabilization (1990/91) will probably be significantly lower - at 4-5% annually - than the double digit rate recorded in 1988. Over the medium-term, and with improved macroeconomic management and more market-oriented pricing policies, the growth rate could average 6-7% annually. There are three reasons why the rapid growth rates of 1984-88 will be difficult to replicate. First, the easiest efficiency gains released by private enterprise in agriculture, based on existing infrastructure, have been largely exploited; and further productivity increases will have to come from new investments and diversification. Second, the high investment rates of the boom years were partly financed through monetary expansion, which now needs to be controlled for macro stability. Third, the process of decentralizing industrial management and investments has reached a stage where directions for improvements are not clear so long as ownership rests with the State.

7. Annex 1 (attached) summarizes briefly the above growth implications for China's external sector, including its borrowing prospects, creditworthiness, and the Bank's exposure. It concludes that: with a projected debt service ratio through 1995 comfortably below the government's official policy target of 15%, China remains fully creditworthy on economic grounds; and that, under all projected lending scenarios, China remains well within the Bank's established exposure and portfolio parameters for Bank lending. It thus provides the basis for moving forward with the implementation of our "base case" program for FY91/92 (see Annex 2).

8. Turning to the prospects for reform, the events of 1989 have obviously shaken confidence, within China and outside, in the government's continued commitment, despite repeated public reassurances by the senior leadership. The Fifth Plenum's detailed "Decision on Improving the Economy and Deepening the Reform", which contains a number of positive statements balanced by several ambiguous ones, was evidently an uneasy compromise. In addition, it is apparent that the maintenance of macroeconomic and, more broadly, political and social stability is the overriding preoccupation of China's leaders for the immediate future. Given these realities, it is neither easy, nor would it be prudent at this early stage, to attempt definitive judgements which, at best, are bound to be mixed. That said, the Bank's mission in China, as elsewhere, is to support the country's economic and social development efforts, including the reforms required to facilitate this; and, a preliminary framework is needed to guide our activities in the immediate future. Accordingly, we are now in the process of defining an agenda of institutional and policy reforms as the basis for our future dialogue, work program and country assessment.

Implications for Country Strategy

9. Assuming that China's economic performance and creditworthiness remain satisfactory and that the Bank's role as an advocate of continued reform may be more important now than ever before, the implications for our country strategy in the short-term are relatively straightforward. Specifically, we should determine periodically over the next few months whether defined elements of China's economic reforms are being advanced or impeded by the current stabilization program. In this connection, we have tentatively identified two major areas of primary focus. First, the objectives of macroeconomic stability must be maintained, with emphasis on strengthening the institutional aspects of macro management. These should include: further developing fiscal and monetary policy instruments; improving the structure, regulation and supervision of the banking system; and, continuing with reforms of the external trade and foreign exchange regimes. Second, price and marketing reforms must be pursued to make sure that relative prices reflect, to a large measure, demand and supply forces in the market.

10. If our overall assessment of progress in these areas 6-9 months hence is positive (e.g., following Mr. Conable's projected visit to China in the fall of this year), it would then be appropriate to resume the rate of growth in Bank/IDA lending envisaged in the last CSP; if, on the

other hand, the outcome is negative, or uncertain, then the lower scenario presented in our business plan's "low case" (Annex 2) will be in order.

11. In addition to the core areas identified in para. 9 above, we intend to monitor the status of existing reform policies and experiments by reference to a set of sector-specific benchmarks - defined in terms of the progress of ongoing Bank/IDA-financed projects and our economic and sector work (ESW) program and the policy content and objectives of lending operations currently in the pipeline. The sectoral composition - but not the overall size - of the program would be dictated by our assessment of progress in these sector-specific areas of reform.

12. The operational impact of this approach in industry and finance, for example, would be as follows. If current enterprise and financial reform experiments continue - a key objective of proposed industrial restructuring projects in Shanghai, Jiangsu and Tianjin - then we would proceed with these operations as planned in FY91/92. Similarly, if a satisfactory financial policy framework for the proposed Financial Institutions Development Loan (FIDL) can be agreed with the authorities, it would also be processed as planned in FY92. If, on the other hand, the process of financial and institutional reform lags or retrogresses, future loans to financial intermediaries would be delayed or, in the extreme, abandoned.

13. Regarding agriculture, if rural reforms are delayed or stalled, we would attach renewed priority to regional/basin development and irrigation infrastructure-type operations with significant policy content - a trend that is already in progress. In addition, operations with explicit poverty-alleviation and/or environmental objectives - in forestry, agricultural production or resettlement - would also receive emphasis.

14. In transport and energy, the main focus of our operations hitherto has been to strengthen the overall planning and project management, including procurement, process, as well as to promote specific tariff/price reforms. We are also launching a major effort in urban development, including urban transport and water supply. Since most of the projects in these areas are province- and sector-specific and may thus be relatively immune to the progress or otherwise of overall reforms, we would continue with a significant lending and ESW program, in line with China's priorities for Bank/IDA lending.

15. Regarding human resources, we would continue to solicit new lending opportunities in education, probably shifting our focus, however, to provincial operations. We have already begun to concentrate on planning and financing issues at the provincial level in education and other social sectors and this should continue. Our modest operational involvement in health and rural water supply will provide continuing opportunities for projects with explicit poverty-alleviation and/or environmental goals.

16. Concerning the Bank's Programs of Special Emphasis (PSEs), we plan to emphasize the two main areas to which China itself attaches growing priority, namely the environment and poverty alleviation. We have three free-standing environmental operations in the FY91/92 pipeline and an environmental sector strategy task in the FY91 ESW program. In addition, an increasing number of our energy, industry, agriculture and urban development operations have specific environmental and poverty alleviation components.

17. Finally, we would use the existing portfolio and upcoming FY91/92 operations to re-engage discussion with the authorities on the systemic issues constraining the effectiveness of Bank assistance, including: strengthening the design, procurement and contracting process; resolving internal on-lending, foreign exchange allocation and repayment issues in a broader context rather than on the current project-by-project basis; and, exploiting our regular three-year rolling lending program and ESW consultations with the authorities to involve the Bank more upstream in project selection and design.

Options for FY90 and FY91-93

18. Regarding the balance of FY90, and subject to your approval, we plan to proceed with Board presentation of the 8 operations totalling about $1 billion already proposed (including the 2 credits approved on February 8 and 27) with an IDA:IBRD blend of 60:40. We will have 9 additional operations totalling about $1 billion ready for Board presentation by early May, of which 5 are already negotiated (including 3 delayed FY89 projects). If and when circumstances permit, Board presentation of any or all of these 9 operations could proceed either in the final quarter of FY90 or early in FY91.

19. Regarding FY91-93, we have prepared two options for planned lending, taking into account the approach, including the core and sector-specific benchmarks, outlined in paras. 9-17 above and these are attached hereto as Annex 2. The first, or base case, assumes in principle the resumption of a "normal" lending scenario of 47 operations totalling about $7.8 billion. The second, or low case, assumes only 33 operations totalling about $5 billion, either because of slow, or no progress, in terms of policy benchmarks or because of continuing political constraints on Bank:IDA lending to China beyond the Department's control, or a combination of both.

20. An important issue in this connection is the disposition of the approximately $1 billion IDA resources available to China under IDA 8, the commitment period for which expires on June 30, 1990. We should, in my view, remain sensitive to China's view that its access to IDA in FY90 has been artificially constrained by political factors beyond its control and therefore accept a significantly "softer" blend than the agreed 65/35 ratio for the FY91-93 three-year rolling plan. Regarding IDA 9 (FY91-93), the low case lending scenario of $5. billion would mean either a very soft blend (about 50/50) if China were to receive 15%, as envisaged by the donors, or reallocation of some $2.4 billion to other IDA recipients. In the circumstances, I recommend: (a) that, for the

time being, the Department continues to work on the base case scenario outlined in para. 18 above; and (b) that we review the situation again in the fall of 1990 to determine whether to lock in the larger base case program or to begin moving toward the more restricted low case scenario. In the latter case, we would envisage some downsizing of the China program by redeploying some CAM/staff resources.

21. We need senior management's decisions with respect to the issues raised in paras. 10 and 12-19 (overall policy benchmark to determine the choice between base vs. low case); para. 11 (sector policy benchmarks to determine the sectoral composition of the lending program without affecting its overall size); and para. 20 (IDA:IBRD blend for the low and high cases).

Attachments: 2

cc: Messrs. Karaosmanoglu (o/r), Ahmad, Ecevit, Goldberg, Montfort, Pearce, Stern, Yusuf, Lim, Wiehen, Yenal

DPearce/SJBurki:em/jd/cdw/em

(DP/CSIssues)

Borrowing Prospects, Creditworthiness and Bank Exposure

1. China's growth during the next two years of stabilization (1990/91) is expected to be substantially slower - at 4-5% annually - than in the recent past. Over the medium term, we expect it to return to its long-term trend rate of 6-7% annually, with exports growing at 7-8% over the 1990-98 period. These longer-term trends are predicated, domestically, on improved efficiency of investment and a continuation of past high savings rates. Externally, they assume continued appropriate exchange rate policy - the recent devaluation was a timely and important action in this regard - and continued growth in exports of processed agricultural products, high value-added textiles and machinery. Imports, temporarily slowed by the stabilization program, are expected to grow more rapidly, at 6% per annum, from 1990-98: their composition split between capital goods for modernization of industry and imports of consumer items. These trends will give rise to small, current account deficits in the remaining two years of the stabilization program, or about 0.6% of GDP, increasing to 1% of GDP in the 1991-95 period.

2. At these current account levels, China will be borrowing $2-5 billion per annum, most of it from commercial banks/suppliers' credits and financial markets in the 1990-95 period. At presently planned commitment levels of [$1.8 billion] per annum, the IBRD share of new commitments averages 21.5%, and of disbursements 16.2% over the 1990-95 period. If China moved away from its past, relatively balanced trade posture to a major opening of its market to imports, its financing requirements would be higher; however, we consider it more likely that past cautious trade and borrowing policies will continue. Indeed, owing to stabilization, the most likely scenario is a current account deficit in the near term smaller than projected, increasing again after 1992/93.

3. Under the base case scenario, China's total external debt (DOD) would rise to US$88 billion by 1998, equivalent to 47% of exports and 9.7% of GDP. Despite this increase, debt service ratios would remain low, at about 6% of exports in 1998 or near the present level of 7.6% (1989). This is well below the 15% ratio China has set itself. Net financing requirements and the level of debt would be lower in a lower case scenario if more conservative policies are pursued.

4. Given the overall low level of debt, China's creditworthiness is not seriously in doubt, despite recent press and other reports. However, recent, minor incidents of payments arrears have raised some concerns. China has made significant progress in improving its external debt management since 1985, and two new sets of regulations, on borrowing authorities and guarantees respectively, were issued in 1989. Nonetheless, the status of some loans (sovereign/non-sovereign) remains unclear, and this is a situation we are encouraging the authorities to remedy.

5. Bank Exposure. With current account deficits and levels of indebtedness of the order of magnitude described above, China's debt indicators remain within prudent limits. With IBRD (Bank and IDA) lending of [$1.8 billion] per annum over the 1990-95 period, preferred creditor debt outstanding will rise to 29.4% of public debt outstanding by 1998. China would thus remain below the Bank's guideline that debt to preferred creditors should be below 35% of total public DOD. IBRD debt service as a share of public and publicly guaranteed MLT debt service would be 17.9% by 1998 (below the Bank guideline of 20%) and, at these levels of borrowing, Bank debt service-to-exports would be only 1.1% (below the guideline of 5.5%).

6. Under a scenario of lower IBRD commitments of $5 billion in the 1991-93 period, Bank exposure would be somewhat lower and still well within the guidelines. Even at the higher commitment and exposure levels however, we believe that a somewhat higher share of an overall very low level of debt poses less risk to the Bank than a low level in a highly indebted country.

7. Bank exposure guidelines for the "base" and "low" cases are analyzed for China in Table 1 below.

Table 1.

	Base Case Commitments /1	Low Case Commitments /2	Exposure Guideline
1. IBRD/Public Debt Service	17.9	14.3	20
2. Preferred Creditor DOD/Public DOD	29.4	26.8	35
3. IBRD Debt Service/XGS	1.1	0.9	5.5
4. IBRD Portfolio	8.0	N/A	<10%

/1 Assumes total IBRD and IDA commitments of $7.7 billion from 1991 to 1993, and $2.9 billion annually thereafter, for a blend for the 1991-93 period of 65/35.

/2 Assumes total IBRD and IDA commitments of $5 billion from 1991 to 1993, and $2.9 billion annually thereafter, for a blend for the 1991-93 period of 53/47.

3/14/90

CWallich/DPearce:em
(DP/CSAnnex 1)

CHINA

SUMMARY OF 5-YEAR LENDING PROGRAM

	Low		Base		Total	
	No. of Projs.	Amt.	No. of Projs.	Amt.	No. of Projs.	Amt.
FY91	11	1.7	15	2.2	26	3.9
92	11	1.7	16	2.7	27	4.4
93	11	1.6	16	2.9	27	4.5
TOTAL	33	5.0	47.0	7.8	80.0	12.8

Vinod Dubey

GS

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: November 29, 1989

TO: Ms. Barbara Kafka

FROM: Fred D. Levy, EAS and Khalid Siraj, ~~COD~~

EXTENSION: 78058 and 73351

SUBJECT: China-Financial Institutions Development Loan and Sector Strategy Paper

1. Thank you for the opportunity to discuss with you the draft FEPS for the proposed project and the annexed strategy paper. As indicated in our discussion, in addition to the comments made at the review meeting, we have a number of concerns and questions that we hope will be taken into account in the revision of the documents and further thinking about and processing of the loan. We fully concur in the objectives set out in the documents; the comments below are related to issues of timing and tactics as well as a need for some further clarification.

2. The strategy paper proposes to forge a closer link between policy performance and continued lending in the financial sector, and five areas are listed where progress is deemed particularly important and is to be monitored. We believe that the approach outlined is correct, and, with one reservation (see para. 5 below), we do not disagree with the indicated priorities. Immediately following this statement, however, the potential sensitivity of the dialogue and the need for a flexible approach are emphasized. These are unquestionably needed, but the paper leaves us without a sense of priorities within the priorities or of minimum acceptable progress--i.e., of where the proposed link would become tangible and binding. We agree that there is no need to document the understandings reached with the Government in this regard, but we do need to be clear on, and communicate to them, the basis on which we expect to assess progress and make lending decisions.

3. Given the importance now to be given to the linkage between policy and financial sector lending, we wonder whether it is advisable, as currently planned, to send a large mission for further development of FIDL prior to the discussion of the sector report and strategy. Might not this heighten the risk of later misunderstanding with the authorities, if they are surprised by a perceived change in the rules of the game?

4. We believe that the strategy paper also needs to present a clearer picture, albeit somewhat speculative, of the future evolution of the banking system that is envisioned. Without such a picture, for example, it is difficult to evaluate the conclusion of both the FEPS and the strategy paper that the principal focus for institutional development should be placed on the major specialized banks. True, their size and reach suggest great potential impact on the system, but it may also limit the speed and likelihood of change. The argument could be made that concentrating on the new and innovative elements of the system--e.g., the rural and urban credit cooperatives--would do more to transform China's financial sector in the desired directions. In any event, we suggest that the strategy paper provide some evaluation of the results of our work with the specialized banks thus far.

5. Both the draft FEPS and strategy paper identify bank spreads as the immediate priority issue as regards interest rates in China, the focus being on assuring the financial integrity of the banks. The overall level and structure of interest rates is viewed as a lesser issue, inasmuch as credit is still largely administratively allocated. While recognizing the latter point, we continue to believe that the level and structure of interest rates are currently matters of great importance in China, especially their impact on the mobilization of financial savings at a time of severe demand pressures. Of particular importance, in our view, is the highly negative real interest rate allowed on enterprise deposits, which is not, we believe, unrelated to the chronic difficulty of restraining enterprise expenditures. In addition to correcting this anomaly in the interest rate structure, we would try to impress upon the Government the potential usefulness of instituting a more flexible interest rate policy, possibly including the introduction of an automatic adjustment mechanism to assure the maintenance of positive real rates. After all, this latest bout with inflation will not be the last; further spurts can be anticipated, if and as economic reform continues.

6. We have an immediate concern regarding FIDL per se. The heart of the operation is the technical assistance to be provided the participating institutions, and, as the FEPS points out, a sustained institutional development effort will be required. However, the difficulties reported in gaining government approval for the various T/A components, its insistence that T/A not exceed 5% of the total loan value, PBC's failure thus far to make a proposal to the State Council regarding its own participation and its reluctance to include BOCOM, the latter's reluctance to provide requested information, and the insistence of all participating institutions on concessionary funding, do not appear to signal a strong commitment on the part of the Government or the banks. This may be further reason to suggest that a major Bank commitment to this project should await discussion of the sector strategy.

cc. Messrs/Mss Burki, Stern, Ahmad, Pearce, Wallich; Yenal, Wiehan; Vergin, Dubey, Lee, Harris, Okonjo-Iweala.

ʻICE MEMORANDUM

—> China CSP

DATE: July 21, 1989

CONFIDENTIAL

TO: Bill Stanton, EXC

FROM: Judith Maguire, EXTPA

EXTENSION: 75324

SUBJECT: IDA-9 and Bank Lending to China

1. During the course of this week I had several conversations with Gary Bombardier from Matt McHugh's office. These discussions centered on the restrictive language on IDA lending to China which was incorporated in the House foreign aid appropriations bill. As you know this language was offered by Jerry Lewis (R-CA); however, it was unopposed at every stage of the process by either Democrats or Republicans, and there would undoubtedly have been support for strengthening the language if it had ever come to a vote on the floor.

2. As it is now, IDA would pay a price (lose $115 million in FY90) if we were to resume lending to China, and the President did not feel it appropriate to make the required certification (always a difficult issue). However, Gary wanted the message conveyed to management that the potential cost to IDA, should we resume lending to China in what he called "unseemly haste", is far greater than may appear from a simple reading of the language.

3. He asked me to be sure that you and others here in the Bank understood that IDA's strongest supporter in the House, Matt McHugh (who with Gary's help was almost single-handedly responsible for securing passage of the IDA-8 legislation), would not be prepared "to lift a finger" to assist passage of the IDA-9 legislation if the Bank were to act in deliberate disregard of strong Congressional sentiment on the China issue. By this he means, I believe, that they trust that the Bank will not move precipitiously on China before the appropriations bill is completed (around September 30) and final China language can be agreed. Even thereafter, depending on events, I believe they would react strongly to a resumption in lending this fall.

4. The bottom line on this? Gary said this evening he sincerely believes that, if the issue of resuming lending to China is not handled with great sensitivity, the backlash in Congress could put the next IDA replenishment in jeopardy. He then said, "the ripple effect on this could last for 2 or 3 years".

5. I think it important that this warning not be underestimated. It comes from the staff of the most influential Member of Congress on World Bank issues. This message was not conveyed as a threat, but rather as what I believe is an accurate reflection of prevailing sentiments. I know the Bank has to do what it thinks is right on this issue. However, I also believe that it is important that everyone understand the possible ramifications of our future policy on China.

cc: Messrs. B. Conable, EXC; E. Stern, SVPFI; J. Wood, FPRVP

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: October 17, 1988

TO: Files

FROM: Marianne Haug, EXC

EXTENSION: 73585

SUBJECT: Minutes of the President's Council - October 12, 1988

Members Present

Messrs. Conable, Hopper, Qureshi, Stern, Shihata, Thahane

Acting Members

Messrs. Parmar, Cosgrove

Other Staff

Messrs. Burke, Cadario, Chap, Churchill, Dubey, Fischer, Karaosmanoglu, Piddington, Pearce, Rajagopalan, Rao, Stanton, Tidrick, Maillat, Jay
Mrs. Haug

China CSP

In introducing the subject Mr. Karaosmanoglu noted that there were a large number of changes taking place in China. Outside reports of these changes were of varying quality--some were accurate, others were not. After the resumption of the Bank program in China an initial focus of the Bank's analytical effort was to develop an understanding of the basic structure of the economy. With that analysis in place attention has turned to the analysis of specific macro-economic issues. He noted three important policy issues: how to establish financial restraint; how to achieve better investment decisions and how to bring together fiscal and monetary policy. The Bank in the upcoming weeks will be discussing with the Chinese the implementation of the existing Bank program, the Bank's three-year lending program and the government's economic policy. As part of these discussions, Mr. Fischer will travel to China in November to discuss a range of macro-economic issues.

Mr. Conable opened the discussion by raising the following issues and questions:

(1) Macro-economic control--does the Government have adequate control over the key macro-economic variables? There are continuing reports of competition between the People's Bank and the Finance Ministry over control of monetary policy and instruments. The transfer of authority to the provinces further complicates the effort to

establish control. Closely related is the concern with the on-again-off-again stop-go pattern of policy action which has developed in recent periods.

(2) Core program. Does the Region have a core program? It appears that the Region is set on a $3 billion per year lending program, come what may. What steps will trigger going above a core program?

(3) Sectoral lending. Are such loans just free money since the government is prepared to undertake these policy measures anyway? Are fast-disbursing loans justified or desirable?

(4) Cofinancing. The Chinese find it difficult to undertake cofinancing projects. One result is that the Bank will be providing a very large share of China's external financing. Should the Bank encourage the Chinese to accept cofinancing as a normal and desirable financing mechanism?

Macro-economic Management and the Pace of Reform. Mr. Qureshi, in response to the issues raised by Mr. Conable, stated that he believed the main questions confronting the Bank in preparing its strategy toward China were: can the reform process be sustained and the needed major adjustments in the economy undertaken, and how is the Bank's lending program geared to assist the Chinese in this effort? Mr. Karaosmanoglu observed that any rapidly growing economy experiences to some extent some stop-and-go. In some cases countries have successfully coped with this stop-and-go pattern, e.g., Korea. In other cases such as Yugoslavia the stop-go pattern has had negative results. Mr. Burki felt that the Chinese will be able to sustain the reform and adjustment process despite inevitable starts-and-stops if they are able to move effectively on fiscal restraint, monetary control and administrative control. To reduce the stop-go pattern the Chinese will need to achieve a more sustainable growth rate. It is believed that a sustainable level may be in the area of 7-1/2 and 8-1/2% which would call for a reduction in investment levels from the current 38% to something closer to 32%. The current investment boom and loose monetary policy threatens not only to worsen inflation but also to produce further distortions and harm the reform effort. In the last three to four weeks the government has taken drastic measures to cut investment. One question now is whether these measures will cut the less efficient investments.

Mr. Fischer called attention to the currently being prepared CEM which is more up-to-date on the macro situation than the CSP and is in his judgment of high quality although it is only in draft. He also noted two serious obstacles to macro-economic policymaking in China: there is no central money market and there is extensive local autonomy which raises questions concerning the amount of central control which the government has. As a result, it may take a long time to get things straightened out.

Core Program and Core Plus. Mr. Burki and Mr. Karaosmanoglu stated that the proposed lending program was not supply driven. The

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Region was not pushing money into China whether the Chinese like it or not. The Region is proposing a core program consisting of 12 to 13 projects per year heavily focused on agriculture, industry and finance, and transportation and energy. Such a level of project lending is viewed as reasonable given the size of the country and the large number of high return activities that can be undertaken. This project-oriented core program would represent 75 to 80% of the total program. In addition to the project lending, the Region would also like to use Bank lending to respond to the reform efforts of the Chinese. Not just to give money but to help develop and support the reforms, to have a seat at the table in the discussion of the reforms. Bank leverage in China is of course different than that in smaller countries such as Gambia, where Bank lending in absolute terms may be small but in comparison to the size of the economy it is large. In China the central thing is the dialogue.

Mr. Stern pointed to what he viewed as a dicotomy in the paper. The beginning of the paper emphasizes, sensibly he thought, the importance of dialogue and structural change; although nowhere did the paper provide criteria regarding the policy action or macro-economic performance which would govern shifting between the core and the core plus program levels. In contrast, the second half of the paper, para. 39 on, appears to say that China is a large country, there is almost no limit to the need and therefore the Bank should supply the proposed level of funding. Indeed para. 44 specifically states that the macro environment does not affect project lending and may not reduce policy-based lending. Mr. Stern felt that to argue that there was no intrinsic connection between policy action and lending was wrong.

Mr. Burki responded that he did not believe that there really was a dicotomy presented in the paper. The CSP in para. 11 specifically states that the lending program will be kept under constant review and will depend on progress on price reform, fiscal deficits, inflation, etc. This point was further highlighted by Mr. Karaosmanoglu who said that it is already agreed that the Bank's program in China will be reviewed every year given the size of the program and the importance of China. At the same time the Chinese have a large number of very good projects. What does the Bank do in this context? The Region has confidence that the Chinese can work their way through the current economic problems and certainly in comparison to other countries they are doing well. The Bank can in the meantime develop a very sound investment program.

Nature of Policy-based Lending. Mr. Shihata noted that para. 46 suggested different procedures and approaches for policy-based lending in China given what is said to be its unique circumstances. He asked what these special procedures were since they were not described in the CSP. Mr. Stern said that he did not think that a quick-disbursing loan made sense when it was proposed for the recent Agricultural Sector Adjustment Loan for China. He still believes that quick-disbursing lending to China does not make sense. Bank loans will represent only a modest percentage of the reserve buildup that China is expected to undertake. China doesn't have an acute balance-of-payments problem. Can the Bank instead develop instruments to engage the Chinese in policy dialogue without using fast-disbursing lending? Mr. Fischer said that it was not clear what the rationale for quick-disbursing loans was if the macro situation was not under control. He also wondered why fast-disbursing loans were important to the Chinese Government. Mr. Hopper observed that in the past, prior to the creation of SALs, the Bank had engaged in policy dialogue which led to lending which was not quick-disbursing. He asked whether the Chinese were more concerned with quick-disbursement or policy action.

Regarding special procedures for policy-based lending Mr. Qureshi said that the Region was not thinking of proposing special procedures. All the procedures envisioned have been used before--they are not new. On this point Mr. Conable stated that there shouldn't be special procedures used for policy lending to China.

On the fast-disbursing issue Mr. Karaosmanoglu disagreed with the statement that China did not have a balance-of-payment problem. He felt that there existed an enormous demand for imports and that the Chinese had kept the balance of payments under control only through controls. If these controls were relaxed, imports would expand rapidly. On a general level he wondered whether the Bank should be able to provide quick-disbursing funds even when a country manages its balance-of-payments situation. He also felt that in the case of China the Bank will need to address some issues at the sector level. How can the Bank address these sector issues without fast-disbursing assistance?

Mr. Stern observed that there was substantial distance between one-year quick-disbursing policy loans and seven-year disbursing projects. He felt that the Bank should be able to find some middle ground between these two. Mr. Qureshi said that the Bank is already moving to this middle ground. It is already agreed that a positive list will be used in sector loans in China which is likely to spread disbursements over several years. The Region can also look at the potential use of hybrid loans.

Portfolio Exposure. Mr. Stern and Mr. Shihata expressed concern over the fact that the proposed lending program could result in a breaching of the Bank's exposure guideline (para. 68). Mr. Stern felt that there was no basis for exceeding the guidelines and that the Bank should stick to them. He also felt that the discussion in that paragraph which argued that the pursuit of a more conservative strategy might lead to lower borrowing requests from the Chinese was upside down and that contrary to the argumentation in that paragraph having a large share of a small debt can also be potentially dangerous.

Mr. Stern suggested that an analysis be done of the effect on the Bank's program and other lending of staying within the guidelines. He noted that once lending programs were in place, they were hard to turn around even if circumstances changed, e.g., existing loans continued to disburse. Mr. Conable reinforced this point by stating that it was important that the Bank avoid being caught in a fait accompli. Mr. Qureshi agreed that the Region should prepare an analysis along the lines suggested by Mr. Stern.

IMF. The Region described recent efforts to achieve greater IMF involvement. The IMF recently participated in the CEM mission and they are working with the Bank on the social security issue. The Fund fielded a mission looking at the inflation issue and prepared a report on inflation and growth. The IMF concluded that excessive money growth was the primary source of inflation. Wage push was not a factor although it could become one if inflation is not reduced. The IMF recommendations on macro-economic issues are in line with the Bank's including: the need to engineer a soft landing in the area of a growth rate of 7-8%; emphasis on a stable monetary framework with growth of the money supply in the 15% range; desirability of expressing concern over the fiscal deficit which although it is not large now (2%), has displayed a worrisome trend; the emphasis by both institutions on the reduction of subsidies--subsidies to loss making enterprises account for 13% of the budget; and continued pressing of the point that there should be no stop to the price reform process. The only area where there is a difference in emphasis between the Fund and the Bank concerns ways to deal with the excess investment pressure. The Bank believes that direct administrative controls may be needed. Credit restrictions alone could disproportionately reduce town and village investment efforts.

IFC. Mr. Conable asked the IFC what their experience in China had been. Mr. Parmar said that so far the record had been quite dismal. For the larger projects the negotiations had gone on and on with no conclusion. The very small projects, financed in large measure by Hong Kong Chinese, were going forward but these were often too small for IFC involvement. One of the problems faced in China is the emphasis by the Chinese on foreign currency generating capacity. Mr. Burki noted that this emphasis on balancing foreign exchange earnings at the project level had been an issue of concern for the Bank as well. The Bank was trying as a first step to get the Chinese to at least balance at the provincial level rather than at the project level. Another foreign investment issue noted by Mr. Conable was the taxation which occurred at the village level.

Other Comments. The question was raised whether sector programs in China, because they tended to be extended to only one or two provinces, fostered fragmentation. Mr. Burki said that in some cases the Bank needed to address issues in specific provinces but in others there was a need to pursue a national program. Forestry and Railways for example involved early on provincial programs but with these in place it was now important to move to the national level. On the other hand, highways and waterways will have to remain at the provincial level.

Mr. Shihata asked whether there was any issue surrounding the Bank's policy on the use of local cost financing, noting that the CSP suggested a level of up to 75% for social projects. Mr. Qureshi, pointing to the OMS on local cost funding felt that the Bank had a detailed policy statement on the issue. Utilization of this policy of course required some interpretation and had to be looked at on a case-by-case basis.

The CSP notes the need for substantial technical assistance. Mr. Conable asked the Region what they had planned in this area and the likely cost. Mr. Burki said that the Chinese have expressed a desire for better coordination of technical assistance. The Chinese have set up an office to coordinate technical assistance and they would like the Bank to do the same. Mr. Burki said that the department has in mind a two-man unit for this purpose.

Mr. Levy

CONFIDENTIAL

CHINA

COUNTRY STRATEGY PAPER

Asia Regional Office

August 31, 1988

China

Key Economic Indicators	Actual							Projections							
	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
GDP Growth Rate	10.4	8.8	10.2	14.5	12.7	7.9	9.4	7.6	7.6	7.6	7.6	7.6	7.6	7.6	7.6
GNP Growth Rate	4.5	9.4	10.5	14.6	12.3	7.6	9.4	7.7	7.6	7.6	7.6	7.6	7.6	7.6	7.5
GNP/capita Growth Rate	3.1	7.8	9.5	13.6	11.1	6.4	8.5	6.6	6.6	6.5	6.5	6.5	6.5	6.5	6.4
Consumption/capita Growth Rate	3.8	3.0	9.0	8.1	2.5	2.2	0.9	8.3	9.4	8.1	8.2	8.1	6.7	6.7	6.8
Total DOD (in Billion US$)	4.504	5.562	5.625	6.486	10.237	17.193	17.936	19.58	27.026	32.589	38.818	46.378	54.829	64.868	76.772
DOD/Exports		23.4	24.0	24.3	36.3	58.1	50.1	48.7	60.0	66.1	71.7	77.9	83.8	90.2	96.3
DOD/GDP		2.09	1.97	2.23	3.61	6.32	5.88	5.56	6.82	7.81	8.58	9.45	10.30	11.24	11.50
Debt Service		1.845	1.914	1.898	1.883	2.382	2.58	2.655	2.836	3.251	3.612	4.041	4.874	5.23	5.77
Debt Service/Exports		7.3	7.5	6.5	6.3	8.0	7.0	6.4	6.1	6.4	6.4	6.6	7.2	7.0	7.0
Debt Service/GDP		0.69	0.67	0.65	0.66	0.88	0.85	0.75	0.72	0.78	0.80	0.82	0.92	0.91	0.86
Interest/Exports		2.1	2.1	2.1	2	2.1	2.8	4	3.7	4.3	4.4	4.5	4.7	4.9	5.1
Interest/GDP		0.2	0.2	0.2	0.2	0.2	0.3	0.5	0.4	0.5	0.6	0.6	0.6	0.6	0.6
Gross Investment/GDP	27.4	29.1	29.6	32.2	38.8	38.8	40.6	39.9	39.4	38.4	37.4	36.4	36.4	36.4	36.4
Domestic Savings/GDP	27.7	31.0	30.5	32.3	34.3	36.0	40.7	39.7	37.7	36.9	36.0	35.0	34.9	34.9	34.8
Marginal Domestic Savings Rate		64.1	27.0	41.2	43.0	49.3	90.2	26.7	11.6	25.8	23.7	22.7	33.8	34.1	34.3
Public Investment/GDP **															
Public Savings/GDP **															
Private Investment/GDP **															
Private Savings/GDP **															
Ratio of Public/Private Investment **															
ICOR	6.1	3.2	3.0	2.2	2.8	5.5	4.1	5.3	5.3	5.2	5.0	4.9	4.8	4.8	4.8
Government Revenues/GDP	30.2	28.0	28.3	27.1	27.5	26.0	22.4	..	..	..	..	..	..	..	..
Government Expenditures/GDP	31.5	29.4	30.0	28.7	28.0	28.0	25.1	..	..	..	..	..	..	..	..
Deficit (-) or Surplus (+)/GDP	-1.3	-1.4	-1.7	-1.6	-0.5	-1.9	-2.6	..	..	..	..	..	..	..	..
Export Growth Rate		1.3	9.7	12.0	33.3	10.8	15.3	7.4	8.2	8.3	8.3	8.3	8.4	8.4	8.4
Exports/GDP		8.9	8.2	9.2	9.9	10.9	11.8	11.4	11.4	11.8	12.0	12.1	12.3	12.5	11.9
Import Growth Rate		-5.4	27.5	24.0	67.3	-13.2	-7.9	8.7	20.0	8.0	8.0	8.0	9.2	9.3	9.3
Imports/GDP		7.1	7.3	9.0	14.4	13.7	11.7	11.6	13.0	13.4	13.4	13.5	13.8	14.0	13.5
Current Account (in US$)	1.241	5.867	4.412	2.372	-11.883	-7.572	0.081	-0.584	-6.448	-6.359	-6.828	-7.227	-8.508	-10.014	-11.534
Current Account/GDP		2.204	1.549	0.814	-4.192	-2.785	0.027	-0.166	-1.626	-1.524	-1.509	-1.473	-1.599	-1.735	-1.728
Terms of Trade Index			99.7	100.8	100	91.9	92.7	91.6	89.8	91.3	91.6	91.9	92.2	92.5	92.8

** Not available for China

CHINA

Country Strategy Paper

A. Summary and Conclusions

1. Almost ten years have passed since China's 11th Party Congress took the landmark decision to "readjust and restructure" the economy. Armed with this mandate, China's leaders embarked on a far-reaching program of administrative decentralization and market-mediated development. The scorecard from these reforms is positive, though not unambiguously so: GNP has increased at an average of 10 percent annually, supported by China's success at finding overseas markets for its exports of petroleum, raw materials, textiles and intermediate products and, more recently, for its machinery; private savings have proven extraordinarily responsive to rising incomes; investment has been strong, averaging 38 percent of GDP in recent years; end-1987 foreign exchange reserves exceeded six months of imports; and the debt situation is comfortable.

2. The Progress of Reform. The impact of the reforms under way since 1979 has been most pronounced in the rural sector: the introduction of the Household Responsibility System, dismantling of communes, and greater separation at the local level of political decision-making from economic management have profoundly restructured rural economic activity. Pricing and markets were increasingly liberalized, and the policy environment adopted encourages decentralized management in the rural sectors of secondary and tertiary industries. The result has been an explosion of growth first in agricultural output (10 percent p.a. from 1979 to 1984) and then in rural manufacturing and services (22 percent annually). Perhaps the most significant achievement, however, has been the massive shift from 1979 to 1987 of about 50 million farm workers to non-farm activities, services and autonomous production units larger than the family farm.

3. By 1984, the scope for further rural sector growth through liberalization and price stimuli had been largely exhausted. Chinese policymakers then turned to the more difficult hurdle of extending the reforms to the urban-based industrial sector. With profit incentives, enterprise autonomy and the dismantling of some price controls, they hoped to coax forth dynamism comparable to that which had transformed the rural economy. But they found that each round of liberalization also triggered an upwelling of investment, often in unproductive activities, with a consequent strain on the balance of payments. Repressed consumer demand backed by sizeable and increasing household savings became a threat to both price stability and the trade balance. By 1985, controls had to be imposed to rein in the trade deficit, which had swelled largely through imports of consumer goods and equipment. In response to these measures, both inflation and GDP growth slowed in 1986. But by mid-1987, inflation was on the upsurge again, fueled by enterprise investment from their own profits, swelled by price decontrol and looser and increasingly decentralized tax administration.

4. For a country that had become accustomed to virtually stable prices but which still harbors memories of a damaging hyperinflation during the 1940s, recent price trends have aroused public concern, renewed qualms over reforms and ignited a considerable debate over causes. Preliminary analysis suggests that high aggregate investment outlay generated by enterprises subject to soft budget constraints, has been reinforced by the surge in consumer and small business demand traceable to indexed urban incomes and rapidly expanding household incomes. As total credit and money supply have grown at the average annual rate of over 30 percent for the past 28 months, there is now probably an excess of liquidity in the system. The situation has not been helped by relative scarcity

of meat and vegetables and some consumer durables, and shifting consumer expectations that are beginning to induce faster spending. The leadership's response in 1987 was to put on hold proposed major price adjustments and restrict growth of reserve money in the second half of the year. The former was detrimental to overall reform and the latter created problems for enterprises, now highly dependent on bank credit for their working capital.

5. As the costs of slower industrial growth are clearly seen to be higher than the pain inflicted by moderate inflation, the Chinese leadership once again loosened the credit strings in the first quarter of 1988 and has resumed price reforms. Prices of certain food items have been raised in some cities with the intention of introducing countrywide changes in coming months. Simultaneously, agricultural subsidies are being withdrawn, but income supplements to households will leave budgetary costs undiminished. If investment spending buttressed by credit availability proceeds unchecked and price adjustments combined with compensating payments to wage earners are introduced, inflation might well accelerate further. Recently there has been growing speculation over devaluation and further price decontrol, leading to reports in the international press of runs on shops and banks. In response to these disturbing trends, and a perception--erroneous we believe--of their detrimental impact on China's creditworthiness, the senior leaders took advantage of their annual retreat at Beidaihe to take stock of the situation. Despite rumors in the foreign press of severe strains and a breakup of the discussions, on August 18 General Secretary Zhao Ziyang announced that the reforms would continue, in the context of a five year plan focussing in the short term on enterprise reforms.

6. The commitment of China's leaders to far-reaching reforms in all aspects of the Chinese economy, to create "socialism with Chinese characteristics" was thus reconfirmed. The reforms are complex, interrelated and in many cases politically difficult however, and challenge the leadership to improve China's macroeconomic management and to mobilize public support. While reforms in rural areas since 1979 have been quite spectacular in their impact, urban enterprise and price reform have proven more problematic. It is difficult to disentangle the price and management aspects of industrial reform, and eventually these will lead to more difficult issues with social and political implications, including labor mobility and performance-based remuneration which will further widen income disparities. For these reforms to be successful, the authorities need to maintain macroeconomic stability, as inflation and budget deficits pose problems which need to be controlled while more complicated reforms aimed at improving economic efficiency proceed. Policies will also need to ensure that China's social security system, the envy of many countries at higher income levels, is maintained and, as incomes and public expectations rise, costs are kept affordable.

7. Bank Assistance Strategy. Our dialogue with China is well-engaged on these reforms and the problems they pose. China's leaders remain keen to discuss sweeping, general matters, and seek the Bank's advice on many issues of institutional reform: during Mr. Conable's recent visit, Zhao asked for the Bank's help in understanding the macroeconomic problems that are plaguing the country. Despite this candid and open relationship, however, we are not often asked to incorporate the actions to implement this advice into specific lending operations. There has been progress on a number of operational issues, including prices and on-lending rates, in the context of specific operations, but we have not encountered great willingness to use project lending to advance reform agendas with broader implications. Price distortions remain a fact of life, and it is difficult to say over the next five years how quickly they will be removed, and thus how soon we will be able to move to usual Bank approaches to financial covenants, pricing and subsidies. We propose to continue the pragmatic, project-by-project approach that has established the credibility of our

advice on the wider implications of these issues, while proceeding with economic work on five main areas: macroeconomic management; enterprise reform; financial system development and reform; price-cum-tax reform; and liberalization of the foreign exchange system, the improvement of which could simplify and improve design of Bank projects and China's investments in general (para. 49).

8. The increasing sophistication of China's requests to the Bank challenges us to provide timely and authoritative advice, as China seeks to acquire the latest in modern technology and thereby achieve middle-income status as soon as possible in the next century. Our efforts will include improving the efficiency of project preparation, and speeding up of procurement and disbursements. To introduce more predictability to the annual lending and ESW programs, the authorities have accepted our proposal to agree with them annually on three-year rolling programs of ESW tasks, lending operations and technical assistance activities. These programs will be targeted on priority macroeconomic and investment issues that are recognized as obstacles to balanced growth and economic efficiency. More explicit linkages between lending and our ESW program represent a shift from our past practice of the "parallel tracks" approach separating project work from economic dialogue. This change is timely, and reflects progress achieved over the years in the policy dialogue with Government and China's growing openness to advice, particularly from the Bank, and the realization that investments are most efficient when accompanied by pricing and management reforms.

9. Both China and the Bank will use the experience of the first Rural Sector Adjustment Loan, which was prepared and negotiated in FY88, to test the applicability of broader "conditionalities" and policy-based lending to our relationship with China, consistent with bridging the earlier gap between broad policy dialogue and projects (para. 21). Three of the 76 operations proposed for FY88-92 would be policy-based (all in agriculture). Taken together they would represent less than nine percent of total lending. Provincial lending starting in three provinces acknowledges the decentralization of investment decision-making and seeks to improve the efficiency of our project work by becoming involved more upstream. Given the size of many provinces, we plan to support this effort with ESW targetted on local resource mobilization and finance, as well as poverty studies in several poorer areas focussing on health, education and social security issues. Work proceeds in other sectors to introduce more policy content to our project lending, a feature considered virtually impossible in many of our early operations. The receptivity of China to our advice is growing as the links between our ESW and lending program are becoming more apparent, and our work program over the next several fiscal years includes ESW tasks whose lending potential is explicit from the initiation of the work. In the urban sector in particular there is great opportunity to establish the urban management, finance and planning context for needed physical investments in transport, housing and water supply/sewerage.

10. The substantial additional investment of Bank staff time this shift implies is amply justified by China's own considerable efforts to modernize its economy as soon as possible, the role it plays on the international scene, and the intellectual and political significance for the Bank to be involved in this major exercise. While there is some risk that investment loans with greater policy content may be delayed or drop from the lending program, we believe that China's willingness to seek policy advice is clear and encouraging, and that policy-based lending for agriculture and, later possibly, financial reforms will become more prominent in our program. In light of the experience with RSAL, we would need to adapt other SECAL procedures and features to China's unique conditions, but in a way that does not compromise their applicability to other borrowers or in future situations with China. Our major focus will remain, however, on traditional project lending, in which the Bank's contribution to investment

quality through attention to management and pricing issues is well recognized, even in sectors where difficult reforms will need to be approached gradually.

11. To pursue this strategy in China, we propose to expand the number of projects from the 14 delivered in FY88 and 14 planned in FY89 to 16 per year, starting in FY90 and to increase the FY88-92 level of lending by $1.0 billion (from the already approved $10.9 billion to $11.9 billion) (Attachment 1). These lending levels and their rate of growth will need to be kept under constant review. The expansion of Bank operations would depend on China's progress on price reform, the level of fiscal deficits and rate of monetary expansion (and therefore efforts to control inflation) and the pace and results of enterprise reform.

12. Doubling the level of lending between FY87 and FY90 and increasing the number of FY88-92 operations from the 68 authorized in February 1988 to the 74 proposed, thereby accumulating a portfolio of around 80 projects by 1990 and around 95 by 1992, would require increased efforts by the China Department. We shall work to reduce lending coefficients by insisting that the Bank be involved earlier in project design, with more preparation work undertaken by Chinese agencies and consultants working for them. Provincial lending should also allow efficiencies through better project design and earlier Bank involvement (para. 45). With the addition of a resident economist, RMC has a strengthened base for undertaking more on-the-spot economic work.

13. Bank Exposure. Even with current account deficits on the order of 1.5 percent of GDP over the medium term, China's overall level of external indebtedness will remain low, reaching less than 13 percent of GDP in 1995. Debt service, too, will remain well within prudent limits. The debt service ratio (including short-term) is projected to increase gradually to 11 percent by 1995, below the 15 percent the Chinese government seems to regard as an upper limit. If annual World Bank lending (IBRD and IDA) reaches $3 billion by the early- to mid-1990s, and preferred creditors' share in public debt service rises from below 13 percent in 1987 to around 40 percent by 1995, China would exceed the Bank's exposure guideline of 33 percent by 1993. However, we do not believe that having a relatively high share of low overall debt poses a significant risk to the Bank. IBRD debt service would be only 1.8 percent of exports in 1995. Given China's low overall indebtedness, the Government's record of honoring past debt commitments, and the need to support the reform effort, we believe that a large Bank program is warranted even if the exposure guideline is exceeded (para. 68). However, we propose that the exposure issue should receive special attention at the next CSP review, which we recommend be held in mid-CY90.

14. Because the Chinese remain lukewarm toward cofinancing, and given what will be the increasingly sensitive areas on which our input will be sought, there are unfortunately few possibilities for sharing lending program development with other official or private lenders (para. 67). The possibilities are also somewhat limited for extensive farming out of this advice to "free" sources. This should increase our recourse to specialized outside consultants, and using a three-year rolling program, we plan to redouble our efforts to get China to accept more Bank financing for technical assistance and use bilateral grant TA for Bank-financed investments. The China Department COD will strengthen its activities to coordinate technical assistance, including the EDI program and bilateral collaboration for TA under Bank projects (para. 51).

15. Cost Sharing. We propose that the current cost-sharing guidelines be continued; namely, the Bank group would finance the higher of the full amount of the foreign exchange cost, or 50 percent of total project cost, but in exceptional cases involving mostly the social sectors in poor areas, the IBRD/IDA

share could be up to 75 percent or the foreign exchange cost, whichever is higher.

B. Background and Historical Perspective

16. Almost ten years have passed since the landmark decision to "readjust and restructure" the economy. Armed with this mandate, China's leaders embarked on a far-reaching program of administrative decentralization and market-mediated development. The impact of the reforms under way since 1979 has been most pronounced in the rural sector, which provides the main livelihood of over 800 million people. The introduction of the Household Responsibility System, dismantling of communes, and greater separation at the local level of political decision-making from economic management have profoundly restructured rural economic activity. Land use rights were progressively transferred to farm households. Pricing and markets were increasingly liberalized, and the policy environment adopted encourages decentralized management in the rural sectors of secondary and tertiary industries. The result has been an explosion of growth first in agricultural output (10 percent p.a. from 1979 to 1984) and then in rural manufacturing and services (22 percent annually). Perhaps the most significant achievement, however, has been the massive shift from 1979 to 1987 of about 50 million farm workers to non-farm activities, services and autonomous production units larger than the family farm. In parallel, agriculture has been revitalized by a rapid expansion since 1980 of cash cropping, non-staple food production and agricultural foreign trade. The reforms--and three successive years of good weather--not only yielded a record grain harvest in 1985, but also made China a net exporter of foodstuffs for the first time in history.

17. By 1984, the reservoir of rural opportunities that could be tapped through liberalization and price stimuli had been largely exhausted. At this point Chinese policymakers began to tackle the more difficult hurdle of extending the reforms to the urban-based industrial sector. With profit incentives, enterprise autonomy and the dismantling of some price controls, they hoped to coax forth dynamism comparable to that which had transformed the rural economy. They found, however, that each round of liberalization also triggered an upwelling of investment, often in such unproductive areas as office construction, with a consequent strain on the balance of payments. Repressed consumer demand backed by sizeable and increasing household savings became a threat to both price stability and the trade balance. By 1985, controls had to be imposed to rein in the trade deficit, which had swelled largely through imports of consumer goods and equipment. In response to these measures, both inflation and GDP growth slowed in 1986. But by mid-1987, inflation was on the upsurge again, fueled by enterprise investment from their own profits, swelled by price decontrol and looser and increasingly decentralized tax administration.

18. The October 1987 13th Party Congress formally recognized the importance of political reform "to build a socialist political system with a high degree of democracy and a complete set of laws" as a corequisite for continuing the economic reforms, now under way for nearly a decade. Announced economic policies of greater outward orientation, decontrol and deregulation of the economy, price reform and use of indirect levers instead of direct administrative controls and mandatory planning offer a sound blueprint for economic success. Markets for technology, finance, and most significantly, labor, are to be introduced. Various forms of ownership and rewards are to be permitted, though with state ownership remaining predominant. The Party Congress gave these measures a political context that not only offers legitimacy to the reform efforts, but also guarantees reformers some freedom from ideological harassment.

19. China's leaders have moved to mobilize public political support around these goals. Efforts to improve enterprise reform and managerial responsibility

are complicated; improving the performance of China's inefficient public administration will be more difficult to conceive and implement. Reorganization of the civil service will likely prove traumatic given the size of the bureaucracy, and could be disruptive in the short term to public administration and China's relations with its external partners, including the Bank. The April 1988 National People's Congress confirmed these political decisions. China's Constitution was amended to allow private transfer of land leases and to remove limits on the number of staff that private enterprises, which now account for some 80 million members of the urban and rural population, are allowed to hire. In the longer term, however, sustaining the pace of reform may prove challenging, since many of the reforms ultimately needed for greater responsibility and efficiency may not be seen as consistent with China's socialist principles, despite their appeal to vast segments of China's population.

20. The very success of first-phase reforms, particularly in the rural sector where performance exceeded expectations, has introduced second-generation problems that the authorities are now moving to address. Ahead loom more difficult issues. The leaders have emphasized a development strategy which focusses on the coastal areas, largely for their easier access to export markets. This has led to fears inside China and abroad that poorer, interior regions, lacking capital, foreign exchange and infrastructure to keep up will fall further behind and thus worsen the internal income distribution, already heavily skewed twoard the coastal provinces. Inflationary pressures surfaced in 1985 and have persisted since. They have become particularly acute in the first half of 1988 as a result of sustained high investment demand, scarcities of certain kinds of foodstuffs and shortages of construction materials. Stoking the increase in prices is a significant expansion of credit, continuing at a 23 percent annualized rate in the first quarter of 1988. The problem of unemployment will arise as market-driven productivity increasingly challenges the pervasive and long-standing overstaffing in factories, farms and state agencies. For consumption levels to rise as a share of GDP, fewer resources should be absorbed by investment and more diverted to satisfying the wants of the people. Recent high rates of growth could be sustained with investment levels closer to 30 percent of GNP if productivity gains can be sustained and "x-inefficiencies" further reduced. This rate would be comparable to other East Asian NICs whose higher productivity and export performance China would like to emulate. Crucial to China's leaders, public expectations about the continued success of economic reforms make the second phase of reforms particularly important. The leaders' promises of the rewards of the reform process have raised hopes of immediate benefits; the risk of overselling policies whose impact is not yet clear and the backlash of public opinion if things do not turn out as promised are real concerns to the Government and the Party.

21. China's Relations with the Bank. A superpower with important geopolitical and internal considerations to weigh in its major decisions, China is selective about the advice it seeks from the outside. Since the change in China's representation in the Bank in 1980, China's leaders have looked to the Bank for advice on the reform process, as well as for increasing levels of investment finance. China has used us as a window on international experience. The economic and sector work program concentrated initially on "megastudies", integrated views of the macroeconomy or large sectors, while until 1985 formal sector work was limited to rather narrow, project-related topics as part of project preparation. This past approach reflected openness to action on some of the broader issues of economic policy, but China's reticence to have outsiders gain an intimate understanding of the management and finances below the economy-wide level. Once the leaders consolidated their reform and saw the Bank's analysis and objectivity as highly useful to their efforts, and working level staff became comfortable with the Bank's techniques and operating style, our ESW focus has shifted. It has moved lately to treat more sectoral and subsectoral

issues, while macroeconomic work has had to deal with more detailed policy design. Over the years, China has been unusually open to Bank advice: its leaders generally concur with the Bank's analysis and the reports' policy prescriptions, and look to the Bank to help implement them. In its borrowing, China has sought Bank financing to remove bottlenecks and acquire the best of available technology.

22. Overall, this approach was successful. Areas where the Bank's role can be identified include the deepening of rural reforms, the diversification of the financial system, trade reforms that are under way, and the move away from reliance on enterprises for funding social security. With agreement on the general policy directions, collaboration on the detailed design of reform policies will become more important if they are to be successfully implemented. This work has already begun: some of the recommendations of the FY86/87 reports on trade and investment are being implemented, and in FY89, major, recommendations-oriented reports are planned to offer advice on redesign of the tax system, policies for industrial development, and reforms of social security. These areas are increasingly sensitive, and requests for advice are becoming more specific: recently, as the authorities' intentions firmed to proceed resolutely with price reforms despite the likely acceleration of inflation, they sought the advice of the Bank (and the Fund) on aggregate demand management, recognizing the danger that accelerating inflation could represent. Several major ESW tasks are now focussing on macroeconomic management issues, and additional, high-quality economic work will be essential to help China through the turbulent short- and medium-term economic situation the reforms will create. Two of the Government's most immediate economic concerns are explored in the CEM (to be discussed with the authorities in January, 1989). The first relates to macro policies that will make it possible to combine rapid growth with relative price stability and medium-term resource equilibrium. The second has to do with the future course of industrial reforms and how these are likely to impinge on the structure of the manufacturing sector, enterprise efficiency and the regional pattern of industrial development. As Party General Secretary Zhao Ziyang and Premier Li Peng recently confirmed to Mr. Conable, China continues to expect the Bank to make a strong intellectual contribution to its reform effort, and associates us openly with the process.

23. Our lending operations have similarly matured. The earliest Bank projects focussed, appropriately for the time, on acquisition of new technologies and techniques to repair the economic and social damage of the Cultural Revolution, with limited institutional goals. As the Bank's credibility was established and our knowledge of China increased, projects became more ambitious in their design and have attempted to tackle broader objectives. The State Council has recently concluded in a formal review of its experience with Bank borrowing that the Bank's technical contribution to investment projects is the major success of the Bank's lending activities. After much persuading and with the example of successful procurement under Bank-financed projects since 1981, China is moving to adopt public sector procurement procedures modelled on the Bank's international competitive bidding guidelines. In recent and upcoming operations, "debottlenecking" is still important, and is reflected in China's emphasis in its borrowing on transport and energy. But lending content is shifting to include institutional questions, pricing issues, and technical assistance to improve planning, policy analysis and management. The quality, timeliness and operational practicality of advice through the ESW program have become more important, in order to link the ESW program to support lending operations, particularly the larger ones and those where a sectoral or policy flavor is more pronounced in support of the reforms.

24. <u>China's Relations with Other Financing Sources</u>. China's dialogue with the IMF has deepened steadily over the years, with a Stand-by Agreement approved

for 1986-87. The Fund has worked closely with the Bank, collaborating on many ESW tasks, and we look to the IMF for assistance on technical assistance for improving macroeconomic management, central banking and the financial sector reforms. China has also launched active programs with Japan (Exim Bank, JICA and OECF) and has joined the Asian Development Bank. ADB plans a program of around $500 million per year, and we have already had contacts with ADB staff over possible cooperation in future investment projects. For reasons explained below, cofinancing prospects with official lenders are slim (para. 67). Foreign banks seem to be broadening their contacts beyond the Bank of China, the country's traditional bank for foreign trade, and the China International Trust and Investment Corporation (CITIC), an investment bank which also provides guarantees. Their activities now include some loans to provincial trust and investment corporations, generally in coastal provinces, where export and repayment prospects are most secure.

C. Central Development Issues and Policy Agenda

25. As is the case with other planned, socialist countries that are perennially juggling with shortages, investment hunger has always been a force to be reckoned with in China. Decentralization by adding to the discretionary powers of local authorities and of enterprises has, if anything given it freer rein. Investment as a ratio of GDP has risen from about 30 percent in the late 1970s to nearly 40 percent in 1987, thereby accelerating the growth of national product. But such extraordinary rates of capital spending over such a prolonged spell have resulted in a worsening of bottlenecks and in serious sectoral imbalances. Because the government has pursued an accommodative credit policy to support the investment drive and finance budget deficits arising inter alia from the decision to raise the level of profit retention by enterprises, demand pull pressures have been translated via supply constraints and free markets into rising prices. Inflationary pressures became noticeable in 1985 when the official retail price index climbed nearly 9 percent and free market prices increased by 17 percent. There was a lull in 1986, a year when GDP growth slowed, but the inflationary tempo quickened in 1987. During the first seven months of 1988, the retail price index was rising at an annualized rate of 17 percent while prices of vegetables and pork traded on the free market increased by nearly 50 percent.

26. For a country that had become accustomed to virtually stable prices but which still harbors memories of a damaging hyperinflation during the 1940s, recent trends have aroused public concern, renewed qualms over reforms and ignited a considerable debate over causes. Preliminary analysis suggests that high aggregate investment outlay generated by enterprises subject to soft budget constraints, has been reinforced by the surge in consumer and small business demand traceable to indexed urban incomes and rapidly expanding household incomes. As total credit and money supply have grown at the average annual rate of over 30 percent for the past 28 months, there is now probably an excess of liquidity in the system. The situation has not been helped by the scarcity of meat and vegetables linked to unfavorable relative prices and land availability in recent years; the inadequate supplies of quality consumer durables; by the construction boom that threatens to outstrip the availability of building materials; and shifting expectations that are beginning to induce spending as people come to anticipate a continuing of the price spiral.

27. The leadership's response in 1987 was to put proposed major price adjustments on hold and to restrict the growth of reserve money in the second half of the year. The former was damaging for the overall reform program and the latter created serious problems for enterprises which under the newly liberalized financial regime, have become heavily dependent on bank credit for their working capital.

28. As the costs of slower industrial growth are clearly seen to be higher than the pain inflicted by moderate inflation, the Chinese leadership once again loosened the credit strings in the first quarter of 1988 and has resumed price reforms. Prices of certain food items have been raised in a number of cities with the intention of introducing these changes throughout the country in the coming months. Simultaneously, agricultural subsidies are being withdrawn, but the income supplements given to urban households so as to win acquiescence for price changes will leave budgetary costs undiminished. If investment spending, more than adequately buttressed by credit availability, proceeds unchecked and price adjustments combined with compensating payments to wage earners are gradually introduced, inflation might well accelerate further.

29. Budgetary policy could retrieve the situation somewhat but even if tax reforms are taken in hand within the next year, the structural imbalance between central revenues and expenditures could only be removed over the medium term. Fiscal decentralization in China has been so sudden and far reaching that the government has suffered a sharp drop in tax income while many of its spending obligations remain inflexible. The 1987 budget deficit of 2.3 percent of GDP is not large. However, there is scant chance of it being narrowed in the next two years, a fact that increases the attractions of seigniorage from the printing of money. Whereas enterprise earnings used to be the major source of state revenues, industrial reforms permitting greater profit retention by firms have reduced flows into the treasury. This has yet to be counterbalanced by revenues from new income taxes introduced during 1986-87. The problems faced by many enterprises in adapting to the new environment have also reduced their incomes and hence, tax payments to the state. Finally, revenues have been affected by curbs on the imports of dutiable consumer goods, which were introduced to narrow the trade gap. After dropping to 0.5 percent of GDP in 1985, the budget deficit has risen in each of the last two years. One third of this was financed through foreign borrowing, the balance by the banking system and the sale of bonds. The budget for 1988 projects a deficit of about 2.5 percent of GDP. In short, the exigencies of the reform process, the pressures unleashed by decentralization of decisionmaking, a loose monetary regime and wage indexing to retain urban political support, all point towards a scenario where high growth is matched by fairly high rates of inflation.

30. This is not our preferred scenario and we see many problems for the reform program and the emerging market system if inflation accelerates much beyond its current level. From a purely economic standpoint, one alternative would be to foreshorten price reforms into a period of a year and subject the economy to a single price shock, albeit a significant one. Following this, the future rate of increase in prices would be brought under control through moderately tight monetary policies; the reassertion of fiscal discipline by restructuring tax instruments and curbing expenditures; and by containing the investment hunger of enterprises especially those that are state owned. The problem with the second approach is that it appears politically impossible to compress price reforms into a short space of time. Further, the provinces are strongly opposed to a marked reduction in their investment plans. And a major tax reform along with new rules for Center-Province revenue sharing, will take time to materialize.

31. To sustain a rapid growth while keeping inflation at tolerable levels in the face of such constraints, the Chinese leadership will need to pursue incremental changes on a broad policy front. A beginning must be made with the budget, which needs to be brought into balance. There needs to be a gradual tightening of credit policy. Price reforms should be introduced in line with tighter fiscal and monetary policy and without fully compensating wages or income supplements. A modest relaxation of import restrictions would help break bottlenecks and reduce price pressures on scarce consumer goods. In

enterprises, incentives to overinvest need to be reduced through appropriate interest rate and credit policy, while wages and bonuses need to be linked to productivity.

32. In addition to these changes in short-term macro management, longer term changes are also needed. Price and fiscal reforms are necessary to create appropriate market signals and to support the state sector. Substantial gains are possible if China continues to pursue increased factor efficiency. In addition to reducing energy intensity and raw material utilization in industry, other issues that need to be addressed include more efficient use of foreign technology, greater productivity of labor in the state sector, and better use of the education system to develop China's human capital. Fragmented foreign exchange markets are a major source of distortions: these need to be integrated through appropriate institutional and policy steps.

33. Price reform at this point is an important objective, but one which must be tempered by and in some cases, must follow, reforms in industrial organization. The Chinese themselves refer to the latter aspects as "enterprise reform", which signifies in some contexts the critical reshaping of state enterprises from pure production units with heavy political oversight and externally planned strategies and targets into autonomous commercial units with clear profit-maximization objectives. It is clear that such a widespread institutional change would be eventually required in order to convert movements toward price liberalization into efficiency gains for the economy. Also needed, however, are reforms at the level of industrial subsectors, where the inherited system of national, regional and local monopolies is gradually replaced by freely competitive industries. Without such a development, Chinese policymakers are frankly worried that simple price liberalization would quickly be transformed into monopolistic profit maximization: e.g. exploitation of consumers and suppliers, with little consequent gain in aggregate efficiency or economic welfare. Given artificial and natural fragmentation of markets, this a major and valid concern, and must temper attempts to impose premature abandonment of all price control. Price liberalization has proceeded, and will continue to proceed most rapidly in those fields (like agriculture or road transport) which inherently are characterized by large numbers of competing units.

34. In this liberalized framework, principles of enterprise management need to encourage innovation and productivity, rather than investment and meeting production targets with little regard for quality and the marketplace. China will also be challenged to improve national economic integration, both to benefit from possibilities large domestic markets offer for efficiency, and to see that all regions of the country share in this overall growth. Policies will therefore also need to ensure that China's social security system, the envy of many countries at significantly higher income levels, is maintained. With fiscal reform, this would also help contain regional disparities, already substantial between the rich eastern provinces where the benefits of trade and price reforms have been impressive, and the isolated interior areas where resource constraints seriously limit their economic options. The push for foreign trade has exacerbated existing trends for regional economic independence with little regard to comparative advantage, economies of scale, and the possibilities for internal exchange. The inability of transport and energy infrastructure to keep up with growth in demand has enhanced these tendencies.

35. China will also need to put some discipline into the decentralized system of investment planning and enterprise control. Since the transfer in 1984 of management of many previously state-run enterprises to provincial and local governments, along with partial authority for price controls, physical allocation of materials and foreign trade, the creation of multiple levels of

control has brought some confusion into the economy. Local interests have restricted movement of raw materials and finished products within China and complicated efforts to maintain economic balance at the national level. The proliferation of administrative controls to enforce or relax regulations has allowed the emergence of special interests that have resulted in influence peddling and corruption. Long a taboo subject, the leaders have admitted corruption exists and plan to pay special attention to it in the next year of the reform process, as they turn to thornier issues of reforming China's public administration. This is important, since the enthusiasm of the Chinese people for the reforms may wane if corruption becomes too widespread, a situation China's leaders have historically faced.

36. Carefully designed and well-implemented institutional reform in enterprises and local authorities would help combat this danger and provide the necessary dynamism to the overall reform process. The approaches China is adopting embody the best of modern technology, changes in management and decision-making at the enterprise level, and decentralization to provincial and local governments. Increasingly, they rely on prices to improve economic efficiency, by moving toward a hybrid system with state ownership predominant. Yet in the context of China's socialist political system, with its high premium on social goods and maintaining a visibly egalitarian income distribution, some of these changes could induce political tensions: from the public, which is accustomed to stability and a protective government, and from the civil service and enterprise bureaucracies, which have grown used to their present shares of power and influence.

D. Macroeconomic Prospects, Creditworthiness and External Capital Requirements

37. Medium-term Prospects. Over the medium term, we expect China to continue a high rate of GDP growth, around 7-8 percent annually, with exports growing at around 8 percent. To maintain these levels of growth, efforts to promote exports of agricultural products, textiles and machinery will have to be successful. Continuing reforms in the external sector, and especially the gradual shift from import licencing toward use of the exchange rate and demand management policies, are expected to lead to increased imports. After a bigger initial increase, imports are therefore projected to grow at slightly more than 10 percent annually, split between increased imports of capital goods essential for China's modernization program, and additional consumer goods needed to provide households' incentives. A small but sustainable current account deficit is likely to persist. Appropriate interest rate and credit policies could contribute to a modest fall in investment from 39 percent of GDP to 36 percent, while the increased supply of consumer goods from domestic firms and through imports could lead to a decline in gross domestic savings from 39 to 34 percent of GDP. This medium term outlook is consistent with China's stated external borrowing policy, under which China intends to borrow US$5-7 billion annually.

38. China would continue to remain creditworthy provided the economic reform thrust were maintained and the external payments position remains sustainable. The current account balance swung from a $7.5 billion deficit in 1986 to a small surplus in 1987, largely due to a continued surge in exports; this strong growth is expected to continue. If China moves away from a balanced trade posture toward a major reopening of its markets to imports, China's current account deficit could rise to $6.3 billion in 1989 to almost $12 billion by 1995, with a corresponding rise in financing requirements. The overall level of external indebtedness would rise from $25 billion currently to $83 billion, equivalent to 101 percent of projected 1995 exports. Despite the rapid build-up of debt, China's debt service ratio would remain low, rising from 8.3 percent currently to 11 percent by 1995. This import liberalization scenario and the

What about continued high growth, low reform?

rapid rise in external financing requirements are subject to considerable uncertainty. If China were to move more slowly on economic reform and implement a conservative growth and balance of payments strategy, it might run much smaller current account deficits. In this case, net financing requirements would be much lower.

E. Bank Assistance Strategy

39. After seven years as an active Bank Group borrower (paras 21 to 23), China is only now beginning to approach its long-term equilibrium status as a leading client of the institution. There are several fairly obvious factors which argue for this country to soon assume this position:

a) Size. At just over 1.1 billion, China's population is the largest in the world, roughly equivalent to the combined population of the entire continents of Africa and South America. When combined with its low per capita income and pockets of material poverty, all equity considerations point to its receiving a proportion of both IDA and Bank lending far greater than is currently the case.

b) Dynamism. China is obviously a developing country, but not mired in a web of bureaucratic inertia, internal political conflict or stalemate, xenophobia, debt, or a paucity of skilled labor. Its rates of growth of per capita income, standards of living, and exports have been among the highest in the world over the last decade. The prime cause of this excellent performance has been the unprecedented, consciously planned dismantling of much of the structure of administrative control of the economy, and with it, enormous visible increases in personal freedom both within and beyond the economic sphere. This social transformation has global significance, both for our borrowers as well as our donors, and indeed is the focus of development worldwide. It is imperative for the Bank Group to maximize its inputs--in terms of lending as well as staff--into helping this process succeed, if it is to maintain its leadership role in the development field.

c) Creditworthiness. China is a creditworthy country, able to borrow significant amounts in the international financial markets at highly favorable rates. Large and rapidly rising exports and high domestic savings rates provide the means for debt repayment, while the will to repay has never been in question. Indeed, one of the frustrations in our operational work has been the intense preoccupation of government authorities with assessing every beneficiary entity (governmental or commercial) and every sub-loan or project activity with a view to ensuring and maximizing repayment capacity, and indeed, to select projects and components on that basis.

A diverse and expanded program of lending and ESW would best respond to the challenge to the Bank to make a major contribution to China's development.

40. The Bank's objectives in China are:

a) to support China's reforms (especially price, finance, trade and enterprise reforms, and changes in wages, employment, social services and management) and handle their institution-building implications;

b) to help address longer-term problems reforms might create (poverty, environment, regional disparities and economic integration);

c) to strengthen infrastructure, including the development of urban services; and

d) to rationalize and modernize the productive sectors.

41. Expanding levels of lending to this unique client calls for us to reinforce the policy dialogue and its links to lending, while maintaining project quality and development impact. It also suggests the need for flexibility as we move to develop new lending instruments. China wants expanded collaboration with the Bank over global reforms in agriculture, finance and prices, and financing for priority sectors--transport, irrigation and energy--with key pricing, institutional and investment quality issues. There are excellent possibilities for expanded cooperation with willing provincial borrowers as well as opportunities for introducing new, efficiency improving instruments (sector and timeslice lending). Provincial urban, transport and industrial operations could help revitalize Shanghai, China's economically most powerful city. This broad approach implies an increase in ESW to back up sector lending and policy-based operations and analyze provincial economies. Detailed policy and institutional engineering will widen the impact of our advice to new clients within China. Larger operations will be possible (transport, energy, irrigation, urban) once these new instruments are understood with new partners in the provinces and other agencies at the national level, but emphasis on larger repeater operations would not be fully consistent with China's apparent wish to see us diversify our support for the reforms. Efficiencies should be possible however, if provincial lending allows continuous relationships with provincial planners and thus improves project design; we are launching provincial operations in Shanghai, Jiangsu and Tianjin to test this approach. This assumes that efforts on the Chinese side to improve macromanagement and project management and design are successful. Savings should also be possible if we can introduce sector and timeslice lending for infrastructure, and, as Chinese capabilities develop, innovative approaches to procurement, such as higher limits for ICB and Bank review of documents and decisions.

42. Risks to the Reform Agenda. China's social and economic experiments and reforms may raise internal tensions, both direct (inflation) and indirect (ideological), that will affect its overall economic performance, and, thereby, its relations with the Bank and overall levels of borrowing. Although the reforms are complex and politically sensitive, it is unlikely that ideological and political tensions could trigger widespread reversals of those already under way, and a subsequent restraint in exchanges with the outside world, including the Bank. Any dangers to the reform process will be mitigated by its substantial economic benefits, to which China's leadership will be able to point as Party and civil service reforms proceed in parallel. Most likely, the open door policy will continue to prevail because of the economic results achieved from system reform, and cooperation with the Bank will further increase in terms of policy advice and total borrowing. Even with the $8.1 billion IBRD levels proposed, China does not present any major creditworthiness risk, and despite higher levels of Bank exposure in the late 1990s, China's overall low level of debt and debt service leave the Bank in a safe position (para. 68).

43. With a deepening of the reforms, we expect that the policy content of "conventional" project lending will increase, as attention turns to the pricing and management issues facing our public sector borrowers in transport and energy, and the managements of industry and financial institutions with which we will be working. The size and composition of the lending program, and the design of upcoming operations already reflects this interest in system reform in the "hard" sectors, while the pipeline of urban operations also reflects the great enthusiasm of provincial officials for preparing and implementing far-reaching experiments in urban management, finance and planning. As long as the

reforms proceed, and the macroeconomic situation remains acceptable and under control, this approach to lending should lead to good results.

44. Ineffective and crudely-articulated macroeconomic institutional frameworks and policies bear large costs for the Chinese economy, particularly in efficiency terms. But they impinge rather little on reform processes and dynamism at the production unit level, and hence on China's need for, and ability to make good use of, investment funds, technical assistance, and sectoral guidance at the project level. Thus the Bank has been able to make major contributions to Chinese development in fields like power, transport, education, irrigation, land development and fertilizer production, under even less efficient macroeconomic regimes than at present. Projects are well-implemented, technological improvements are rapidly assimilated, and lessons are learned and replicated. However, owing to the enormous size of the country, and subsequent understandable efforts to decentralize responsibility, decision-making and authority, our projects are necessarily geographically limited and defined. Hence the need for an unusually large lending program, both in terms of lending volume and numbers of projects, to generate a measurable impact and involvement of the Bank in China's development. Thus neither China's needs for Bank borrowing, nor the Bank's interst in substantial lending to China, nor its ability to formulate such a lending program with extremely high economic returns and development impact, is intrinsically related to the pace of adjustments in macroeconomic management.

45. While it is difficult to speculate on the most appropriate Bank response should there be delays in the pace of macroeconomic adjustment, two scenarios can be sketched out. Should the reforms falter for lack of political will to follow through on some of the difficult management and income distribution implications of price and enterprise reforms, it would be difficult to include the policy-based operations now proposed in our lending program, and the institutional objectives of traditional projects would need to be set more modestly. The political consolidation process seems well in hand, however, and should the reforms falter, it is more likely to be the result of macroeconomic instability and the authorities' lack of appropriate instruments to bring these fluctuations under control. In this second case, it will be important to maintain the high level of economic dialogue, focussed on detailed policy design, backed up if necessary by adjustment lending, which we would offer to the authorities if the overall dialogue over economic management remains good.

46. Of great political importance to China's leaders, we expect that policy-based lending will further enrich our dialogue over major reforms, since it allows us greater involvement in policy design and monitoring than dialogue and technical assistance alone can in China. Policy-based lending in China is unlikely to follow conventional Bank approaches, given that China's reformers normally test new policies before generalizing them nationwide; it is therefore unlikely that traditional "conditionalities" and tranching would be practical, or, indeed, necessary to reinforce our policy advice and agreements. In light of the experience with RSAL, we would need to adapt other sector adjustment procedures and features to China's unique conditions, but in a way that does not compromise their applicability to other borrowers or in future situations with China when more precise policy packages and time-bound programs might be more crucial to drive the reforms forward and sustain their momentum. Because the adjustment instrument is new for China, and because of the contribution we can make through conventional lending, the FY88-92 program would include only three policy-based operations, representing less than nine percent of total lending.

47. Building on our experience in China with traditional project lending--emphasis on which will continue--sector lending would be a cost-effective way to reinforce the dialogue, build working relationships and obtain feedback from

experience in lending and sector work. We therefore plan more intensive efforts to combine dialogue on sector issues with support for priority investments. These would remove infrastructural bottlenecks and reorient urban and social sector programs to take more account of planning, cost effectiveness and management issues. In this area, we hope to also make a breakthrough into sector lending for forestry, with an emphasis on effective and sustainable afforestation, leading to self-sufficiency in wood products. As long as economic management remains weak, we will need to focus on the details of sector reforms (finance, social security) and pricing and institutional issues with our major clients (railways, transport, power, urban, forestry).

48. Responding to decentralization of planning responsibility and investment decisions, we will also experiment with provincial lending. Reflecting the new political and administrative realities of China, a continuous as well as direct Bank relationship with provinces should improve our ability to contribute to more systematic elaboration of subsectoral strategies in these nation-sized jurisdictions. Work with provincial sector agencies and planners should increase the efficiency of our project preparation, our ability to influence project design much enhanced by becoming involved further upstream. Work has begun with Jiangsu and Shanghai. As we develop confidence in overall provincial investment programs and build up planning abilities, timeslice operations would allow increased project size. Design of provincial projects would take into account national economic priorities and sector strategies, so as to counteract any local tendencies hindering national economic integration.

49. Operational Issues. Short-term action on a number of operational questions would make the Bank's objectives easier to achieve. The concept of market-based onlending and relending rates is gradually being accepted. With agreement with MOF on principles that should guide onlending of Bank resources, we will continue our dialogue with the goal of improving domestic resource mobilization by eliminating subsidization of capital expenditures with interest rates. On pricing, we will provide intellectual support for price reform and analysis of its impact, and use this analysis for dialogue with the central agencies, as well as in projects in transport and energy, sectors where resolution of pricing questions is central to action throughout the economy. The East China power tariff study completed last year is one example of this approach. Long-run marginal cost pricing is being recommended to the power bureaux with which we are working as one approach to tariff reform. Following a successful effort to improve procurement by introducing ICB, we shall try to ensure that LCB under Bank-financed projects can also be fairer, more efficient and open to suppliers throughout China. Foreign exchange allocation and pricing has tended to bias project selection and location, and gives rise to inefficiencies in project design. In agriculture and industry, the Government's project proposals have often been strongly influenced by considerations related to equipment procurement, export development and repayment ability of the project entity in foreign exchange, with a consequent focus on relatively prosperous eastern China and on export-oriented investments. A lasting solution awaits reform of exchange controls and establishment of foreign exchange markets. Working closely with the IMF, we shall continue to seek improvements to the system, and prevent distortions in investment and pricing decisions, while using provincial lending as one way to reduce temptations to balance foreign exchange earning and repayment on a project by project basis. Disbursement performance has waned over the past few fiscal years, with the rapid growth of the portfolio. We intend to address this problem in future projects by closer supervision of projects with disbursement lags and review with Government general disbursement performance at the next Country Implementation Review in fall 1988.

50. Institutional questions may give rise to short-term disruption in our operations while the reorganization proceeds in the central administration. We

intend to adapt to the new structures of government, focussing dialogue with central agencies on essential support to important macroeconomic reforms, while accepting increasing decentralization of investment decisions to provinces and local bodies as a growing feature of our lending work. The quality of Bank advice is important, but there is also the need to develop Chinese planners and managers, more and more in the provinces as well. To meet these needs in a cost-effective manner, the China Department has already taken several important steps. In December 1987, we agreed with the Government on a three-year rolling ESW program (Attachment 2), which gives greater predictability to the timing and content of the ESW tasks. A free-standing TA project was approved in FY87, with the objectives of both strengthening the planning process and financing important study inputs to the Eighth Five Year Plan. We have also diversified our partners in the task of policy analysis. Our collaborators now include agencies at the State Council level, and academic and research organizations. Each year, we mount high-level policy seminars and symposia for senior policy makers and political leaders. As many of these bodies have responsibilities for both policy setting and implementation, collaboration with them supports our efforts to expand lending to China. One area of note, on which continued Bank/Fund collaboration will be essential, is external debt management: the creation of a single agency should improve overall management and we stand ready to offer technical assistance, once the Government's internal debates over the relative roles of MOF and People's Bank have reached some conclusion.

51. The need for technical assistance in China is large and growing. Already, the Bank has committed considerable resources through our past lending (around $500 million, including three free-standing TA projects), collaboration with UNDP, an active EDI program partially financed with UNDP resources, TA linked with our ESW program, and study/training visits to Bank headquarters. As China proceeds with the next critical phase of reform, demand for technical assistance is growing and far exceeds available resources, even to manage activities funded by other sources. In developing a three-year rolling TA program, we plan to focus on four areas: institutional development in the core agencies of economic management; planning support to the central line ministries and city governments; support for key training institutes, through EDI and project work; and continued seminars, symposia and study tours on issues of primary interest to government (such as enterprise reform and management, taxation, technology transfer and social security). We intend to use training components of upcoming operations to support the network of training institutions which are working with EDI, thus reinforcing EDI's links to operational work in the China Department. For EDI programs which cannot be financed through EDI's budget, and whose financing through loan/credit proceeds is not permitted, we shall seek UNDP or bilateral funding, along the lines of the current UNDP-supported EDI program. We shall devote more attention to design of technical assistance and training components, both to provide more effective support to the implementing agencies, and to better justify its cost. Following an internal review which we have just completed, the China Country Operations Division will be the focal point for addressing technical assistance design issues, for relations with EDI and for identifying cost-effective sources of financing for training and consultants. The Ministry of Finance has established its own technical assistance unit to systematize China's approach to Bank-financed technical assistance and identify the most cost-effective sources, including bilateral funding for project-related technical assistance.

Sector Strategies

52. Overview. Our lending will continue to support the reform priorities and investments identified by the Government in the Seventh Five Year Plan. Despite some cooling of public investment in response to the acceleration of inflation in CY87, China's investment needs remain large. We expect to achieve

annual lending of $2 billion in FY89, and higher levels thereafter, if conditions permit reaching around $3 billion during the Eighth Plan (after 1991). Even at these expanded levels, the Bank's contribution is small relative to China's investment program. Consequently, our operations will attempt to tackle issues of sector investment priorities, technology transfer and modernization, technical assistance and institutional development. By the end of FY89, work will be nearing completion on three officially-designated provincial operations. They are designed to get us involved earlier in project design and help provinces develop their new planning and investment responsibilities. Supporting government efforts to develop transport and energy will remain our first priority. Difficulties of access and shortages remain serious constraints to capacity utilization throughout the economy, and China plans sustained investment in these fields. There is substantial room for improving efficiency both through improved pricing and use of market mechanisms, and through wider introduction of new technologies. Involvement in industry will continue, with a diversification from the direct support for large greenfield projects which we supported in the past to collaboration with provincial industrial agencies on broad subsectoral investment programs. New operations with China Investment Bank will continue our important institution-building role, but in the broader context of the imminent expansion of competition in the financial sector. With the Government's interest in accelerating the pace of rural reforms, we will continue our considerable efforts on agriculture. Our lending for health, education and urban urban will reach a level of at least three operations per year in FY89 and beyond, reflecting increased Government interest in the Bank's advice on resolving policy issues in these sectors. We plan to coordinate our approaches in the various transport, industrial, urban and water projects under discussion with Shanghai, so as to help one of the world's largest cities, a key player in China's reforms, modernize and cope with growth in China's dynamic coastal zone. The pace of expansion of Bank lending would depend on progress toward price and enterprise reform, and the authorities' success at controlling inflation through prudent fiscal and monetary policies.

53. Agriculture and Rural Development. Agriculture and rural development remains one of the main sources of growth in the Chinese economy, particularly in terms of personal income growth for large masses of people. The sustainability of recent production gains is in question, owing to deterioration of agricultural infrastructure, and uncertainty over the legal and institutional framework in which future agricultural development should take place. Past lending has given us a sufficiently wide understanding of the sector to identify issues and priorities for future operations. A first Rural Sector Adjustment Loan supports the launch of a second phase of rural reforms: new land use, consolidation and land tenure arrangements, deregulation of product prices and elimination of input subsidies, and increased incentives to export of high-value crops rather than grain production for local self-sufficiency. Traditional investment project proposals, now developed by provincial and lower-level authorities themselves, tend toward multi-component operations focussing on quick-return, export-oriented activities. The selection process, motivated by immediate economic concerns over dropping production levels, has been strongly influenced by considerations related to the foreign exchange system (para. 49) and production of marketable surpluses in food deficit areas. In each of these operations we are attempting to focus on significant technical and organizational breakthroughs in various subsectors.

54. The agricultural lending program would include: (i) land and water resource conservation and development, principally through interregional and on-farm water management and development; (ii) sectoral lending for forestry to help resolve extreme shortages of wood products and promote environmental protection; (iii) support services for agricultural research, education, exten-

sion and improved seed production, slow maturing and less showy than area development projects but important if production gains are to be sustained, productivity increased, and agricultural technologies improved; (iv) provincial multi-component operations, taking into account domestic as well as foreign market possibilities, expansion of rural, off-farm employment, and poverty alleviation in poor areas; (v) further agricultural credit lending, if continuing efforts are successful at strengthening rural credit institutions. Although provincial projects are likely to get most of the government's attention, and indeed offer much potential, we shall aim at a balanced program in which they fit well into a national context which includes national-level support services projects, including water conservancy and forestry. If the first RSAL is successful, we plan a series of policy-based operations every two years in support of the rural reforms as they are implemented. Since investments in the rural sector should be a focal point of both China's plans, and the Bank's lending, a pipeline of three-four projects per year, including agricultural credit and sector adjustment operations in alternate years, would represent around 25 percent of lending volume.

55. Industry and Finance. Operations since FY83 have established an important relationship with China Investment Bank and provided direct lending for fertilizer, machine tools, pharmaceuticals and phosphates. Studies on finance and investment, external trade, and enterprise reform were well received by the highest levels of the Party and the Government, and parts are being implemented. For reasons parallel to those discussed above under the rural sector, expansion of Bank lending for industry has been hampered. As well, "surplus commodity" issues make large Bank operations for heavy industry with national developmental priorities and immense domestic markets (iron and steel and non-ferrous metals) problematic, despite the potential for Bank involvement to help efforts to reform prices, improve efficiency and upgrade technology. This issue, in fields where China's imports are unsustainably large, and where a local comparative advantage exists, needs to be revisited.

56. While at the national level we will continue dialogue on industrial sector and subsector policies, we plan to focus on helping provincial industry agencies work out the specifics of enterprise reforms and their own changing responsibilities. Establishing direct relationships with a number of provinces to develop provincial industrial operations could have strong multiplier and demonstration effects. Early experience suggests that the Bank can make a contribution to subsectoral restructuring and technology transfer, improving efforts to promote exports through greater emphasis on quality and marketing, and developing local support institutions. This would encourage local adoption of policy measures already supported at the national level through our ESW program. Bank involvement in the Structural Change exercise, under which Chinese agencies are preparing industrial strategy documents for key subsectors, will help develop an intellectual framework for the integration of now fragmented strategy questions. We are also exploring options for the Bank to play a role in improving the access of non-state industry to formal financial markets and other institutionalized services, including the State Science and Technology Commission's SPARK program, a new channel for credit and support to rural industry. Although there seems to be adequate commercial and bilateral finance for telecommunications development, we plan to explore the Government's interest in advice on sector planning and management, crucial if China is to have the communications networks necessary to support national economic integration and greater openness to the outside world.

57. Lending in the **financial sector**, building on the completed ESW on the sector itself and on foreign trade and investment, will focus on the evolving financial sector reforms. The financial system is only rudimentary at all levels, and the policy environment is weak. Our experience has underlined the

need for greater independence for financial institutions, more competition, and better oversight by the central bank. Work will be needed both on the regulatory institutions and on the banks and other financial agents that are emerging, particularly the "informal" financial instruments and intermediaries in rural areas, operating with approaches to market rates, competition and risk the Government has so far been reluctant to introduce throughout the financial sector. Discussions have begun on a financial sector operation. It would include technical assistance and material support both to the monetary authorities (in collaboration with the Fund) and to selected developing banking institutions. A strong network of financial institutions would reinforce policies to move to market mechanisms and move away from administrative control of the economy. As the Government's intentions become clear on the role of the six new sector investment corporations, likely to play an important role in financing public investments, we shall assess their technical assistance requirements and the Bank's role in their development.

58. In summary, our approach to industry and finance would be a combination of: (i) highly focussed sector work on areas where the economic payoffs to China through technological adaptation, management improvements and regional economic specialization are likely to be high; (ii) dialogue with the central policy-setting bodies on substantive issues such as pricing, trade policy and the climate for private investment, which the industrial ministries and the provincial industrial bureaus have been unable to discuss concretely, supported by policy-based operations if the pace of reforms warrants; (iii) lending to provinces with industrial development programs in subsectors with national priority; and (iv) support for CIB and other financial intermediaries who develop the capacity to appraise industrial projects within overall policies and pricing practices that we find acceptable. Backed up by a strong program of sector work on both national issues and strategic subsectors, and a strong policy dialogue over price reform and financial sector development, we plan three-four projects per year, representing about 20 percent of the lending program, for industry and finance. This would include large loans every two years to CIB and other financial intermediaries, and a series of financial sector development operations if the dialogue is productive.

59. <u>Infrastructure</u>. Rapid growth in demand for energy and transport resulting from the reforms is stretching physical and operational limits, leading to a huge unsatisfied demand in China. Past projects have increased capacity in transport and energy sectors and helped the Ministry of Railways and the Ministry of Water Resources and Electric Power make modest starts on improving their planning and management. The Bank has also helped improve port facilities and management, alleviating one of the bottlenecks to foreign trade. Dialogue on broad sectoral issues is lagging on transport, although well engaged for electric power planning and pricing. This is due to the Government's past reluctance to allow extensive sector work and to the fragmentation of responsibilities between central agencies and local authorities.

60. In **transport**, continuing shortages of capacity imply very high economic returns to further investments in rail, road and water transport, while returns on civil aviation--a new sector for the Bank--would likely be even higher. The Bank's greatest contribution, however, would lie in helping examine long-term strategic options in developing the transport system and associated spatial location of economic activities. At all levels, there is a need to utilize existing capacity better, take advantage of new transport technologies and fully understand how to move toward a more efficient balance among competing modes and introduce integrated intermodal services. We plan to support transport management training and the development of applied research on policy issues and transport technology. The new provincial lending instruments are well-suited to transport: we have proposed, for example, a multi-modal transport study for the

Shanghai Economic Zone. In railways and aviation, a central perspective is needed, however, and sector lending will be the preferred instrument. The Ministry of Finance has asked that work begin on sector lending for railways. Civil aviation will initially be addressed through a small sector survey.

61. In **energy**, the impact of unmet demand on industrial efficiency and capacity utilization gives the highest priority to the power subsector. The good working relationship established with all levels of the Ministry of Water Resources and Electric Power, now the Ministry of Energy, and their openness to policy advice augurs well for expanded lending in spite of the reshuffle of responsibility. Efforts to strengthen power institutions and policies for planning, pricing, organization and management will continue. Bank sector work and lending should help China move toward power companies and regulatory models that have a good track record elsewhere and avoid the proliferation of small, suboptimal power projects. Future lending will focus on strengthening the regional grids with large projects and on accelerating subsector investment to eliminate shortages by the end of the century. Priority goes to generation and transmission investments: eventually a sector approach would be appropriate to promote tariff reforms and regional integration. The Bank will continue to mobilize resources needed for technical assistance for the economic, environmental and resettlement aspects of the giant Three Gorges Project. The coal industry is of paramount importance to the energy sector on its own right and because of its strong linkages with power and transport projects. The Bank's operations will deal primarily with these linkages and on measures to improve efficiency of coal use and reduce environmental pollution. In the oil and gas subsector, we would focus on natural gas development operations where the Bank has a comparative advantage on topics of policy formulation, regional planning and coordination between gas producers and end users.

62. For transport and energy, we plan to focus on institutional issues, and in particular the inherent risk of inefficiencies in planning, operations and pricing for natural monopolies with economies of scale. The integration of the two sectors in the China Department will permit a closer look at their linkages, primarily on the issues of coal transport and railway capacity bottlenecks. While large projects beyond FY90 cannot be firmed up until the Eighth Plan is known, discussions continue on project concepts and proposals, and we plan to devote about one-third of the lending program to these sectors. Sector lending would be feasible and cost-effective for both.

63. The Urban Sector. Reflecting years of relative neglect, the need is pressing for policy reforms in housing and the financing of public services, and for investment to modernize China's expanding cities. With the reforms, expansion of services and labor-intensive light industrial production have boosted demand for labor and led to relatively large rises in urban incomes. Increased affluence, combined with public commitment to provide services at standards well above those expected from low income countries, have aggravated pressures on urban health and education facilities. Among the issues China will need to address are: (i) poor resource mobilization and financial management practices, an inadequate revenue base and weak tax administration, all growing out of distortions in prices of goods and services delivered to urban consumers; (ii) inadequate urban infrastructure, and the need to invest to remedy past neglect and catch up with growth-driven demand; (iii) poorly articulated planning, insufficient attention to priorities, budget forecasts and recurrent cost implications, and mounting levels of subsidies for urban services; (iv) uncontrolled urban sprawl and environmental mismanagement; and (v) growing inequality of access to services.

64. We are preparing operations to help translate China's market-oriented model into action on urban issues. They would encourage expanded local respon-

sibility for urban management and financing, accelerate investment in higher-return urban projects, promote more efficient financial intermediation, and pay more attention to environmental problems. This approach includes: more intensive dialogue with the center on finance and tax issues; concentration on the three provincial municipalities (Shanghai, Tianjin and Beijing) which would guarantee visibility for this approach; and lending and sector work in areas most affected by rapid rural industrialization, medium-sized cities and new towns, which may be more replicable. Urban projects will be broad-based, rather than concentrated only on water or transport improvements. They would include components to develop planning methodology, improve municipal management and planning, and improve cost recovery. In addition to taking advantage of the organization of AS3PW to integrate health and education components, we will also address environmental and architectural concerns. Sector work will be the principal vehicle for a thorough review of municipal finance and urban financial management, including resource mobilization by local governments. Housing finance shows great potential for developing a major domestic industry without recourse to subsidies. Translating this strategy into lending operations will aim at at least one urban project of about $150 million per year.

65. <u>Education</u>. Following the disarray in education brought about by the Cultural Revolution, four IDA projects have assisted the top priority of reestablishing universities as centers of excellence. The 1985 Education Reform calls for universalizing primary education and strengthening technical and vocational education, and for devolving financial, planning and managerial responsibility for these levels to the provinces. Despite its strong project implementation capacity, the State Education Commission has proved vulnerable to local and provincial pressures to focus on equipment purchase, a narrow view of technology transfer. Following a reevaluation of our approach to support for education, we are diversifying our program to include direct support to provinces, as well as national projects. Our initial work in Gansu has shown that efforts at the provincial level allow more direct Bank involvement, with policy makers as well as professional staff of the educational bureaus. Sector work on planning and finance in two provinces (Jiangsu and Guizhou) will improve our knowledge base for future provincial lending. A project to strengthen research capacity in science and technology would continue the national focus of prior years, but with greater attention to policy content and institution building. We expect to broaden our policy dialogue at the national level, addressing such issues as the internal efficiency of schooling, more efficient and imaginative civil works planning, design and execution, and better justification and procedures for selecting teaching equipment. Sector work will examine training for the services sector, a new and burgeoning employment area. As government reorganization and reform of enterprise management proceed, we will respond to requests for assistance for programs to train civil servants and enterprise managers.

66. <u>Health</u>. China's past successes in largely eradicating infectious diseases have dramatically increased life expectancy, now at 69 years. Simultaneous reductions in fertility through its family planning program have fundamentally altered its demographic structure. China now needs to refine its health care strategy with greater attention to prevention of chronic diseases, reduction of occupational and environmental hazards and provision of effective emergency care, along with continued emphasis on infectious disease control in rural and poor areas. Cost-consciousness has so far not been a preoccupation. Current and future demands for health care cannot conceivably be met without better coordinated, efficient management of all parts of the health system. Alternative strategies such as preventive services, health education and non-institutional programs can address these problems, and at lower cost. We plan to help build consensus in China for a more financially sustainable approach, including better planning and financial management in health care institutions and national and provincial health bureaus; better use of health system infra-

structure; reforms of health insurance programs; and new systems of emergency care, rehabilitative medicine and medical education. Few of the Bank's other borrowers face these problems in health care, and will need such approaches to redirect health investments away from high technology imports and capital formation toward prevention, appropriate local technologies, and improved efficiency and recurrent cost funding: these are complicated issues which have proved difficult even in advanced countries. Future projects should also address remaining health problems in China's poor areas. Lending would be expanded to a $100-150 million project in alternate years.

67. Cofinancing. China's internal organization does not facilitate cofinancing operations: the Bank, by far the largest donor, works with the Ministry of Finance; Asian Development Bank, much smaller and a newcomer, works with People's Bank of China (the central bank); and the Ministry of Foreign Economic Relations and Trade manages financial relations with Japan. With the exception of Japan, bilateral programs, generally less than $50 million per year, aim at small projects with reasonable visibility. UNDP has worked closely with the Bank on a number of technical assistance operations, including project preparation, but also has a dispersed program of generally small operations. In addition to these administrative obstacles, the Bank now faces a perception in China that our funds are relatively expensive compared to other sources, particularly the Japanese banks and official agencies, and while there is scope for involving other donors in specific operations, there is also the risk that the Bank may have to bear a heavy and expensive burden of preparation and appraisal work. To resolve this problem, our main cofinancing efforts will focus on mobilizing grant technical assistance for project preparation and implementation, a growing need and one for which both the Ministry of Finance and implementing agencies have shown some resistance to borrowing IBRD funds. We plan nonetheless to expand our working level contacts with staff of the Asian Development Bank and the Japanese agencies, and maintain good informal contacts with banks active in China.

68. Bank Exposure. Under a liberalized import scenario, IBRD's share of net public borrowing would average 20 percent through 1995. Including IDA, the Bank's Group's share of net flows would amount to about one-third of total public net flows. This large Bank role assumes that China will open up the economy as reform proceeds, in line with stated government policy to expand overall borrowing. If China were to follow a more conservative strategy, combined IBRD and IDA lending at the levels proposed would cover virtually all of the borrowing requirement: this would be inappropriate from a risk management point of view and would probably lead to a scaling down of China's resource requests from the Bank. Under the import liberalization strategy, Bank exposure rises in the outer years of the projection period. The Bank's share of public debt would more than double to 19.1 percent by 1995 and the Bank's share of public debt service would rise to nearly 34 percent. China would thus break through the Bank's exposure guideline which normally limits the Bank's share of total public and publicly guaranteed debt and debt service to 20 percent, or to 15 percent if the share of preferred creditors in total public debt exceeds 33 percent. This poses a dilemma: is it riskier to have a larger share of a small debt service or a smaller share of a larger debt service? Although Bank exposure will have to be kept under review, we believe that exceeding the Bank's exposure guidelines in China would be justified for two reasons. First, IBRD debt service is projected to be only 1.8 percent of exports in 1995 and debt service to all preferred creditors is projected to be only 2.5 percent. Second, China has a strong record of honoring the government's commitments, e.g. when Soviet aid was disrupted in 1960, the government prepaid all Soviet loans within a brief period. Rapid increases in Bank exposure would be justified both by China's low overall indebtedness and by the Bank's support for a strong policy effort. The share of China in the Bank's portfolio would rise from 1.6 percent at the end of

December 1987 to 7 percent by 1995. Depending on the overall level of Bank lending in the 1990s, and in particular the date at which lending rises to \$3 billion, by the year 2000 China could reach 10 percent of the Bank's portfolio.

69. Poverty Issues. Because of the perception that China has been more successful at meeting basic human needs and (with rare exceptions) preventing famine, than in putting together an efficient, dynamic economic system, the Bank's attention has focussed on incentives, markets and better flows of resources rather than on distributional and poverty issues. China has made impressive progress in reducing absolute poverty: with strong economic growth, there has been strong commitment to improving standards of education, nutrition and health for all. Over the last 10 years, the number of absolute poor has declined dramatically from an estimated 200 million to about 70 million today. Apart from the aged, this group consists largely of unskilled people living in resource-poor areas where prospects for increasing incomes are limited. The current Five Year Plan allocates about \$1 billion annually to combat the problems of the very poor. The impact of this funding could be enhanced by fundamental institutional and policy changes including allowing increased labor mobility within and between regions. A broadened approach to poverty along these lines would also be effective against a potential new problem in poverty control: the emergence of "new poor" or those who, existing now at the margin, might lose out in the competitive, market-oriented environment brought about by the reforms. Although Government policies did not appear to be impeding women's participation in development, past Bank projects have been designed to reinforce China's maternal and health system and improve the quality of health and education services and access of women and children to them. As a more market-based system takes hold in China, potential problem areas include employment, resettlement and access of women to land and credit. Enterprise reforms may lead to changes in how social services, particularly health care, housing and pensions, are provided. New ESW tasks and the design and supervision of projects will accordingly be more sensitive to the potential and intended impact, particularly on women. We have sharpened the poverty focus in our ESW and lending. Economic work prior to provincial lending to poorer areas (including another study of a poor province, possibly Guizhou) and a study of rural employment (already accepted in the three-year ESW program) would have a poverty dimension. Appropriately targeted operations could then address the needs of the identified poor in rural areas.

70. The Environment. Environmental issues are receiving increasing attention in China as developmental pressures on natural resources and on air and water quality grow each year. China has established comprehensive and strict pollution guidelines, including environmental assessments for most public investments. On the other hand, the lack of market prices for water and land have accelerated conversion of suburban farm land to urban uses and excessive tapping of groundwater. Given the volume and high quality of China's coal, it is the obvious energy alternative. But its extensive (and underpriced) use for heating and cooking, and heavy reliance on thermal power generation with virtually no application of scrubbing technology, have polluted the air of China's cities. The explosive and unplanned growth of rural industry has also been a major factor in water, soil and air pollution. In general, until price reform is completed, neither pollution fees or fines nor administrative regulations are likely to carry sufficient force to encourage treatment of industrial wastes and emissions, or to reduce worker exposure to unhealthy occupational environments. Decision-makers tend to see technology policy as the key to improving environmental standards, but it may not be as effective a motivating mechanism as raising the price paid by users of energy to something approaching its real cost. An upcoming ESW task will examine the environmental implications of development in Jiangsu Province, a candidate for provincial lending.

71. We plan to finance a program of technical assistance to the National Environmental Protection Agency (NEPA), including a major study on the environmental impact of rural industrialization. This would improve our understanding of the issues, policies and procedures that guide NEPA's work and help develop techniques and administrative and economic measures for implementation and enforcement. Involvement with NEPA will also help ensure that future Bank projects adequately address environmental impact and incorporate measures to mitigate them. Future lending for urban projects and public utilities would review technologies proposed for energy conservation and reduction in air and water pollution, examining pollution control and land use standards, fiscal incentives and enforcement. Issues of involuntary resettlement and land compensation seem to be addressed systematically and well in China, and our evaluation of experience under Bank-financed projects could offer lessons for other member countries.

August 31, 1988

1987 SOCIAL INDICATOR DATA SHEET

CHINA

	1965	1973	Most Recent Estimate	Reference Groups (MRE) Low-income	Lower mid income
LABOR FORCE					
Total Labor Force (mill)	320	394	479 c		
Female (%)	41	42	43	31	29
Agriculture (%)	81	77	74	72	55
Industry (%)	8	11	14	13	16
Participation rate (%):					
Total	45	45	47 c	41	35
Male	54	54	56	54	49
Female	35	35	36	28	20
Age dependency ratio	0.8	0.7	0.6	0.7	0.8
HOUSING					
Average size of household:					
Total	..	..	5	..	..
Urban	..	..	4	..	..
Rural	..	..	5	..	..
Percentage of dwellings with electricity:					
Total	..	..	..	..	..
Urban	..	..	..	..	..
Rural	..	..	63	..	..
EDUCATION					
Enrollment rates:					
Primary: Total	..	126	118	97	103
Male	..	135	129	109	110
Female	..	115	107	84	97
Secondary: Total	..	47	37	32	40
Male	..	55	43	41	48
Female	..	38	31	25	39
Pupil-Teacher ratio:					
Primary	30	43	25	36	32
Secondary	20	29	17	18	20
Pupils reaching grade 6 (%)	..	..	..	49	71
INCOME, CONSUMPTION, AND POVERTY					
Energy consumption per cap. (kg of oil equivalent)	178	308	515	310	345
Percentage of private income received by:					
Highest 10% of households	..	..	..	..	..
Highest 20%	..	..	39 d	..	..
Lowest 20%	..	..	7 d	..	..
Lowest 40%	..	..	18 d	..	..
Est. absolute poverty income level (US$ per capita):					
Urban	..	..	..	..	..
Rural	..	..	..	..	..
Est. pop. below absolute poverty income level (%)					
Urban	..	..	..	..	..
Rural	..	..	..	..	..
Passenger cars/thou pop.	..	0.1	0.2	0.3	4.0
Newspaper circulation (per thousand population)	..	..	18.9	16.0	14.0

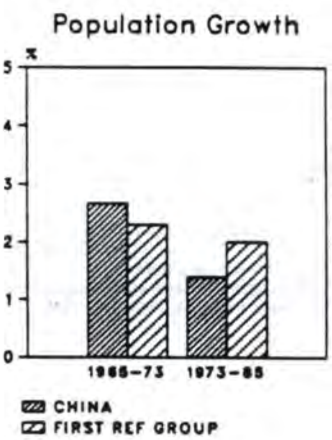
IECSE August 1987

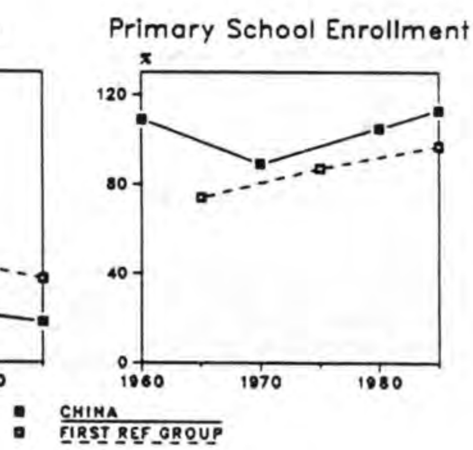
.. Not available. Note: Most recent estimates of population and GNP per capita are for 1986 unless otherwise noted.
Group averages are population weighted. Country coverage depends on data availability and is not uniform. Unless otherwise noted, 1965 refers to any year between 1962 and 1968; 1973 between 1970 and 1976; and most recent estimate between 1980 and 1986.
a. Senior doctors of western medicine. b. Figures from the government, not the WHO.
c. Figures from the government, not the ILO.
d. Distribution of people ranked by household income, 1979 data.

1987 SOCIAL INDICATOR DATA SHEET

CHINA

	1965	1973	Most Recent Estimate	Reference Groups (MRE) Low-income	Lower mid income
AREA					
Total land area (thou sq km)	9,561.0	9,561.0	9,561.0		
Agricultural (% of total)	33.9	40.5	40.3		
GNP PER CAPITA (current US$)	90	150	280	260	820
POPULATION AND VITAL STATISTICS					
Total population (mill)	714	879	1,055		
Urban pop. (% of total)	18	19	22	22	36
Population growth rate(%):					
Total		2.7	1.4	2.1	2.5
Urban		2.6	3.1	3.8	4.2
Life expect. at birth (yrs)	50	64	69	60	58
Population projections:					
Pop. in 2000 (mill)			1,274		
Stationary pop. (mill)			1,600		
Population density per sq km of agricultural land	220	227	269	349	284
Pop. age structure (%):					
0-14 yrs	40	36	30	37	39
15-64 yrs	55	58	65	59	55
65 and above	5	5	5	4	6
Crude birth rate (per thou)	39	29	18	29	36
Crude death rate (per thou)	13	8	7	10	11
Total fertility rate	6.4	4.4	2.2	3.2	3.6
Infant mort. rate (per thou)	90	56	35	72	82
Child death rate (per thou)	11	10	2	9	11
Family planning:					
Acceptors, annual (thou)	..	..	..	..	..
Users (% of married women)	..	..	69	..	..
FOOD, HEALTH AND NUTRITION					
Index of food production per capita (1979-81 = 100)	..	90	120	115	108
Per capita supply of:					
Calories (per day)	2,034	2,219	2,620	2,339	2,514
Proteins (grams per day)	51	53	61	55	56
Pop. per physician (thou)	3.8 a	4.0 a	1.9 b	8.9	6.9
Pop. per nurse (thou)	3.0	3.0	1.2 b	2.4	1.4
Pop. per hospital bed (thou)	0.9	0.6	0.5 b	1.1	0.8
Access to safe water (% of population): Total	..	..	50	..	..
Urban	..	..	81	..	..
Rural	..	..	40	..	..





Attachment 1

CHINA: Approved Five-Year Lending Program

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	IBRD $M	IDA $M
AGRICULTURE		
Northern Irrig.	-	103.0
Coastal Dev.	40.0	60.0
Rural Cr. III	-	170.0
Daxing Forestry	-	56.9
RSAL	200.0	100.0
(5)	240.0	489.9
INDUSTRY & FINANCE		
Pharmaceuticals	127.0	-
Phosphate I	62.7	-
(2)	189.7	0.0
TRANSPORTATION & ENERGY		
Huangpu Port	63.0	25.0
Dalian Port	71.0	25.0
Hwy III-Sichuan	75.0	50.0
Railway IV	200.0	-
Hwy IV-Shaanxi	50.0	-
Beilungang II	165.0	-
(6)	624.0	100.0
POP., HEALTH, URBAN & WATER SUPPLY		
Teacher Train.	-	50.0
(1)	0.0	50.0
TOTALS (14)	1053.7	639.9
	$1693.6	

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	IBRD $M	IDA $M
AGRICULTURE		
Shaanxi Prov. Agr.	-	106.0
Shandong Ag Dev	-	115.0
(2)	0.0	221.0
INDUSTRY & FINANCE		
CIB V	400.0	-
Tianjin Light Ind	156.0	-
Rural Ind Tech	-	111.4
PhosphateII(Hubei)	137.0	-
(4)	693.0	111.4
TRANSPORTATION & ENERGY		
N, X & S Ports	133.0	-
Jiangsu Multimodal	122.0	28.0
Hwy V-Shandong	70.0	50.0
Hwy VI-Jiangxi	50.0	12.0
Rwy-Inner Mongol	100.0	50.0
Yanshi Thermal	151.0	-
(6)	626.0	140.0
POP., HEALTH, URBAN & WATER SUPPLY		
Int. Health	-	110.0
Textbook Devt.	-	55.0
(2)	0.0	165.0
(14)	1319.0	637.4
	$1956.4	

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	IBRD $M	IDA $M
AGRICULTURE		
Middle Yangtze	25.0	50.0
Rural Sec. Adj.II	200.0	100.0
S Jiangxi Agr Dev	-	75.0
(3)	225.0	225.0
INDUSTRY & FINANCE		
Shanghai Prov	150.0	-
Yunan Ind. Sect.	100.0	-
S Jiangsu Prov	75.0	50.0
Fin.Sec.Dev. I	175.0	75.0
(4)	500.0	125.0
TRANSPORTATION & ENERGY		
S Railway V	200.0	-
Ertan Hydro	150.0	-
N. China Therm	150.0	-
S Daguangba-Hain.	95.5	-
(4)	595.5	0.0
POP., HEALTH, URBAN & WATER SUPPLY		
S Tech. Educ.	-	70.0
Liaoning Urban	-	100.0
S Med-size Cities	-	125.0
Shanghai Transp.	-	101.7
(4)	0.0	396.7
(15)	1320.5	746.7
	$ 2067.2	

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	IBRD $M	IDA $M
AGRICULTURE		
S Rural Cr. IV	100.0	100.0
Agr. Sup. Serv.	-	105.7
S Coastal II	40.0	100.0
S Forestry Sector I	-	110.0
S Hebei Agri	0.0	100.0
(5)	140.0	515.7
INDUSTRY & FINANCE		
Tianjin II	175.0	-
Petrochemicals	125.0	-
Rur. Ind. Tech.II	175.0	-
(3)	475.0	0.0
TRANSPORTATION & ENERGY		
Shanghai Port	180.0	-
Longtan Hydro	275.0	-
S Rwy VI	250.0	-
Jiangsu Tr.	130.0	-
Shuikou II	175.0	-
(5)	1010.0	0.0
POP., HEALTH, URBAN & WATER SUPPLY		
S Zhejiang Urban	-	120.0
S Key Studies	-	100.0
S Tianjin Urban	-	100.0
(3)	0.0	320.0
(16)	1625.0	835.7
	$2460.7	

92

	IBRD $M	IDA $M
AGRICULTURE		
Yellow Riv Bas	50.0	100.0
Xinjiang Irrg.	-	120.0
S Rural Sec. III	200.0	100.0
Sichuan Agr Dev	-	120.5
(4)	250.0	440.5
INDUSTRY & FINANCE		
CIB VI	400.0	-
Jiangsu II	150.0	-
S Shanghai II	150.0	-
		-
		-
(3)	700.0	0.0
TRANSPORTATION & ENERGY		
Inland Waterways	150.0	-
S Ertan II	200.0	-
Power Dist.	150.0	-
Hwys. VII	200.0	-
S Rwys. VII	175.0	-
(5)	875.0	0.0
POP., HEALTH, URBAN & WATER SUPPLY		
S Voc. Educ.	-	100.0
Beijing Water	-	150.0
S Mgmt. Educ.	-	100.0
S Rur. Health	-	100.0
(4)	0.0	450.0
(16)	1825.0	890.5
	$2715.5	

TOTAL

	No. of Proj.	IBRD $M	IDA $M
AGRICULTURE	(19)	855.0	1892.1
INDUSTRY & FINANCE	(15)	2557.7	236.4
TRANSPORTATION & ENERGY	(26)	3730.5	240.0
POP., HEALTH, URBAN & WATER SUPPLY	(15)	0.0	1381.7
TOTALS	(75)	7143.2	3750.2
		$10893.4	

	88	89	90	91	92	TOTAL
Million SDR	465	490	545	610	650	2760.0
IBRD:IDA Ratio	62 : 38	67 : 33	64 : 36	66 : 34	67 : 33	

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CHINA: Recommended Five-Year Lending Program

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	IBRD $M	IDA $M
AGRICULTURE		
Northern Irrig.	-	103.0
Coastal Dev.	40.0	60.0
Rural Cr. III	-	170.0
Daxing Forestry	-	56.9
RSAL	200.0	100.0
(5)	240.0	489.9
INDUSTRY & FINANCE		
Pharmaceuticals	127.0	-
Phosphate I	62.7	-
(2)	189.7	0.0
TRANSPORTATION & ENERGY		
Huangpu Port	63.0	25.0
Dalian Port	71.0	25.0
Hwy III-Sichuan	75.0	50.0
Railway IV	200.0	-
Hwy IV-Shaanxi	50.0	-
Beilungang II	165.0	-
(6)	624.0	100.0
POP., HEALTH, URBAN & WATER SUPPLY		
Teacher Train.	-	50.0
(1)	0.0	50.0
TOTALS (14)	1053.7	639.9
	$1693.6	
Million SDR		465
IBRD:IDA Ratio	62 :	38

89

	IBRD $M	IDA $M
AGRICULTURE		
Shaanxi Prov. Agr.	-	145.0
Shandong Ag Dev	-	140.0
(2)	0.0	285.0
INDUSTRY & FINANCE		
CIB V	400.0	-
Tianjin Light Ind	156.0	-
Rural Ind Tech	-	162.8
PhosphateII(Hubei)	137.0	-
(4)	693.0	162.8
TRANSPORTATION & ENERGY		
N, X & S Ports	135.0	-
Jiangsu Multimodal	154.0	-
Hwy V-Shandong	50.0	50.0
Hwy VI-Jiangxi	70.0	-
Rwy-Inner Mongol	80.0	50.0
Yanshi Thermal	153.2	-
(6)	642.2	100.0
POP., HEALTH, URBAN & WATER SUPPLY		
Int. Health	-	110.0
Textbook Devt.	-	55.0
(2)	0.0	165.0
(14)	1335.2	712.8
	$2048.0	
Million SDR		520
IBRD:IDA Ratio	65 :	35

90

	IBRD $M	IDA $M
AGRICULTURE		
Middle Yangtze	50.0	50.0
Rural Sec. Adj.II	200.0	100.0
Jiangxi Agr Dev	-	75.0
(3)	250.0	225.0
INDUSTRY & FINANCE		
S Shanghai Prov	150.0	-
Yunan Ind. Sect.	100.0	-
Jiangsu Prov	100.0	50.0
Fin.Sec.Dev. I	175.0	75.0
Heilongjiang Tools	79.6	-
(5)	604.6	125.0
TRANSPORTATION & ENERGY		
S Railway V	200.0	-
Ertan Hydro	200.0	-
N. China Therm	200.0	-
S Daguangba-Hain.	95.5	-
(4)	695.5	0.0
POP., HEALTH, URBAN & WATER SUPPLY		
S Tech. Educ.	-	70.0
Liaoning Urban	-	100.0
S Med-size Cities	-	125.0
Shanghai Transp.	-	101.7
(4)	0.0	396.7
(16)	1550.1	746.7
	$ 2296.8	
Million SDR		545
IBRD:IDA Ratio	67 :	33

91

	IBRD $M	IDA $M
AGRICULTURE		
S Rural Cr. IV	160.0	100.0
Agr. Sup. Serv.	-	105.7
S Coastal II	40.0	100.0
S Forestry Sector I	-	110.0
S Hebei Agri	0.0	100.0
(5)	200.0	515.7
INDUSTRY & FINANCE		
Tianjin II	210.0	-
Petrochemicals	160.0	-
Rur. Ind. Tech.II	200.0	-
(3)	570.0	0.0
TRANSPORTATION & ENERGY		
Shanghai Port	210.0	-
Longtan Hydro	310.0	-
S Rwy VI	250.0	-
Jiangsu Tr.	153.4	-
Shuikou II	210.0	-
(5)	1133.4	0.0
POP., HEALTH, URBAN & WATER SUPPLY		
S Zhejiang Urban	-	120.0
S Key Studies	-	100.0
S Tianjin Urban	-	100.0
(3)	0.0	320.0
(16)	1903.4	835.7
	$2739.1	
Million SDR		610
IBRD:IDA Ratio	69 :	31

92

	IBRD $M	IDA $M
AGRICULTURE		
Yellow Riv Bas	100.0	100.0
Xinjiang Irrg.	-	120.0
S Rural Sec. III	250.0	100.0
Sichuan Agr Dev	-	120.5
(4)	350.0	440.5
INDUSTRY & FINANCE		
CIB VI	400.0	-
Jiangsu II	150.0	-
S Shanghai II	150.0	-
		-
		-
(3)	700.0	0.0
TRANSPORTATION & ENERGY		
Inland Waterways	200.0	-
S Ertan II	300.0	-
Power Dist.	200.0	-
Hwys. VII	250.0	-
S Rwys. VII	233.0	-
(5)	1183.0	0.0
POP., HEALTH, URBAN & WATER SUPPLY		
S Voc. Educ.	-	100.0
Beijing Water	-	150.0
S Mgmt. Educ.	-	100.0
S Rur. Health	-	100.0
(4)	0.0	450.0
(16)	2233.0	890.5
	$3123.5	
Million SDR		650
IBRD:IDA Ratio	71 :	29

TOTAL

	No. of Proj.	IBRD $M	IDA $M
AGRICULTURE	(19)	1040.0	1956.1
INDUSTRY & FINANCE	(16)	2757.3	287.8
TRANSPORTATION & ENERGY	(26)	4278.1	200.0
POP., HEALTH, URBAN & WATER SUPPLY	(15)	0.0	1381.7
TOTALS	(76)	8075.4	3825.6
		$11901.0	
Million SDR		2790.0	

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CHINA

PROPOSED THREE YEAR ECONOMIC AND SECTOR WORK PROGRAM

Proposed study	Lead agency	Other counterparts	Beginning date	Remarks
1988				
Country Economic Memorandum Description: Review of macro-economic developments, effectiveness of macro policy instruments, including their impact on the control of consumption funds. This will be followed by an examination of industrial, infrastructure and marketing measures to promote a closer integration of the national market.	MOF	DRC, PBC	May 1988	Original timing was April, but MOF requested delay. Inst. of Trade, Fin. & Mat. sp. (CASS) has asked to participate, particularly with respect to reform of the commercial sector. SRC will participate on issue of control of consumption funds.
Fiscal System Description: Examine the tax structure and administration at national level as well as the fiscal system at the local level. Propose recommendations aimed at (1) increasing effectiveness and revenue elasticity of income and commodity taxes, and user charges, (2) rationalizing center-provincial fiscal relations.	MOF	SRC	2nd qtr 1988	The study will provide background for the International Symposium to be held next fall in collaboration with MOF and SRC.
Social Security Description: On the basis of a review of China's current enterprise level problems and longer term requirements, study would propose a system covering pension and health needs. International experience would be drawn upon to answer questions relating to funding and financial links of pensions fund,etc.	MOF/MOLP	SPC,SRC	4th qtr 1988	Timing advanced from 2nd qtr 1989. Data gathering to begin 3rd qtr 1988. Inst. of Sociology (CASS) also interested in some aspects of rural social security system.

12/87, as per discussions in Beijing

Attachment 2

Proposed study	Lead agency	Other counterparts	Beginning date	Remarks
Agricultural Markets & Pricing Description: Analyze mechanics of price formation in commodity markets and responsiveness of supplies to price signals and government intervention. Discuss various forms of government regulation and subsidies. Suggest ways of increasing efficiency of policy initiatives.	RCRD	Inst. of Trade Fin. & Mat. Sup (CASS)	1st qtr 1988	
Structural Change Description: Prepare paper on international experience with industrial policies. Assist Research Center in reviewing subsectoral and provincial studies. Conduct two independent industrial subsectoral studies. Advise on macro-modelling exercise.	DRC	Inst. of Quant & Tech. Econ. (CASS)	Nov. 1987	Subsectors to be covered identified as automobiles and electronics.
Housing Reform Description: Focus on financial issues including institutional development to ensure adequate supply of housing finance, and pricing and subsidy policies. Long-term housing needs will also be analyzed.	SRC	MURCEP	3rd qtr 1988	Inst. of Trade, Fin. & Mat. Sup. (CASS) also wishes to participate. Leading Group on Housing Reform would also be closely involved.
Enterprise Reform Description: Followng up symposium on enterprise management, study will address selected topics in greater depth. Topics include reorganization of government ownership role, the role of enterprise groupings and holding companies, role of financial institutions in diversification of state ownership, and changing role of industrial bureaus.	SRC	Inst. of Econ. (CASS)	1st qtr 1988	New task requested by SRC.

12/87, as per discussions in Beijing

Attachment 2

Proposed study	Lead agency	Other counterparts	Beginning date	Remarks
1988 Related Work				
Rural Financial Markets Description: Findings from sample surveys will be used to estimate the demand for credit in selected rural areas as well as the pattern of credit supplies.	RCRD		1987	Collaborative research project. Inst. of Trade, Fin, and Mat. Sup. (CASS) also interested in participating.
Land Consolidation Description: Draws on international experience relating to agricultural land consolidation so as to provide guidelines for reversing the process of land fragmentation in China and promoting efficient resource use.	RCRD		4th qtr 1988	Start up date depends on additional resources from research budget or other sources such as the possible Rural Sector Adjustment Loan.
Education for Public Admin. Description: Develop a program for supporting reforms in public administration through the provision of suitable training by specialized institutions.	MOLP	SEdC	3rd qtr 1988	Proposal by MOLP. Further discussions needed to decide if sector work is appropriate, or whether this should be studied in the context of project preparation.

12/87, as per discussions in Beijing

Attachment 2

Proposed study	Lead agency	Other counterparts	Beginning date	Remarks
1989				
Telecom Survey Description: Assist in defining financial, regulatory, pricing and procurement policies aimed at promoting the efficient growth of the sector.	MPT		2nd qtr 1989	Research Center of MPT wants to collaborate, but Ministry has not yet confirmed interest.
Non-Bank Financial Institutions Description: Role of non-bank financial intermediaries in increasing resource mobilization supporting industrial development, deepening financial markets and reinforcing monetary policies.	PBC	SRC	3rd qtr 1989	SRC has confirmed interest & wants to advance study to 1988. Some points of the study may be commenced under ongoing financial sector collaboration.
Rural Employment & Poverty Description: Project trends in supply and demand of rural labor. Discuss the prospects of absorbing labor into rural works. Explore the possibility of provincial redistribution of the workforce so as to match supplies with demands.	CASS	RCRD	1st qtr 1989	Timing advanced after discussion with RCRD. Design work begins 1988.
Export Marketing Description: Examine strategies for market penetration in trading environment of the nineties. Describe experience of the NICs. Analyze approaches to export marketing of industrial products such as automobile components, textiles and computers.	MOFERT	DRC, Inst. of Trade, Fin. & MS (CASS)	1st qtr 1989	MOFERT has not yet confirmed interest.

12/87, as per discussions in Beijing

Attachment 2

Proposed study	Lead agency	Other counterparts	Beginning date	Remarks
Yellow River Basin Description: Estimate trend in available supplies of and the total demands for water from different sources. Recommend measures for conserving water and criteria for prioritizing demands. Review investment needs for an efficient water allocation system.	MWREP	Yellow River Comm.	1st qtr 1989	Not confirmed. Study might be advanced to 1988 if resources permit. IRD (CASS) interested in ecological aspects.
Railway Sector Description: Review the existing system and offer guidance on future investments, technological choices related to fleet modernization, and management techniques.	MOR		2nd qtr 1989	Not confirmed. Bank will provide MOR with more information.
Transport Plan for Shanghai Econ. Zone Description: Propose measures for more effective utilization of existing facilities and define investment needs in different transport modes to meet the growth of demand.	Shanghai E.Z. Devel. Office		1st qtr 1989	Initial discussions have taken place, and it has been agreed that a detailed study proposal will be developed in 1988.
Long-distance Passenger Transport Description: Explore the most suitable options for satisfying the demand for long distance travel. Particular attention given to the role of air transport and the costs of this mode relative to alternatives.			2nd qtr 1989	This would be a Washington-based desk study. No counterpart needed.
Provincial Education Description: Discuss the decentralization of responsibility for education management. Examine the planning and finance of education in selected provinces.	SEdC	MOF	1st qtr 1989	Inst. of Sociology (CASS) may be interested in some aspects of study.

Attachment 2

12/87, as per discussions in Beijing

Proposed study	Lead agency	Other counterparts	Beginning date	Remarks
Manpower Resources for Service Sector Description: Assess training needs of services sector. Study the process of allocating labor under a decentrailised regime. Review the options for providing training and their cost effectiveness.	MOLP	SEdC	3rd qtr 1989	Counterpart agencies confirmed.
1990				
Provincial Development Description: Define the ingredients of a regional development policy for a selected province. Emphasis on resource mobilization, incentive mechanisms, infrastructure, social services, market linkages, and accumulation of skills.	Provincial Gov't Concerned		1st qtr 1990	Not confirmed. Inst. of Sociology (CASS) interested in participating. The Bank has suggested Jiangsu as the province to be studied.
Manufacturing & Agro-industries in Rural Sector Description: Examine avenues for supporting development of this dynamic sector through improvements in (1) regulatory and legal systems (2) extension and training service (3) technology transfer and (4) specialization.	RCRD	Inst. of Rural Devel. (CASS)	2nd qtr 1990	Originally proposed to precede & now proposed to follow Rural Employment & Poverty Study. Interest of counterparts confirmed.
Power Distribution & Linkage of National Grid Description: Examine nationwide distribution of electricity over high voltage intra and inter grid lines. Determine the nature of infrastructure needed to meet growing low voltage household demands.	MWREP	Inst. of Quant & Tech. Econ. (CASS)	1st qtr 1990	Not confirmed.

Attachment 2

Proposed study	Lead agency	Other counterparts	Beginning date	Remarks
Coal Utilization & Transport Description: Survey current and future coal quality and preparation. Examine technologies of utilization and the demands of the various consumers. Explore future pricing and technology options for transporting and utilizing coals that satisfy environmental standards investment criteria.	MOCI	Inst. of Indus. Econ. (CASS)	2nd qtr 1990	Previous agreement in principle on similar study with MOCI. Timing might be advanced.
City Management Description: Examine land use, the delivery of housing and other services as well as planning, financing and management of a major city, such as Shanghai or Tianjin. Drawing on earlier urban studies dealing with China together with the experience gained in other countries, the study could present an integrated view of managing an urban economy.	Shanghai or Tianjin Munic. Gov't	MURCEP	3rd qtr 1990	Not confirmed. Support for planning discussed with both Shanghai & Tianjin authorities. Study wold be limited to one city.

12/87, as per discussions in Beijing

Attachment 2

CHINA - NATIONAL ACCOUNTS

1986 Per Capita GNP in US$: 300
Mid-1986 Population (Mill): 1054

A. National Accounts Indicators as Shares of GDP/GDY (%):

	Historical (shares of GDP in Current Prices)							Shares of GDY in Constant 1986 Prices: Prelim	Shares of GDY in Constant 1986 Prices: Projected			
	1965	1973	1980	1982	1984	1985	1986	1987	1988	1989	1990	1995
Gross Domestic Product m.p.	100.0	100.0	100.0	100.0	100.0	100.0	100.0	99.9	100.0	100.2	100.0	99.9
Net Indirect Taxes	..	..	..	..	..	..	0.0	0.0	0.0	0.0	0.0	0.0
Agriculture	39.1	33.1	32.0	35.3	34.1	31.3	30.7	29.3	28.3	27.3	25.2	21.2
Industry	37.5	43.6	48.0	44.7	43.6	45.3	46.2	49.2	50.2	51.4	53.4	57.5
(of which Manufacturing)	29.6	33.3	35.3	32.5	32.0	33.5	33.7	n.a	n.a	n.a	n.a	n.a
Services	23.3	23.3	20.0	20.0	22.3	23.4	23.1	21.4	21.5	21.5	21.4	21.1
Resource Balance	0.5	0.5	-1.3	1.8	0.2	-4.4	-2.8	0.0	-0.2	-1.5	-1.4	-1.7
Exports of GNFS	4.2	4.7	7.1	8.9	9.2	9.9	10.9	11.5	11.4	11.5	11.7	12.0
Imports of GNFS	3.7	4.2	8.4	7.1	9.0	14.4	13.7	11.5	11.6	13.0	13.1	13.7
Total Expenditures	99.5	99.5	101.3	98.2	99.8	104.4	102.8	99.9	100.2	101.7	101.4	101.6
Total Consumption	74.9	69.8	71.3	69.0	67.7	65.7	64.0	59.3	60.3	62.2	64.0	65.2
Private Consumption	59.5	54.5	55.0	54.4	53.3	51.8	50.4	46.1	47.1	49.1	51.1	52.5
General Government	15.4	15.2	16.3	14.6	14.4	13.9	13.6	13.3	13.2	13.1	13.0	12.7
Gross Domestic Investment	24.6	29.7	30.0	29.1	32.2	38.8	38.8	40.6	39.9	39.5	37.4	36.4
Fixed Investment	..	..	..	23.8	27.1	30.6	32.2	38.4	38.1	37.7	35.6	34.6
Changes in Stocks	..	..	..	5.3	5.1	8.1	6.6	2.1	1.8	1.8	1.8	1.8
Capacity to Import	..	..	..	..	..	..	10.9	11.6	11.4	11.3	11.6	12.1
Terms of Trade Adjustment	..	..	..	..	..	..	0.0	0.1	0.0	-0.2	0.0	0.1
Gross Domestic Income	..	..	..	..	..	..	100.0	100.0	100.0	100.0	100.0	100.0
Gross National Income	..	..	..	..	..	..	99.9	99.9	100.0	100.0	99.9	99.7
Gross National Product	100.0	100.0	100.0	100.2	100.6	100.2	99.9	99.8	100.0	100.2	99.9	99.5
Gross Domestic Saving	25.1	30.2	28.7	31.0	32.3	34.3	36.0	40.7	39.7	37.8	36.0	34.8
Net Factor Income	0.0	0.0	0.0	0.2	0.6	0.2	-0.1	-0.1	0.0	0.0	-0.1	-0.3
Net Current Transfers	..	..	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Gross National Saving	..	..	28.9	31.3	33.0	34.6	36.1	40.6	39.8	37.9	35.9	34.5

B. National Accounts Growth Rates (%) at Constant Prices:

	Actual							Prelim.	Projections			
	1965-73	1973-80	1980	1982	1984	1985	1986	1987	1988	1989	1986-90	1990-95
Gross Domestic Product m.p.	7.8	5.4	6.6	8.8	14.5	12.7	7.9	9.4	7.6	7.6	8.0	7.6
Net Indirect Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Agriculture	2.8	2.8	-1.7	11.1	12.3	3.4	3.4	4.7	3.7	3.7	3.9	3.1
Industry	12.1	8.6	12.3	7.8	16.3	21.7	11.4	16.5	9.8	9.8	11.1	9.7
(of which Manufacturing)	11.8	8.4	10.4	8.1	18.4	22.7	9.6	n.a	n.a	n.a	n.a	n.a
Services	11.7	3.4	8.2	7.5	13.9	6.4	5.4	-3.3	6.6	5.9	4.2	5.6
Exports of GNFS	2.1	3.6	17.8	1.3	12.0	33.3	10.8	15.3	7.4	8.2	9.4	8.4
Imports of GNFS	1.6	11.3	16.1	-5.4	24.0	67.3	-13.2	-7.9	8.7	20.0	8.2	8.8
Total Expenditures	7.9	5.9	6.6	8.3	15.4	15.6	5.2	6.5	7.8	9.0	7.8	7.7
Total Consumption	6.4	5.0	9.0	4.5	9.1	3.6	3.4	1.6	9.2	10.8	8.1	8.3
Private Consumption	6.3	4.6	13.0	5.7	9.1	3.6	3.4	0.2	9.8	11.8	8.4	8.7
General Government	7.0	6.6	-2.5	0.4	9.1	3.6	3.4	7.0	7.0	7.0	7.0	7.0
Gross Domestic Investment	12.9	8.1	1.3	18.0	29.0	37.8	7.8	14.5	5.7	6.2	7.4	6.5
Fixed Investment	n.a	n.a	n.a	19.7	31.7	30.3	13.5	30.8	6.6	6.1	10.5	6.5
Changes in Stocks	n.a	n.a	n.a	10.7	15.7	78.8	-15.0	-64.5	-11.4	7.0	-18.8	7.7
Capacity to Import	2.8	8.0	16.5	14.4	11.5	13.6	-0.1	16.3	6.4	6.4	8.9	8.7
Terms of Trade Adjustment	..	..	..	..	..	..	..	..	..	..	..	..
Gross Domestic Income	7.9	5.7	6.5	9.8	14.4	11.3	7.0	9.5	7.5	7.4	7.9	7.6
Gross National Income	7.9	5.7	6.5	10.5	14.6	10.9	6.7	9.5	7.5	7.4	7.9	7.6
Gross National Product	7.8	5.4	6.6	9.4	14.6	12.3	7.6	9.4	7.7	7.6	8.0	7.5
Gross Domestic Saving	12.8	7.3	0.8	23.2	25.6	25.5	12.5	23.6	5.0	2.2	7.6	6.4
Net Factor Income	n.a	n.a	n.a	..	..	..	..	..	..	..	..	..
Net Current Transfers	n.a	n.a	n.a	..	..	..	..	..	..	..	..	..
Gross National Saving	n.a	n.a	0.6	25.0	25.6	24.0	11.8	23.3	5.3	2.2	7.6	6.3

CHINA - NATIONAL ACCOUNTS (continued)

C. Price Indices (1980=100):	Actual					Prelim	Growth Rates (% p.a)		
	1980	1982	1984	1985	1986	1987	1965-73	1973-80	1980-86
Consumer Prices (IFS 64)	100.0	104.6	109.6	119.8	127.1	136.4	..	2.0	3.9
Wholesale Prices (IFS 63)	100.0	108.2	117.5	127.6	..	..	..	..	..
Implicit GDP Deflator	100.0	102.8	109.3	119.1	124.7	137.2	-0.9	1.5	3.8
Implicit Expend. Deflator	100.0	101.8	108.1	120.1	126.9	138.5	-1.1	1.2	4.0
Deflators for Sector VA:									
Agricultural Sector	100.0	109.3	117.0	127.4	136.6	n.a	1.1	3.0	4.4
Industrial Sector	100.0	99.1	100.5	105.3	108.9	n.a	-2.3	0.0	0.9
Services Sector	100.0	100.4	117.8	143.1	151.0	n.a	-4.8	1.9	6.8

D. Other Indicators:	1965-73	1973-80	1980-86	1986-95
Growth Rates (% p.a.)				
Population	2.7	1.5	1.2	1.0
Labor Force	..	..	..	n.a
Gross Nat'l Income p.c.	5.1	4.1	9.1	6.6
Private Consumption p.c.	3.5	3.0	5.5	7.9
Import Elasticity:				
Imports (G+NFS)/GDP(mp)	0.2	2.1	1.6	1.2
Marginal Savings Rates:				
Gross National Savings	..	..	46.0	29.5
Gross Domestic Savings	36.5	25.4	46.2	30.2
ICOR (period averages)	..	..	..	5.6

Share of Total Labor Force in:	1965	1973	1980	1986	1991
Agriculture	81.0	77.3	72.0	61.1	n.a
Industry	8.0	11.2	16.3	21.9	n.a
Services	11.0	11.6	11.7	17.0	n.a
Total	100	100	100	100.0	n.a

E. National Accounts (millions of LCUs at 1980 Prices):

	Actual						Prelim.	Projections							
	1980	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Gross Domestic Product m.p.	430000	490000	540000	619000	697000	752233	823086	885835	952983	1025298	1103237	1186955	1276742	1374215	1479194
Net Indirect Taxes	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Agriculture	138000	163000	175000	197000	204000	210716	220620	228783	237248	245551	254145	262278	270146	278251	286598
Industry	206000	227000	253000	294000	357000	398239	463948	509415	559838	614153	673726	739078	810768	889413	975686
(of which Manufacturing)	151000	165000	182000	216000	265000	289918	337754	370854	407198	447104	490473	538048	590239	647492	710299
Services	86000	100000	112000	128000	136000	143278	138518	147637	156397	165593	175365	185599	195827	206552	216910
Resource Balance	-6000	4000	-1000	-6000	-25000	-7525	-109	-562	-4961	-5256	-5550	-5840	-6780	-7864	-9070
Exports of GNFS	31000	36000	40000	44000	59000	65382	75384	80966	87627	94871	102751	111325	120654	130807	141859
Imports of GNFS	36000	32000	41000	50000	84000	72907	67114	72963	87577	94588	102164	110346	120484	131638	143831
Total Expenditures	435000	486000	541000	625000	722000	759758	809045	871942	949982	1021844	1099233	1182287	1273086	1371833	1478288
Total Consumption	306000	337000	370000	404000	419000	432828	439827	480306	532092	581456	635262	693877	747729	805879	868935
Private Consumption	236000	265000	292000	319000	330000	341025	341598	375201	419629	461121	506504	556105	600313	648144	700158
General Government	70000	71000	79000	86000	89000	91803	98229	105105	112463	120335	128758	137772	147416	157735	168776
Gross Domestic Investment	129000	149000	171000	220000	303000	326930	374369	395651	420115	440555	461762	483442	519868	560004	602814
Fixed Investment	..	122699	141426	186280	242653	275296	360035	383950	407543	426831	446769	467143	502409	540982	582323
Changes in Stocks	..	26301	29574	33720	60347	51634	18336	16238	17377	18714	20169	21665	23235	25224	27167
Capacity to Import	31000	40000	46000	51000	58000	58022	67474	71765	76372	83710	90930	98806	107377	116725	127343
Terms of Trade Adjustment	0	4000	6000	7000	-1000	-7359	-7248	-8787	-11265	-10703	-11149	-11594	-12064	-12546	-12441
Gross Domestic Income	430000	494000	547000	625000	698000	744874	815838	877048	941718	1014594	1092088	1175361	1264678	1361669	1466753
Gross National Income	429000	495000	549000	629000	698000	744197	815118	876604	941474	1013653	1090549	1173314	1261722	1357536	1461720
Gross National Product	429000	491000	543000	622000	699000	751556	822366	885394	952745	1024357	1101692	1184898	1273768	1370054	1474125
Gross Domestic Saving	123000	157000	176000	221000	277000	312046	385587	404944	413854	435404	456637	478434	513353	551694	593164
Net Factor Income	0	1000	2000	4000	1000	-658	-699	-419	-214	-915	-1517	-2026	-2941	-4125	-5030
Net Current Transfers	1000	1000	1000	1000	1000	706	278	608	598	661	692	726	761	797	736
Gross National Saving	124000	159000	179000	226000	279000	312093	384687	404940	414044	434878	455444	476683	510559	547545	587797

CHINA - EXTERNAL TRADE

Attachment 3b

A. Volume, Value and Prices	1980	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
	Actual					Prelim.	Projections							
Merchandise Exports	Volume Index 1986=100													
Food					100.0	76.7	79.0	81.4	83.8	86.3	88.9	91.6	94.3	97.2
Petroleum					100.0	96.7	101.5	106.6	111.9	117.5	123.4	129.6	136.1	142.9
Commodity 3					0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commodity 4					0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufactures					100.0	127.4	137.6	150.7	165.0	180.6	197.8	216.6	237.2	259.7
Other Exports					100.0	121.9	131.7	142.2	153.6	165.8	179.1	193.4	208.9	225.6
Total Merch. Exports FOB					0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Merchandise Exports	Value-Current Prices (million US$)													
Food	3138	2692	3347	4017	4121	1898	2679	2804	3076	3177	3282	3391	3503	3619
Petroleum	4063	4348	5498	6528	3091	3266	3711	3718	4216	4546	4902	5286	5701	6147
Commodity 3					0	0	0	0	0	0	0	0	0	0
Commodity 4					0	0	0	0	0	0	0	0	0	0
Manufactures	8892	11803	12909	12303	16484	22966	25340	29246	31896	35345	39167	43403	48096	53297
Other Exports	2400	1864	2151	2260	2060	2987	3012	3074	3543	3933	4367	4848	5383	5976
Total Merch. Exports FOB	18492	20707	23905	25108	25756	31117	34743	38841	42730	47002	51719	56929	62683	69040
Merchandise Imports	Volume Index 1986=100													
Food					100.0	164.0	178.4	194.1	211.2	229.8	250.0	272.0	296.0	322.0
POL and Other Energy					100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Other Imports					100.0	85.8	93.5	114.6	123.8	133.8	144.6	158.3	173.3	189.8
Other Consumer Goods					100.0	92.0	100.1	122.1	132.9	144.6	157.3	171.1	186.2	202.6
Intermediate Goods					100.0	75.3	84.1	106.4	118.9	132.7	148.1	165.4	184.6	206.1
Primary					100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufactures					100.0	75.3	84.1	106.4	118.9	132.7	148.1	165.4	184.6	206.1
Capital Goods					100.0	84.6	91.4	111.0	117.3	123.9	130.7	142.5	155.6	169.9
Total Merch. Imports CIF					100.0	89.1	96.9	117.6	127.0	137.2	148.3	162.1	177.3	194.0
Merchandise Imports	Value-Current Prices (million US$)													
Food	3200	2861	2121	1428	1396	1874	2050	2266	2626	2865	3127	3412	3723	4063
POL and Other Energy	242	102	128	157	419	388	495	473	511	524	538	553	568	583
Other Imports	18607	15754	21642	36647	33081	30056	34543	44624	48035	52536	57456	63639	70532	78167
Other Consumer Goods	294	363	711	1657	13190	12023	14751	18968	20554	22631	24918	27436	30209	33262
Intermediate Goods	11056	10659	12496	17600	6282	5718	5903	7867	8757	9894	11178	12629	14269	16121
Primary	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Manufactures	11056	10659	12496	17600	6282	5718	5903	7867	8757	9894	11178	12629	14269	16121
Capital Goods	7060	4371	7388	16312	13609	12315	13890	17789	18724	20011	21359	23573	26054	28785
Total Merch. Imports CIF	22049	18717	23891	38231	34896	32316	37089	47362	51172	55926	61121	67604	74823	82814
Country Indices	Price Indices 1980=100													
Merchandise Exports	100.0	92.6	91.8	88.6	86.6	90.9	94.7	97.7	99.3	100.8	102.3	103.9	105.4	107.0
Merchandise Imports	100.0	92.9	91.0	88.6	94.5	98.2	103.6	109.1	109.1	110.4	111.6	112.9	114.3	115.6
Merch. Terms of Trade	100.0	99.7	100.8	100.0	91.9	92.7	91.6	89.8	91.3	91.6	91.9	92.2	92.5	92.8

	B. Share of Total X or M (%) at current prices						C. Growth Rates (%) at constant prices				
	1965	1973	1980	1986	1991	1995	1965-73	1973-80	1980-85	1986-90	1990-95
Merchandise Exports											
Food	n.a	n.a	17.0	16.0	6.8	5.2	n.a	n.a	n.a	-2.9	3.0
Petroleum	n.a	n.a	22.0	12.0	9.7	8.9	n.a	n.a	n.a	3.3	5.0
Commodity 3	n.a	n.a	0.0	0.0	0.0	0.0	n.a	n.a	n.a	0.0	0.0
Commodity 4	n.a	n.a	0.0	0.0	0.0	0.0	n.a	n.a	n.a	0.0	0.0
Manufactures	46	49	48.1	64.0	75.2	77.2	n.a	n.a	n.a	12.4	9.5
Other Exports	n.a	n.a	13.0	8.0	8.4	8.7	n.a	n.a	n.a	10.6	8.0
Total Merch. Exports FOB	100	100	100.0	100.0	100.0	100.0	n.a	n.a	n.a	9.3	8.4
Merchandise Imports											
Food	n.a	n.a	14.5	4.0	5.1	4.9	n.a	n.a	n.a	18.1	8.8
POL & Other Energy	0	0	1.1	1.4	0.9	0.7	n.a	n.a	n.a	0.0	0.0
Other Imports	n.a	n.a	84.4	94.8	93.9	94.4	n.a	n.a	n.a	7.4	9.0
Other Consumer Goods	n.a	n.a	1.3	36.8	40.5	40.2	n.a	n.a	n.a	8.9	8.8
Intermediate Goods	n.a	n.a	50.1	18.0	17.7	19.5	n.a	n.a	n.a	7.2	11.6
Primary	n.a	n.a	0.0	0.0	0.0	0.0	n.a	n.a	n.a	0.0	0.0
Manufactures	n.a	n.a	50.1	18.0	17.7	19.5	n.a	n.a	n.a	7.2	11.6
Capital Goods	n.a	n.a	32.0	34.9	35.8	34.8	n.a	n.a	n.a	6.1	7.8
Total Merch. Imports CIF	100	100	100.0	100.0	100.0	100.0	n.a	n.a	n.a	7.8	8.9

Note: Definition of categories between 1980-85 and after 1986 are not comparable.

CHINA - BALANCE OF PAYMENTS

Attachment 3c

(US$ millions at Current Prices)

	Actual						Prelim.	Projections							
	1980	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
A. Exports of Goods & NFS	19812	23786	23433	26716	28163	29583	35822	40245	45064	49302	54156	59508	65408	71914	79747
1. Merchandise (FOB)	18492	21125	20707	23905	25108	25756	31117	34743	38841	42730	47002	51719	56929	62683	69040
2. Non-Factor Services	1320	2661	2726	2811	3055	3827	4705	5503	6222	6572	7155	7789	8479	9231	10707
B. Imports of Goods & NFS	23435	18900	20711	26269	40755	37172	35631	40917	51675	55709	60847	66458	73391	81102	90072
1. Merchandise (FOB)	22049	16876	18717	23891	38231	34896	32316	37089	47362	51172	55926	61121	67604	74823	82814
2. Non-Factor Services	1386	2024	1994	2378	2524	2276	3315	3828	4312	4537	4921	5337	5787	6278	7258
C. Resource Balance	-3623	4886	2722	447	-12592	-7589	191	-672	-6611	-6407	-6690	-6950	-7983	-9188	-10325
D. Net Factor Income	-111	451	1254	1620	538	-238	-249	-159	-83	-320	-506	-645	-898	-1195	-1578
1. Factor Receipts	512	1092	1549	2008	1478	986	1001	1319	1450	1707	1814	1943	2083	2257	2452
2. Factor Payments	623	641	295	388	940	1224	1250	1478	1533	2027	2320	2588	2976	3452	4030
(interest payments)	318	543	525	611	586	638	1039	1107	1182	1656	1949	2217	2605	3081	3659
E. Net Current Transfers	640	530	436	305	171	255	139	368	368	368	368	368	368	368	368
1. Current Receipts	640	543	446	317	180	266	150	505	505	505	505	505	505	505	505
a. workers' remittances	0	541	446	317	180	208	125	125	125	125	125	125	125	125	125
b. other current trans.	640	2	0	0	0	58	25	380	380	380	380	380	380	380	380
2. Current Payments	0	13	10	12	9	11	11	137	137	137	137	137	137	137	137
F. Current Account Balance	-3094	5867	4412	2372	-11883	-7572	81	-463	-6326	-6359	-6828	-7227	-8508	-10014	-11534
G. Long-Term Capital Inflow	271	365	1183	1745	4511	7381	2087	3573	9404	7520	8250	9546	10551	12187	14045
1. Direct Investment	57	386	543	1124	1031	1425	1900	1929	1958	1987	2017	2047	2078	2109	2141
2. Official Capital Grants	-70	-44	75	137	72	124	19	0	0	0	0	0	0	0	0
3. Net LT Loans (DRS data)	1927	554	986	1038	4007	4194	1517	1644	7446	5533	6233	7499	8474	10078	11904
a. Disbursements	2539	1856	2375	2325	5303	6005	3060	3193	9120	7399	8296	9839	12129	14261	16813
b. Repayments	613	1302	1389	1287	1297	1810	1543	1549	1674	1866	2063	2340	3655	4183	4909
4. Other LT Inflows (net)	-1643	-531	-421	-554	-599	1638	-1349	0	0	0	0	0	0	0	0
H. Total Other Items (net)	3067	-157	-1471	-3337	2698	-1854	2066	0	0	0	0	0	0	0	0
1. Net Short Term Capital	1396	-450	-1116	-2448	2270	-2005	2066	0	0	0	0	0	0	0	0
2. Capital Flows N.E.I.	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
3. Errors and Omissions	1671	293	-354	-889	428	151	0	0	0	0	0	0	0	0	0
I. Changes in Net Reserves	-244	-6075	-4124	-780	4674	2045	-4234	-1748	-3428	-1435	-1722	-1864	-2321	-2595	-3027
1. Net Credit from IMF	..	-27	-496	..	..	731	0	0	0	0	0	0	0	0	0
2. Other Reserve changes	-244	-6048	-3628	-780	4674	1314	-4234	-1748	-3428	-1435	-1722	-1864	-2321	-2595	-3027
(- indicates increase)															
Shares of GDP (Current US$):															
1. Resource Balance	-1	2	1	0	-4	-3	0	-0.2	-1.7	-1.5	-1.5	-1.4	-1.5	-1.6	-1.5
2. Total Interest Payments	0	0	0	0	0	0	0	0.3	0.3	0.4	0.4	0.5	0.5	0.5	0.5
3. Current Account Balance	-1	2	2	1	-4	-3	0	-0.1	-1.6	-1.5	-1.5	-1.5	-1.6	-1.7	-1.7
4. LT Capital Inflow (Line G)	0	0	0	1	2	3	1	1.0	2.4	1.8	1.8	1.9	2.0	2.1	2.1
5. Net Credit from the IMF	..	0	0	..	..	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Item:															
GDP (____ of Current US$)	286716	266209	284816	291423	283481	271884	304802	352014	396496	417198	452503	490735	532080	577283	667365
Foreign Exchange Reserves:															
1. Int'l. Reserves (IFS 11d)	2545	11349	14987	17366	12728	11453	16305	18648	22075	23511	25233	27096	29417	32012	35039
2. Gold (end yr London price)	7546	5803	4845	3915	4153	4964	6148	5704	5704	5704	5704	5704	5704	5704	5704
3. Gross Reserves incl. Gold	10091	17152	19832	21281	16881	16417	22453	24352	27779	29215	30937	32800	35121	37716	40743
4. Gross Res. in Months Import	5	11	11	10	5	5	7	5.3	5.0	4.9	4.8	4.7	4.6	4.5	4.5
Exchange Rates (LCU/US$):															
1. Nom. Off. X-Rate (IFS rh)	1.53	1.92	1.98	2.79	3.20	3.45	3.72	3.73	3.81	4.15	4.38	4.63	4.89	5.17	5.13
2. Real Eff. X-Rate (1980=100)	100	85	84	74	63	46	40	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
3. X-Rate for GNP Conversion	1.53	1.92	1.98	2.79	3.20	3.45	3.72	3.73	3.81	4.15	4.38	4.63	4.89	5.17	5.13

CHINA - EXTERNAL CAPITAL AND DEBT

(US$ millions at Current Prices)

Attachment 3d
(Page 1 of 2)

	Actual						Prelim.	Projections							
A. Disbursements	1980	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
1. Public & Publicly Guar. LT	2539	1856	2375	2325	5303	6005	3060	3193	5768	5340	5875	6661	7771	8829	9990
Official Creditors	244	662	606	844	1124	1400	1403	2567	3148	3673	4208	4540	4866	5208	5442
Multilateral	0	1	78	208	599	620	700	1316	1850	2235	2617	2930	3233	3542	3742
of which IBRD	0	0	4	73	354	324	306	622	853	1076	1321	1554	1774	2004	2132
of which IDA	0	1	67	124	212	282	394	373	501	537	585	618	649	674	689
Bilateral	244	661	528	636	525	780	703	1251	1298	1438	1591	1610	1633	1666	1699
Private Creditors	2295	1195	1770	1481	4180	4604	1657	626	2620	1667	1667	2121	2905	3621	4549
Suppliers	671	664	1074	888	442	372	98	49	9	3	0	0	0	0	0
Financial Markets	1624	530	696	593	3737	4232	1559	577	2611	1664	1667	2121	2905	3621	4549
2. Private Non-Guar. LT	0	0	0	0	0	0	0	0	3352	2059	2421	3179	4358	5432	6823
3. Total LT Disbursements	2539	1856	2375	2325	5303	6005	3060	3193	9120	7399	8296	9839	12129	14261	16813
4. IMF Purchases	0	0	0	0	0	701	0	0	0	0	0	0	0	0	0
5. Net Short-Term Capital	0	0	0	0	0	0	2066	0	0	0	0	0	0	0	0
6. Total incl. IMF & Net ST	2539	1856	2375	2325	5303	6706	5126	3193	9120	7399	8296	9839	12129	14261	16813
B. Repayments															
1. Public & Publicly Guar. LT	613	1302	1389	1287	1297	1810	1543	1549	1674	1866	2063	2340	2984	3101	3343
Official Creditors	50	76	55	56	42	286	432	448	470	520	598	855	1095	1237	1574
Multilateral	0	0	0	0	0	38	97	99	124	156	244	372	517	704	929
of which IBRD	0	0	0	0	0	0	97	24	48	81	203	331	437	580	758
of which IDA	0	0	0	0	0	0	0	0	0	0	0	2	3	7	11
Bilateral	50	76	55	56	42	248	335	349	346	364	354	482	579	533	645
Private Creditors	563	1227	1335	1231	1255	1524	1111	1100	1205	1346	1464	1486	1889	1864	1769
Suppliers	294	399	475	623	696	304	211	232	356	251	218	183	201	88	72
Financial Markets	268	828	860	608	558	1220	900	868	848	1095	1247	1302	1688	1775	1697
2. Private Non-Guar. LT	0	0	0	0	0	0	0	0	0	0	0	0	670	1082	1566
3. Total LT Repayments	613	1302	1389	1287	1297	1810	1543	1549	1674	1866	2063	2340	3655	4183	4909
4. IMF Repurchases	0	0	481	0	0	0	0	0	0	0	0	0	0	0	0
C. Interest															
1. Public & Publicly Guar. LT	318	543	525	611	586	638	1039	1107	1162	1384	1549	1700	1889	2129	2428
Official Creditors	17	80	100	123	165	273	356	395	478	593	732	890	1057	1237	1426
Multilateral	0	2	5	11	32	78	123	156	224	318	433	562	704	858	1018
of which IBRD	0	0	3	6	26	66	111	137	182	240	310	387	475	575	678
of which IDA	0	0	1	4	4	8	12	13	14	17	20	24	28	32	37
Bilateral	17	78	95	113	133	195	233	239	254	275	299	327	353	378	409
Private Creditors	301	463	425	488	421	366	683	711	684	791	816	811	833	892	1001
Suppliers	82	140	171	210	207	94	135	126	109	82	63	50	34	21	15
Financial Markets	219	323	254	278	214	271	548	586	575	709	753	761	799	871	986
2. Private Non-Guar. LT	0	0	0	0	0	0	0	0	0	272	400	517	716	952	1231
3. Total LT Interest	318	543	525	611	586	638	1039	1107	1162	1656	1949	2217	2605	3081	3659
4. IMF Service Charges	0	32	20	0	0	0	47	0	0	0	0	0	0	0	0
5. Interest on ST Debt	0	248	277	386	594	417	640	541	541	541	541	541	541	541	541
6. Total incl. IMF & Net ST	318	823	821	998	1179	1055	1726	1648	1703	2197	2490	2758	3146	3622	4200

CHINA - EXTERNAL CAPITAL AND DEBT

	Actual						Prelim.	Projections							
D. External Debt (DOD)	1980	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
1. Public & Publicly Guar. LT	4504	5562	5625	6486	10237	16313	17936	19580	23674	27178	30986	35367	40131	45821	52468
Official Creditors	446	1790	2346	2928	4738	7057	7930	10048	12727	15910	19519	23265	27013	30946	34813
Multilateral	0	342	401	578	1256	2151	2756	3766	5498	7572	9945	12563	15256	18056	20868
of which IBRD	0	0	4	73	498	965	1427	1708	2513	3508	4626	5849	7186	8610	9983
of which IDA	0	1	67	181	431	774	1330	1408	1909	2446	3030	3645	4291	4957-	5636
Bilateral	446	1448	1945	2350	3482	4907	5174	6282	7234	8338	9575	10702	11757	12890	13945
Private Creditors	4058	3773	3279	3558	5499	9256	10006	9532	10947	11268	11467	12102	13118	14875	17655
Suppliers	1037	1580	1739	1817	1252	1544	1711	1528	1180	932	711	527	327	239	167
Financial Markets	3020	2193	1541	1741	4247	7712	8295	8004	9767	10336	10756	11574	12791	14637	17489
2. Private Non-Guar. LT	0	0	0	0	0	0	0	0	3352	5412	7832	11011	14698	19047	24304
3. Total Long-Term DOD	4504	5562	5625	6486	10237	16313	17936	19580	27026	32589	38818	46378	54829	64868	76772
4. IMF Credit	0	496	0	0	0	731	848	0	0	0	0	0	0	0	0
5. Short-Term Debt	0	2300	3984	5600	6419	4769	6761	6761	6761	6761	6761	6761	6761	6761	6761
6. Total incl. IMF & Net ST	4504	8359	9609	12086	16656	21813	25545	26341	33787	39350	45579	53138	61589	71629	83533
Percent of Total LT DOD:															
1. On Concessional Terms	9.3	13.7	19.9	24.2	25.4	23.3	37.8	40.7	34.6	33.6	32.8	31.3	29.6	27.7	25.7
2. With Variable Int. Rates	38.6	35.4	26.0	20.7	26.8	24.5	46.2	40.9	48.5	48.3	47.9	48.7	50.1	51.9	54.4
E. Bank and IDA Ratios															
Share of Total LT DOD (D.3)															
1. IBRD as % of Total	0.0	0.0	0.1	1.1	4.9	5.9	8.0	8.7	9.3	10.8	11.9	12.6	13.1	13.3	13.0
2. IDA as % of Total	0.0	0.0	1.2	2.8	4.2	4.7	7.4	7.2	7.1	7.5	7.8	7.9	7.8	7.6	7.3
3. IBRD+IDA as % of Total	0.0	0.0	1.3	3.9	9.1	10.7	15.4	15.9	16.4	18.3	19.7	20.5	20.9	20.9	20.3
Share of LT Debt Serv (B.3+C.3)															
1. IBRD as % of Total	0.0	0.0	0.1	0.3	1.4	2.7	8.1	6.1	8.1	9.1	12.8	15.8	14.6	15.9	16.8
2. IDA as % of Total	0.0	0.0	0.0	0.2	0.2	0.3	0.5	0.5	0.5	0.5	0.5	0.6	0.5	0.5	0.6
3. IBRD+IDA as % of Total	0.0	0.0	0.2	0.5	1.6	3.1	8.5	6.5	8.6	9.6	13.3	16.3	15.1	16.4	17.3
F. DOD-to-Exports Ratios (a)															
1. Long-Term Debt/Exports	22.2	21.9	22.1	22.3	34.3	53.0	48.5	47.0	57.9	63.7	69.2	75.3	81.1	87.3	98.3
2. IMF Credit/Exports	0.0	2.0	0.0	0.0	0.0	2.4	2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3. Short-Term Debt/Exports	0.0	9.0	15.7	19.3	21.5	15.5	18.3	16.2	14.5	13.2	12.1	11.0	10.0	9.1	8.2
4. LT+IMF+ST DOD/Exports	22.2	32.9	37.8	41.6	55.9	70.9	69.1	63.2	72.4	77.0	81.3	86.3	91.1	96.4	101.5
G. DOD-to-GDP Ratios															
1. Long-Term Debt/GDP	1.6	2.1	2.0	2.2	3.6	6.0	5.9	5.6	6.8	7.8	8.6	9.5	10.3	11.2	11.5
2. IMF Credit/GDP	0.0	0.2	0.0	0.0	0.0	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3. Short-Term Debt/GDP	0.0	0.9	1.4	1.9	2.3	1.8	2.2	1.9	1.7	1.6	1.5	1.4	1.3	1.2	1.0
4. LT+IMF+ST DOD/GDP	1.6	3.1	3.4	4.1	5.9	8.0	8.4	7.5	8.5	9.4	10.1	10.8	11.6	12.4	12.5
H. Debt Service/Exports (a)															
1. Public & Publicly Guar. LT	4.6	7.3	7.5	6.5	6.3	8.0	7.0	6.4	6.1	6.4	6.4	6.6	7.2	7.0	7.0
2. Private Non-Guar. LT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.5	0.7	0.8	2.0	2.7	3.4
3. Total LT Debt Service	4.6	7.3	7.5	6.5	6.3	8.0	7.0	6.4	6.1	6.9	7.2	7.4	9.3	9.8	10.4
4. IMF Repurchases+Serv.Chgs.	n.a	n.a	n.a	n.a	n.a	n.a	n.a	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
5. Interest only on ST Debt	n.a	n.a	n.a	n.a	n.a	n.a	n.a	1.3	1.2	1.1	1.0	0.9	0.8	0.7	0.7
6. Total (LT+IMF+ST Int.)	n.a	n.a	n.a	n.a	n.a	n.a	n.a	7.7	7.2	7.9	8.1	8.3	10.1	10.5	11.1
I. Interest Burden Ratios															
1. Total Interest/GDP	0.1	0.2	0.2	0.2	0.2	0.2	0.3	0.5	0.4	0.5	0.6	0.6	0.6	0.6	0.6
2. Total Interest/Exports (a)	1.6	2.1	2.1	2.1	2.0	2.1	2.8	4.0	3.7	4.3	4.4	4.5	4.7	4.9	5.1

(a) Ratio to "Exports" with latter defined to include merchandise, all services and workers remittances.

CHINA - PUBLIC FINANCE, MONEY AND CREDIT

Attachment 3a

	Actual					Prelim.	Growth Rate (% p.a.)		
	1980	1982	1984	1985	1986	1987	1980-84	1985	1986
I. Public Finance (% shares of GDP)									
Government Budget (Level)									
A. Total Current Receipts	..	..	..	..	..		..	..	..
1. Indirect Tax Revenues	..	..	..	..	..		..	..	..
(of which from public sector)	..	..	..	..	..		..	..	..
2. Direct Tax Revenues	..	..	..	..	..		..	..	..
(of which from public sector)	..	..	..	..	..		..	..	..
3. Non-Tax Current Receipts	..	..	..	..	..		..	..	..
(of which from public sector)	..	..	..	..	..		..	..	..
B. Total Current Expenditures	..	..	..	..	..		..	..	..
1. Interest Payments	..	..	..	..	..		..	..	..
2. Subsidies (of prices)	..	..	..	..	..		..	..	..
(of which to public sector)	..	..	..	..	..		..	..	..
3. Other Transfer Payments	..	..	..	..	..		..	..	..
(of which to public sector)	..	..	..	..	..		..	..	..
4. Goods and Services	..	..	..	..	..		..	..	..
C. Current Budget Balance	..	..	..	..	..		..	..	..
D. Capital Receipts	..	..	..	..	..		..	..	..
E. Capital Expenditures	..	..	..	..	..		..	..	..
1. Financial Investments & Grants	..	..	..	..	..		..	..	..
(of which to public sector)	..	..	..	..	..		..	..	..
2. Budgetary Real Investment	..	..	..	..	..		..	..	..
F. Overall Balance Financed by:	-3.0	-0.6	-0.7	0.3	-0.7		..	-148.9	-418.2
1. Official Capital Grants	..	..	..	..	..		..	..	..
2. External Borrowing (net)	..	..	..	..	..		..	..	..
a. disbursements	..	..	..	..	..		..	..	..
b. repayments	..	..	..	..	..		..	..	..
3. Domestic Financing	..	..	..	..	..		..	..	..
a. non-bank borrowing (net)	..	..	..	..	..		..	..	..
b. borrowing from banks	..	..	..	..	..		..	..	..
G. GDP at Current Market Prices (in ___ of LCUs)	429500	503800	676100	830600	938000		..	..	..
II. Money and Credit (Monetary Survey Data from IFS)									
A. In Millions of LCUs at end year:									
Money Supply	114880	148840	251470	336530	421530		20	34	25
Money + Quasi-Money	167110	226570	359850	521280	667690		20	45	28
Total Net Domestic Credit	242250	304670	451450	620210	821550		16	37	32
To Government (net)	820	-560	9490	-9830	5860		..	-198	-163
To Official Entities	..	..	..	..	..		..	..	..
To Private Sector	241430	305230	441960	629540	815690		15	42	30
Net Foreign Assets	-2780	16140	27030	23447	14213		..	..	..
Net Other Assets & Liabilities	-72360	-94240	-118630	-122377	-168073		..	..	..
B. Offsets to Expansion of MQM(%):									
Net Foreign Assets	-3	47	3	-2	-6		..	..	..
Credit to Government	19	7	10	-12	10		..	..	..
Credit to Official Entities	..	..	..	..	..		..	..	..
Credit to Private Sector	109	100	112	116	127		..	..	..
Net Other Assets & Liabilities	-25	-53	-25	-2	-31		..	..	..
Increase in Money + Quasimoney									

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: 7/8/88

NAME	ROOM NO.
Mr. Thierry Baudon	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS:

RE: CHINA CSP - Minutes of OC Meeting

The attached Minutes incorporate the Region's comments. No comments were received from PPR, Finance & Legal.

FROM: Fred Levy Acting Director	ROOM NO.:	EXTENSION: 78058

Eunice,

I delivered the copy to Mr. Baudon's office on Friday. I am leaving this with you, as I may not be here on Monday or maybe the whole next week, and Cheryl will be off on Monday.

Leonor

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: 7/8/88	
NAME		ROOM NO.
r. Thierry Baudon		

RECEIVED
88 JUL -8 PM 3:05
OFFICE OF THE SVPOP

OK
see minor comment on the last page
B
7/11

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
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The World Bank
OPERATIONS COMMITTEE

CONFIDENTIAL

The Operations Committee met on July 1, 1988 to discuss the China-Country Strategy Paper. The meeting was held at 3:00 p.m. in Room E-1243.

A. Attendance

Committee

Messrs. M. Qureshi (Chairman)
S. Fischer (VPDEC)
D. Goldberg (VPLEG)
S. Husain (LACVP)
E. Jaycox (AFRVP)
A. Karaosmanoglu (ASIVP)
W. Thalwitz (EMNVP)
H. Vergin (SVPOP)
J. Wood (VPFPR)

T. Baudon (SVPOP)
P. Cadario (AF3CO)
V. Dubey (EAS)
W. Fleisig (ASIVP)
J. Goldberg (AS3AG)
D. Hanna (FRS)
K. Jay (SPRPA)
F. Levy (EAS)
B. Merghoub (AS3CO)
S. Rajasingham (DFS)
G. Tidrick (AS3CO)
A. Vorkink (LEG)
S. Yusuf (AS3CO)

B. Issues

The discussion followed the agenda prepared by the Economic Advisory Staff. The principal issues concerned economic management and its implications for Bank lending.

C. Discussion

The Region began the discussion with a brief history of the Bank's relationship with China, noting that there is still much to be learned about the country and what needs to be done there. A comprehensive long-term strategy is thus not feasible; rather the Region would continue to learn and to monitor the reforms and the development of the economy as they progress and recommend any consequent needed changes in the Bank's program.

The Chairman commended the brevity of the CSP but indicated that some issues and their implications for the Bank could have been given a fuller discussion. Specifically, he asked to what extent China's macroeconomic management put the progress of its economic reforms and the Bank's own lending program at risk. He noted that inflation was inhibiting more aggressive price reform, which, in turn, was essential to the effectiveness of other elements of reform. Another member of the Committee observed that some "turbulence" was to be expected in China's economic management under the present circumstances and urged that the Bank persuade the Government to allow the resultant inflation to be open rather than to hide it with price subsidies which would only compound the inflationary pressures.

The Region pointed out that China's fiscal deficit was not out of line for a rapidly growing economy, but that, nevertheless, the Government did not have full control of macroeconomic policy. Part of the problem derives from the decentralization of authority over state enterprise revenues and investments to the provincial and local governments without a matching reduction in the expenditure responsibilities of the central government. Moreover, the provincial and local governments often have more influence over the credit decisions of the banking system, including the local branches of the central bank, than do the central authorities. At the same time, state enterprises are still not effectively responsible for their losses, and so their demand for credit is relatively unconstrained. To some extent, the problem is one of political will, and the central authorities have so far not faced the task of taking back some of the power that was previously decentralized. As a consequence of these factors, the money supply has been growing rapidly, and inflation has accelerated. The central authorities can always reinstitute direct controls and slam on the breaks, if need be. That has been their tendency in the face of inflationary pressures in the past, but they are currently more willing to take a calculated risk and go forward with price reforms despite the likely acceleration of inflation. At the same time, they have sought the advice of the Bank and Fund regarding aggregate demand management, recognizing the danger that accelerating inflation could represent. Several major Bank ESW tasks are currently focussing on macroeconomic management issues.

One member expressed concern that the CSP seemed to lack a strategic vision of the sequence and priority of the reform measures that need to be taken in China. Having determined the country to be creditworthy, the paper appears to have adopted a rather passive stance, not using the lending program as way of dealing with strategic issues. He remarked that, given China's very high investment rate and high capital-output ratio, there must be substantial allocation problems to be resolved. The Region pointed out the difficulty of clearly identifying an optimal sequencing of reforms, given the magnitude of the change China has undertaken. The problem is not one of leverage; the Chinese authorities have been unusually open to Bank advice. In general, the Bank has focussed on those reform elements where it had a comparative advantage to offer--e.g., financial sector, agriculture, and enterprise reforms--and has been able to make a wide range of recommendations, many of which are being implemented. The Region also explained that the sequencing decision is not made in a vacuum but depends on the opportunities and demands of a changing economic and political situation. Moreover, there is a need to be cautious in the face of our limited knowledge--it is only in the last 2-3 years that the Bank has been able to do intensive sector work in China--and the great diversity of conditions from one part of the country to another.

The Chairman pointed to a few areas where he thought the Bank might be a bit more active in its advice; viz., the importance of price reform, the need to restore central management to credit expansion, and the rationalization of foreign exchange allocation. He emphasized also the need to push the IMF more actively into the picture. He asked whether debt management was still a problem. The Region indicated that there was still some problem in the coordination and execution of debt policy, with both the People's Bank and the Ministry of Finance claiming competing responsibilities.

The Chairman asked about internal barriers to trade in China and whether market entry continued to be circumscribed. The Region indicated that a major study had been launched on this issue, and that the forthcoming CEM would have several chapters devoted to it. The segmentation of the domestic market is beginning to break down as a result of improving infrastructure and enterprise and price reforms, but it remained a serious problem. The Government's policy to emphasize coastal development conflicted in some respects with internal market integration, and there is no domestic consensus on the issue. The general problem, however, is not one of national laws and policies but rather of local power and tradition. Meanwhile, the Bank is contributing to integration through infrastructure projects and improving local competitive bidding procedures. It was pointed out that the tax system gives local governments the incentive to prevent resources from leaving the locality and new enterprises from entering it. The foreign exchange retention system provides similar incentives. The Bank is working on these issues through ESW and policy advice.

A member remarked that the CSP seemed to promote greater external borrowing by China, and he questioned whether this was wise in view of the institutional and macroeconomic management issues. The country's creditworthiness could deteriorate very quickly. Another member disagreed, however, noting that China was directing borrowed funds to highly productive investments, that it was basically a very conservative country enjoying high rates of growth of output and exports and a high savings rate, leading him to conclude that it is difficult to see a creditworthiness problem. The Chairman agreed that creditworthiness was not an imminent problem, but that the authorities could lose macroeconomic control given their present lack of adequate policy instruments. The CSP therefore needed to give greater attention to the questions of risk analysis, country creditworthiness, and the Bank's options in this regard.

A member noted the paradox that in order for the Bank to remain a small relative creditor, it could be tempted to encourage a country to borrow more from others. He pointed out that holding a small portion of a large debt is not necessarily less risky than holding a larger portion of a smaller debt. Another member added that the Bank's exposure guidelines were not concerned only with the issue of risk but also the concentration of resources in a single country. He argued that high concentration needs to carry with it important developmental implications, and he did not get an impression from the CSP that the proposed Bank lending level was related to any particular development goals. The Region responded that, given China's size, it would necessarily be difficult to demonstrate a major Bank impact on any particular sector of the economy. The lending level is explained chiefly by the fact that China is one of the lowest-income countries in the world, and that it is able to absorb a high volume of resources with very high returns. Moreover, the recent Communist Party Conference made a clear decision to push forward with the economic reforms, and the Government sees Bank lending as offering concrete support to our reform recommendations.

In response to a question regarding which activities would be affected if the total program were to be reduced, the Region described the Bank's lending to China as spread widely across sectors and regions, in a pilot fashion, with the expectation that the Chinese themselves would carry out the repeater operations in other regions. Given the high priority of all the sectors, it is difficult to identify a core program, except on a project-by-project rate of return basis.

A member cited a reference in the CSP to the problem of deteriorating agricultural infrastructure, which he characterized as very worrisome and wondered what is being done about it. The Chairman affirmed that this should be a major aspect of the Bank's work in the agricultural sector. The Region agreed and indicated that the Government had recently asked the Bank to study the problem.

is certainly one

The Chairman summed up the meeting by noting that China is ~~one of~~ xx of the ~~few~~ large member countries where the Bank ~~seems to be~~ playing a major role in influencing Government thinking. He instructed that the CSP be modified with greater focus on the role the Bank has played and will continue to play with regard to the economic reforms. He specifically asked that the sections on debt management and creditworthiness be treated in a more comprehensive fashion, and that a greater sense be given to how the economy's performance will affect the Bank's lending posture and role.

F.D. Levy, EAS
July 8, 1988

Very well articulated plan

Concerns -

sustainability of reform } need to articulate base case + probability & other scenarios

its uncertainty -

a "plea" for investigating "trend" improved assistance but it does not discuss what conditions are likely to take place + how they will be safeguarded by Bank response!!

→ China has become an island of conservatism, whereas before 1988, it was in the forefront of all socialist reforming countries moving towards market

→ the above is likely to create new internal conditions that would change domestic reform agenda -

how does CSP incorporate this - a high case?

Scenarios -

core

base case?

high case?

how MFN affects scenarios - this is likely a signaling change?

ESW program is well-conceived → directed to country needs + relevant to reform process

What would be lending profile in the cases? —

✓ at hardening

blend

✓ burden-sharing / Japan share increasing

✓ adjustment/SECALs? ...

proportions —

✓ blend < IDA/Bank ...

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The Region began the discussion with a brief history of the Bank's relationship with China, noting that there is still much to be learned about the country and what needs to be done there. A comprehensive long-term strategy is thus not feasible; rather the Region would continue to learn and to monitor the reforms and the development of the economy as they progress and recommend any consequent needed changes in the Bank's program.

The Chairman commended the brevity of the CSP but indicated that some issues and their implications for the Bank could have been given a fuller discussion. Specifically, he asked to what extent China's macroeconomic management put the progress of its economic reforms and the Bank's own lending program at risk. He noted that inflation was inhibiting more aggressive price reform, which, in turn, was essential to the effectiveness of other elements of reform. Another member of the Committee observed that some "turbulence" was to be expected in China's economic management under the present circumstances and urged that the Bank persuade the Government to allow the resultant inflation to be open rather than to hide it with price subsidies which would only compound the inflationary pressures.

The Region pointed out that China's fiscal deficit was not out of line for a rapidly growing economy, but that, nevertheless, the Government did not have full control of macroeconomic policy. Part of the problem derives from the decentralization of authority over state enterprise revenues and investments to the provincial and local governments without a matching reduction in the expenditure responsibilities of the central government. Moreover, the provincial and local governments often have more influence over the credit decisions of the banking system, including the local branches of the central bank, than do the central authorities. At the same time, state enterprises are still not effectively responsible for their losses, and so their demand for credit is relatively unconstrained. To some extent, the problem is one of political will, and the central authorities have so far not faced the task of taking back some of the power that was previously decentralized. As a consequence of these factors, the money supply has been growing rapidly, and inflation has accelerated. The central authorities can always reinstitute direct controls and slam on the breaks, if need be. That has been their tendency in the face of inflationary pressures in the past, but they are currently more willing to take a calculated risk and go forward with price reforms despite the likely acceleration of inflation. At the same time, they have sought the advice of the Bank and Fund regarding aggregate demand management, recognizing the danger that accelerating inflation could represent. Several major Bank ESW tasks are currently focussing on macroeconomic management issues.

One member expressed concern that the CSP seemed to lack a strategic vision of the sequence and priority of the reform measures that need to be taken in China. Having determined the country to be creditworthy, the paper appears to have adopted a rather passive stance, not using the lending program as way of dealing with strategic issues. He remarked that, given China's very high investment rate and high capital-output ratio, there must be substantial allocation problems to be resolved. The Region pointed out the difficulty of clearly identifying an optimal sequencing of reforms, given the magnitude of the change China has undertaken. The problem is not one of leverage; the Chinese authorities have been unusually open to Bank advice. In general, the Bank has focussed on those reform elements where it had a comparative advantage to offer--e.g., financial sector, agriculture, and enterprise reforms--and has been able to make a wide range of recommendations, many of which are being implemented. The Region also explained that the sequencing decision is not made in a vacuum but depends on the opportunities and demands of a changing economic and political situation. Moreover, there is a need to be cautious in the face of our limited knowledge--it is only in the last 2-3 years that the Bank has been able to do intensive sector work in China--and the great diversity of conditions from one part of the country to another.

The Chairman pointed to a few areas where he thought the Bank might be a bit more active in its advice; viz., the importance of price reform, the need to restore central management to credit expansion, and the rationalization of foreign exchange allocation. He emphasized also the need to push the IMF more actively into the picture. He asked whether debt management was still a problem. The Region indicated that there was still some problem in the coordination and execution of debt policy, with both the People's Bank and the Ministry of Finance claiming competing responsibilities.

The Chairman asked about internal barriers to trade in China and whether market entry continued to be circumscribed. The Region indicated that a major study had been launched on this issue, and that the forthcoming CEM would have several chapters devoted to it. The segmentation of the domestic market is beginning to break down as a result of improving infrastructure and enterprise and price reforms, but it remained a serious problem. The Government's policy to emphasize coastal development conflicted in some respects with internal market integration, and there is no domestic consensus on the issue. The general problem, however, is not one of national laws and policies but rather of local power and tradition. Meanwhile, the Bank is contributing to integration through infrastructure projects and improving local competitive bidding procedures. It was pointed out that the tax system gives local governments the incentive to prevent resources from leaving the locality and new enterprises from entering it. The foreign exchange retention system provides similar incentives. The Bank is working on these issues through ESW and policy advice.

A member remarked that the CSP seemed to promote greater external borrowing by China, and he questioned whether this was wise in view of the institutional and macroeconomic management issues. The country's creditworthiness could deteriorate very quickly. Another member disagreed, however, noting that China was directing borrowed funds to highly productive investments, that it was basically a very conservative country enjoying high rates of growth of output and exports and a high savings rate, leading him to conclude that it is difficult to see a creditworthiness problem. The Chairman agreed that creditworthiness was not an imminent problem, but that the authorities could lose macroeconomic control given their present lack of adequate policy instruments. The CSP therefore needed to give greater attention to the questions of risk analysis, country creditworthiness, and the Bank's options in this regard.

A member noted the paradox that in order for the Bank to remain a small relative creditor, it could be tempted to encourage a country to borrow more from others. He pointed out that holding a small portion of a large debt is not necessarily less risky than holding a larger portion of a smaller debt. Another member added that the Bank's exposure guidelines were not concerned only with the issue of risk but also the concentration of resources in a single country. He argued that high concentration needs to carry with it important developmental implications, and he did not get an impression from the CSP that the proposed Bank lending level was related to any particular development goals. The Region responded that, given China's size, it would necessarily be difficult to demonstrate a major Bank impact on any particular sector of the economy. The lending level is explained chiefly by the fact that China is one of the lowest-income countries in the world, and that it is able to absorb a high volume of resources with very high returns. Moreover, the recent Communist Party Conference made a clear decision to push forward with the economic reforms, and the Government sees Bank lending as offering concrete support to our reform recommendations.

In response to a question regarding which activities would be affected if the total program were to be reduced, the Region described the Bank's lending to China as spread widely across sectors and regions, in a pilot fashion, with the expectation that the Chinese themselves would carry out the repeater operations in other regions. Given the high priority of all the sectors, it is difficult to identify a core program, except on a project-by-project rate of return basis.

A member cited a reference in the CSP to the problem of deteriorating agricultural infrastructure, which he characterized as very worrisome and wondered what is being done about it. The Chairman affirmed that this should be a major aspect of the Bank's work in the agricultural sector. The Region agreed and indicated that the Government had recently asked the Bank to study the problem.

The Chairman summed up the meeting by noting that China is certainly one of the large member countries where the Bank is playing a major role in influencing Government thinking. He instructed that the CSP be modified with greater focus on the role the Bank has played and will continue to play with regard to the economic reforms. He specifically asked that the sections on debt management and creditworthiness be treated in a more comprehensive fashion, and that a greater sense be given to how the economy's performance will affect the Bank's lending posture and role.

F.D. Levy, EAS
July 13, 1988

Mr. Dubey cc: FL

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 30, 1988

TO: Mr. Stanley Fischer, VPDEC
THROUGH: Robert Liebenthal, Chief, SPRPA
FROM: Keith Jay, SPRPA

EXTENSION: 34799

SUBJECT: China CSP

The agenda proposed by Mr. Dubey (paras. 5, 6, 7) and Steve Webb's note highlight two interrelated questions: (a) what are the dangers that macroeconomic management in such areas as money and credit growth, debt management and fiscal deficits/subsidies will remain weak; and (b) what are the implications of continued uncertainty in this area for both the reform process particularly price liberalization and the Bank's program? As para. 22 of the CSP notes "with only rudimentary economic management tools, there is a significant danger of stop-go cycles". This suggests that Bank support for macroeconomic adjustment should be "self-regulating"; i.e., that SECALs should only proceed when macroeconomic issues are being appropriately addressed.

There are four additional issues:

-- A substantial Bank lending program in China is both appropriate and desirable as long as the policy and macro environment remain favorable. It is also important that the Bank's program in China remain top quality. The CSP calls for an extremely rapid expansion in the Bank's program to $3 billion a year. Is there a danger of quality slippage with such a rapid buildup? Recognizing that financing itself is not a crucial constraint for China, what effect would a less rapid buildup have on the overall impact and contribution of the Bank to China's development?

-- If the level of uncertainty concerning the reform process and macro environment is indeed high, would it be desirable, as hinted at in the first para. 9 agenda question, to have an alternative or core lending program? What conditions would trigger a change in the program?

-- The CSP calls for an increased use of SECALs (approximately 13% of the program). Throughout the CSP where these SECALs are discussed it is suggested that procedures and features will have to be adopted to China's "unique" conditions. (The impression is given that this could mean having no conditionality or tranching as in the recent rural sector loan). The recent Board discussion of that loan indicated substantial Board uneasiness with this position. What specific aspects of China's position warrant a different approach to policy-based lending? (See the second question of para. 9 of the agenda.)

-- The CSP reports that the Chinese are lukewarm toward cofinancing and that the existing donor/China relationships provide little opportunity for its use. This absence of cofinancing opportunities seems to be an implicit argument for a larger Bank lending program. While recognizing the current situation and the difficulties involved, is the potential that limited and is there more that can be done to encourage more cofinancing?

cc: Messrs. Hopper, Rajagopalan, Baneth, Churchill, Holsen, Picciotto, Piddington, Pouliquen, Shakow, Vyas, Willoughby, Dubey, Pfeffermann, Steer, Vergin, Burki, Merghoub, Tidrick
Mss. Hamilton, Haug

KJay:rm

BB 226 - China

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 28, 1988

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

Dubey

EXT: 78051

SUBJECT: China - Country Strategy Paper - Agenda

1. The Operations Committee will meet on Friday, July 1, 1988, at 3:00 p.m., in Room E-1243 to consider the China CSP. The Committee may wish to discuss the issues outlined in paragraphs 5-10 below.

Background

2. Ten years ago, China embarked upon an far-reaching program of reforms, aimed at decentralizing economic decision making away from the central administration and toward farm households, enterprise managers, and provincial and local governments. Resource allocation decisions have increasingly responded to market forces in place of administrative command and fixed prices, and material incentives are rapidly supplanting strict egalitarianism. The reforms were introduced first and have proceeded the fastest in the rural economy, with the result of substantial shifts in land use and explosive growth of rural industries. Reforms have been slower and more uneven in the bureaucratically, politically, and technically more complicated urban industrial sector. Nevertheless, the multiplication and diversification of financial instruments and institutions and of service enterprises generally, the gradual commercialization of housing, cautious steps toward allowing greater labor mobility, the introduction of a bankruptcy law, active debate over property rights, etc. all attest to the dynamism of the reform process.

3. The growth of output over the decade has been unusually rapid. Investment rates have remained very high, financed in part by credit expansion and increased foreign borrowing. Indeed, increasing concern has been expressed over growing inflationary pressures and the apparent difficulty of constraining domestic credit, external borrowing, and the level of investment during the present incomplete state of reforms. Although substantial price adjustments and liberalization have occurred, crucial actions on this front continue to be inhibited both by the resistance of the potentially injured parties and by the fear of setting off a cost-price spiral in the absence of effective monetary control.

4. In the meantime, an unusually close and active policy dialogue has evolved between the Chinese authorities and the Bank, placing particularly heavy demands on Bank staff for high quality economic and sector work, the orchestration and, in some cases, the direct management of broad-ranging technical assistance, as well as a large and fast growing lending program.

Issues

Economic Management

5. Inflation has accelerated in recent years partly as a result of rapid monetary expansion, which may reflect in turn the continuing weakness of the People's Bank vis a vis central, provincial and local government spending authorities. Also contributing to inflationary pressures are a growing budget deficit, including the food and other subsidies the Government has felt compelled to provide to consumers rather than pass on the increases in producer prices. Views within the Government seem to differ now on the urgency of curbing inflation and on the degree to which other reforms, especially price reforms, must await progress against inflation. The Region may wish to comment on:

- The current "state of play". Does the Government have a clear understanding of these issues and a coherent strategy for dealing them?

- The prospects, therefore, for aggregate demand management over the next few years and the implications for the progress of reforms more generally. Specifically, does it make sense for China to proceed with trade and financial sector liberalization before further substantial progress is made in macroeconomic management and price reform?

- The status of demand management issues in our policy dialogue with China. What progress has been made in these areas under the Fund Stand-by?

- The assumption that reforms at the sectoral level (and, hence, Bank sector lending) can be effective in a context of weak macroeconomic management?

6. Although China's external debt and creditworthiness indicators remain strong, debt has grown rapidly in recent years, and concern has been expressed by the international agencies and others with regard to the decentralization of borrowing authority and incompleteness of debt data available to the authorities. Meanwhile, responsibility for debt management has been contested between the People's Bank and the Ministry of Finance.

- What progress is being made in external debt management? Has the issue of authority over the formulation, execution, and monitoring of external debt policy been satisfactorily resolved?

7. Integration of China's vast domestic market is important to creating a competitive environment, taking advantage of regional comparative advantages, and thus raising the efficiency of the industrial sector. However, the Central Government's policy of creating foreign trade zones seems to run counter to this objective. At the same time, provincial and local governments have erected barriers to trade to protect their own industries and assure them cheap raw material supplies.

- What is the nature of the Bank's dialogue with the authorities on this issue? Is policy conditionality in this regard called for in proposed lending in the industrial sector and to provincial governments? At a minimum, what will be done to assure that our operations do not contribute to market segmentation?

8. The CSP stresses the importance of maintaining China's relatively generous social security system. Its funding will have to change radically, however, as a prerequisite of enterprise reforms and increased labor mobility. Moreover, the current one-child policy and its impact on the age profile of the population have important implications for the future finances of the present or any successor system.

- What are the implications of the economic reforms for the quality of the social safety net in China?

- What must be done to prevent social security from becoming a major fiscal burden?

- What are the implications for the one-child policy, and of any changes in the latter on other social expenditures?

Bank Strategy

9. The CSP proposes a rapid growth of the Bank's exposure in China over the next several years, noting that the country will remain creditworthy, provided that economic reforms are continued and macroeconomic stability is maintained. Neither of these assumptions, however, is assured. The Region may want to clarify:

- How the size and composition of the proposed lending program would be modified in the event that the reforms falter or proceed more slowly than presently foreseen, and/or macroeconomic management weakens. Has the Region defined a "core" program?

- The kinds of conditionalities expected to apply to the various elements of the lending program, and how they are to be handled in the China situation. What is meant by the CSP's reference to adapting "SECAL procedures and features to China's unique conditions, but in a way that does not compromise their applicability to other borrowers or in future situations with China" (para. 33)?

10. China's demand for technical assistance is large and growing, and the Bank has been playing a central role in orchestrating and finding grant funding for various technical assistance activities. The Region proposes to add a new technical assistance unit to the China Department as a focal point for these activities.

- Is this a proper role for the Bank to play? What are the pros and cons of the Bank staffing such an effort, in contrast, say, to UNDP, or to using a loan vehicle such as the recent special credit to strengthen China's own capabilities in this regard?

cc: Messrs. Lee, Shakow, Holsen, Rao, Burmester/Thahane, Liebenthal, Steer, Baudon, Hopper, Bock, Goldberg, Frank, Parmar, Pfeffermann, Baneth, Aguirre-Sacasa, Tanaka, Robless, Burki, Merghoub, Tidrick, Cadario, Ms. Haug

F. Levy, EAS

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE June 23, 1988

TO Operations Committee

FROM Vinod Dubey, Director, EAS V Dubey

EXTENSION 78051

SUBJECT China: Country Strategy Paper

The Operations Committee will meet on Friday, July 1, 1988 at 3:00 p.m. in Room E-1243 to discuss the China Country Strategy Paper. An Agenda will be issued shortly.

cc: Messrs. Lee, Shakow, Holsen, Rao, Burmester/Thahane, Liebenthal, Steer, Baudon, Hopper, Bock, Goldberg, Frank, Parmar, Pfefferman, Baneth, Aguirre-Sacasa, Robless, Burki, Anderson, Tanaka, Ms. Haug

P-1866

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 16, 1988

TO: Mr. Moeen A. Qureshi, Senior Vice Present, SVPOP, and Chairman, Operations Committee

FROM: Attila Karaosmanoglu, Regional Vice President, ASI

EXTENSION: 72283

SUBJECT: CHINA - Country Strategy Paper

Please find the attached China Country Strategy Paper for review by the Operations Committee. Paragraphs 7 and 9 summarize our proposals for increased resource allocation to the China lending and ESW programs.

K. Jay
Rajagopalan
Yusuf
Merghoub
Karaosmanoglu

Attachment

cc: Messrs. Edward V.K. Jaycox (AFRVP), W. P. Thalwitz (EMNVP), S. Shahid Husain (LACVP), D. Joseph Wood (VPFPR), ~~I.F. Shihata~~ (VPLEG), V. ~~Rajagopalan~~ (VPPRE), H. Vergin (SVPOP), Ducksoo Lee (CODDR), V. Dubey (3)(EAS), O. ~~Yenal~~, M. Wiehen, B. Gouveia, Ms. L. Schaeffer (ASIVP), A. Golan (ASTDR), K. Ahmed (ASICA), K. Inakage (VPCOF), A. Shakow (4)(SPR), S. Fischer (VPEDC), J. Holsen (CEC), Mrs. A. Hamilton (PHR), J. Warford (ENV), V. Vyas (AGR), A. Churchill (IEN), L. Pouliquen (INU), D.C. Rao (2)(FRS), C. Willoughby (EDI), K. Ahmed (LOAAS), S. Burmester, T. Thahane (SEC), R. Liebenthal (SPRPA), A. Steer (FRS), T. Baudon (SVPOP), A. Vorkink (LEG), R. Picciotto (PBD),

Fischer

Goldberg

Fleisig

Tidrick
Baudon
Fleisig

For Information:

Messrs. D. Hopper (SVPPR), D. Bock (DFS), D. Goldberg (VPLEG), R. Frank (CIO), J. Parmar, G. Pfeffermann (CEI), J. Baneth (IEC), F. Aguirre-Sacasa (EXT), Ms. M. Haug (EXC), C. Robless (OPNMS).

China Management Group

RNAnderson:hk

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CHINA

Country Strategy Paper

A. Summary and Conclusions

1. Almost ten years have passed since China's 11th Party Congress took the landmark decision to "readjust and restructure" the economy. Armed with this mandate, China's leaders embarked on a far-reaching program of administrative decentralization and market-mediated development. The macroeconomic scorecard from these reforms is positive, though not unambiguously so: GNP has increased at an average of 10 percent annually, supported by China's success at finding overseas markets for its exports of petroleum, raw materials, textiles and intermediate products and, more recently, for its machinery; private savings have proven extraordinarily responsive to rising incomes; investment has been strong, averaging 38 percent of GDP in recent years; end-1987 foreign exchange reserves exceeded six months of imports; and the debt situation is comfortable.

2. The commitment of China's leaders to far-reaching reforms in all aspects of the Chinese economy, to create "socialism with Chinese characteristics" is not in question. The reforms are complex, interrelated and in many cases politically difficult however, and challenge the leadership to improve China's macroeconomic management and to mobilize public support. While reforms in rural areas since 1979 have been quite spectacular in their impact, the more difficult areas of urban enterprise and price reform have proven more problematic. It is difficult to disentangle the price and management aspects of industrial reform, and eventually these will lead to more difficult issues with social and political implications, including labor mobility and performance-based remuneration which will further widen income disparities. For these reforms to be successful, the authorities need to maintain macroeconomic stability, but both inflation and budget deficits pose short-term problems which need to be controlled while more complicated reforms aimed at improving economic efficiency proceed. Policies will also need to ensure that China's social security system, the envy of many countries at higher income levels, is maintained and, as incomes and public expectations rise, costs are kept affordable.

Is this really feasible & desirable?

3. Our dialogue with China is well-engaged on these reforms. China's leaders remain keen to discuss sweeping, general issues, and seek the Bank's advice on many issues of institutional reform. Despite this candid and open relationship, however, we are not often asked to incorporate the actions to implement this advice into specific lending operations. There has been progress on a number of operational issues, including prices and on-lending rates, in the context of specific operations, but we have not encountered great willingness to use project lending to advance reform agendas with broader implications. Price distortions remain a fact of life, and it is difficult to say over the next five years how quickly they will be removed, and thus how soon we will be able to move to usual Bank approaches to financial covenants, pricing and subsidies. **We propose to continue the pragmatic, project-by-project approach that has established the credibility of our advice on the wider implications of these issues, while working through economic work on three main areas: enterprise and price reforms, and liberalization of the foreign exchange system; the improvement of which could simplify and improve design of Bank projects and China's investments in general** (para. 54).

mac management?

4. The increasing sophistication of China's requests to the Bank challenges us to provide timely and state-of-the-art advice, as China seeks to acquire the latest in modern technology and thereby achieve middle-income status as soon as possible in the next century. This is likely to be a staff-intensive effort for the Bank, with only limited possibilities for economies, making additional resources an absolute prerequisite. Our efforts will include improving the efficiency of project preparation, and speeding up of procurement and disbursements. To introduce more predictability to the annual lending and ESW programs, the authorities have accepted our proposal to agree with them annually on three-year pipelines of ESW tasks and lending operations. These programs will be targeted on priority macroeconomic and investment issues that are recognized as obstacles to balanced growth and economic efficiency. More explicit linkages between lending and our ESW program represent a shift from our past practice of the "parallel tracks" approach separating project work from economic dialogue. This change is timely, and reflects progress achieved over the years in the policy dialogue with Government and China's growing openness to advice, particularly from the Bank, and the realization that investments are most efficient when accompanied by pricing and management reforms.

contradicts para. 3?

5. Both China and the Bank will use the experience of the first Rural Sector Adjustment Loan, which was prepared and negotiated in FY88, to test the applicability of broader "conditionalities" and policy-based lending to our relationship with China, consistent with bridging the earlier gap between broad policy dialogue and projects (para. 3). Hence, five of the 74 operations proposed for FY88-92 would be policy-based (three in agriculture, one for forestry and one for finance). Taken together they would represent less than 13 percent of total lending. Work proceeds in other sectors to introduce more policy content to our project lending, a feature considered virtually impossible in many of our early operations. The receptivity of China to our advice is growing as the links between our ESW and lending program are becoming more apparent, and our work program over the next several fiscal years includes ESW tasks whose lending potential is explicit from the initiation of the work. In the urban sector in particular there is great opportunity to establish the urban management, finance and planning context for needed physical investments in transport, housing and water supply/sewerage.

6. The substantial additional investment of Bank staff time this shift implies is amply justified by China's own considerable efforts to modernize its economy as soon as possible, the role it plays on the international scene, and the intellectual and political significance for the Bank to be involved in this major exercise. While there is some risk that investment loans with greater policy content may be delayed or drop from the lending program, we believe that China's willingness to seek policy advice is clear and encouraging, and that policy-based lending for agriculture (including forestry) and financial reforms will become more prominent in our program. In light of the experience with RSAL, we would need to adapt other SECAL procedures and features to China's unique conditions, but in a way that does not compromise their applicability to other borrowers or in future situations with China. Our major focus will remain, however, on traditional project lending, in which the Bank's contribution to investment quality through attention to management and pricing issues is well recognized, even in sectors where difficult reforms will need to be approached gradually.

7. To pursue this strategy in China, **we propose to expand the number of projects from the 14 delivered in FY88 and 14 planned in FY89 to 16 per year, starting in FY90 and to increase the FY88-92 level of lending by $1.0 billion (from the already approved $10.9 billion to $11.9 billion)** (Attachment 1).

8. Doubling the level of lending between FY87 and FY98 and increasing the number of FY88-92 operations from the 68 authorized in February 1988 to the 74 proposed, thereby accumulating a portfolio of around 80 projects by 1990 and around 95 by 1992, calls for increased resources for the China Department. With modest increases in our supporting ESW program, **we recommend that the resources for the China Department be increased by 8 staffyears by FY90, and another 5 staffyears by FY92.** We shall work to reduce lending coefficients by insisting that the Bank be involved earlier in project design, with more preparation work undertaken by Chinese agencies and consultants working for them. Provincial lending should also allow efficiencies through better project design and earlier Bank involvement (para. 36). With the addition of a resident economist, RMC has a strengthened base for undertaking more on-the-spot economic work. **Within the additional staffyears provided, we propose to add one more headquarters higher level staff member to provide a full complement of counterparts to the SODs, and two to four more locally-recruited staff, to support the level of project work that we foresee.**

9. Because the Chinese remain lukewarm toward cofinancing, given what we expect will be the increasingly sensitive areas on which our input will be sought, there are unfortunately few possibilities for sharing lending program development with other official or private lenders (para. 52). The possibilities are also somewhat limited for extensive farming out of this advice to "free" sources. This should increase our recourse to specialized outside consultants, and we plan to redouble our efforts to get China to accept more Bank financing for technical assistance and use bilateral grant TA for Bank-financed investments. **We propose that part of the additional staffyear allocation be used to create in the China Department COD a position to coordinate technical assistance, including the EDI program and bilateral collaboration for TA under Bank projects** (para. 56).

10. Cost Sharing. **We propose that the current cost-sharing guidelines be continued**; namely, the Bank group would finance the higher of the full amount of the foreign exchange cost, or 50 percent of total project cost, but in exceptional cases involving mostly the social sectors in poor areas, the IBRD/IDA share could be up to 75 percent or the foreign exchange cost, whichever is higher.

11. Bank Exposure. Even with current account deficits on the order of 1.5 percent of GDP over the medium term, China's overall level of external indebtedness will remain low, reaching less than 13 percent of GDP in 1995. Debt service, too, will remain well within prudent limits. The debt service ratio (including short-term) is projected to increase gradually to 11 percent by 1995, below the 15 percent the Chinese government seems to regard as an upper limit. If annual World Bank lending reaches $3 billion by the early- to mid-1990s, and preferred creditors' share in public debt service rises from below 13 percent in 1987 to around 40 percent by 1995, China would exceed the Bank's exposure guideline of 33 percent by 1993. However, as China turns increasingly to debt with longer maturities, and to commercial sources, such past commitments will be reflected in its debt outstanding so that the share of preferred

creditors in total debt will fall gradually during the 1990s. Moreover, we expect that China's liberal policies on foreign direct investment will attract more capital from private sources. Although future policy-based operations (of which five are planned for the FY89-92 period) need not be quick disbursing, this exposure issue will need to be followed, particularly if the China's balance of payments situation, which we project will continue to show strong export performance and moderate, though contained growth of imports, does not develop as predicted (para. 53). **We propose that the exposure issue should receive special attention at the next CSP review, which we recommend be held in mid-CY90.**

B. Background and Historical Perspective

12. Almost ten years have passed since the landmark decision to "readjust and restructure" the economy. Armed with this mandate, China's leaders embarked on a far-reaching program of administrative decentralization and market-mediated development. The impact of the reforms under way since 1979 has been most pronounced in the rural sector, which provides the main livelihood of over 800 million people. The introduction of the Household Responsibility System, dismantling of communes, and greater separation at the local level of political decision-making from economic management have profoundly restructured rural economic activity. Land use rights were progressively transferred to farm households. Pricing and markets were increasingly liberalized, and the policy environment adopted encourages decentralized management in the rural sectors of secondary and tertiary industries. The result has been an explosion of growth first in agricultural output (10 percent p.a. from 1979 to 1984) and then in rural manufacturing and services (22 percent annually). Perhaps the most significant achievement, however, has been the massive shift from 1979 to 1987 of 80 million farm workers to non-farm activities, services and autonomous production units larger than the family farm. In parallel, agriculture has been revitalized by a rapid expansion since 1980 of cash cropping, non-staple food production and agricultural foreign trade. The reforms--and three successive years of good weather--not only yielded record grain harvests, but also made China a net exporter of foodstuffs for the first time in history.

? 13. By 1984, the reservoir of rural opportunities that could be tapped through liberalization and price stimuli had been largely exhausted. At this point Chinese policymakers began to tackle the more difficult hurdle of extending the reforms to the urban-based industrial sector. With profit incentives, enterprise autonomy and the dismantling of some price controls, they hoped to coax forth dynamism comparable to that which had transformed the rural economy. They found, however, that each round of liberalization also triggered an upwelling of investment, with a consequent strain on the balance of payments, and that repressed consumer demand backed by sizeable and increasing household savings became a threat to both price stability and the trade balance. By 1985, controls had to be imposed to rein in the trade deficit, which had swelled largely through imports of consumer goods and equipment.

lack of monetary control

14. The very success of first-phase reforms, particularly in the rural sector where performance exceeded expectations, has introduced second-generation problems that the authorities are now moving to address. Ahead loom more difficult issues. The problem of unemployment will arise as market-driven productivity increasingly challenges the pervasive and long-standing

overstaffing in factories, farms and state agencies. For consumption levels to rise, fewer resources should be absorbed by investment and more diverted to satisfying the wants of the people. Recent high rates of growth could be sustained with investment levels closer to 30 percent of GNP, comparable to other East Asian NICs whose higher productivity and export performance China would like to emulate. Crucial to China's leaders, public expectations about the continued success of economic reforms make the second phase of reforms particularly important. The leaders' promises of the rewards of the reform process have raised hopes of immediate benefits; the risk of overselling policies whose impact is not yet clear and the backlash of public opinion if things do not turn out as promised are real concerns to the Government and the Party.

15. The October 1987 13th Party Congress formally recognized the importance of political reform "to build a socialist political system with a high degree of democracy and a complete set of laws" as a corequisite for continuing the economic reforms, now under way for nearly a decade. Announced economic policies of greater outward orientation, decontrol and deregulation of the economy, price reform and use of indirect levers instead of direct administrative controls and mandatory planning offer a sound blueprint for economic success. Markets for technology, finance, and most significantly, labor, are to be introduced. Various forms of ownership and rewards are to be permitted, though with state ownership remaining predominant. The Party Congress gave these measures a political context that not only offers legitimacy to the reform efforts, but also guarantees reformers some freedom from ideological harassment.

16. China's leaders will have to mobilize public political support around these goals. Efforts to improve enterprise reform and managerial responsibility are complicated, but need not be problematic if they are properly formulated and carried out; improving the performance of China's inefficient public administration will be more difficult to conceive and implement. Reorganization of the civil service will likely prove traumatic given the size of the bureaucracy, and could be disruptive in the short term to public administration and China's relations with its external partners, including the Bank. The April 1988 National People's Congress ratified the reform process, amending China's constitution to allow private transactions in land leases and other private sector activities. In the longer term, however, sustaining the pace of reform may prove challenging, since many of the reforms ultimately needed for greater responsibility and efficiency may not be seen as consistent with China's socialist principles, despite their appeal to vast segments of China's population.

17. China's Relations with the Bank. A superpower with important geopolitical and internal considerations to weigh in its major decisions, China is selective about the advice it seeks from the outside. Since the change in China's representation in the Bank in 1980, China's leaders have looked to the Bank for advice on the reform process, as well as for increasing levels of investment finance. China has used us as a window on international experience. The economic and sector work program concentrated initially on "megastudies", integrated views of the macroeconomy or large sectors, moving lately to focus more on sectoral and subsectoral issues. The leaders generally concurred with the Bank's analysis and the reports' policy prescriptions, and looked to the Bank to help implement them. China sought Bank financing to remove bottlenecks and acquire the best of available technology.

18. Overall, this approach was successful. Areas where the Bank's role can be identified include the deepening of rural reforms, the diversification of the financial system, trade reforms that are under way, and the move away from reliance on enterprises for funding social security. The State Council has recently concluded that the Bank's technical contribution to investment projects is the major success of the Bank's lending activities. With agreement on the general policy directions, collaboration on the detailed design of reform policies will become more important if they are to be successfully implemented. The areas are frequently more sensitive, and requests for advice are becoming more specific. As Party General Secretary Zhao Ziyang and Premier Li Peng recently confirmed to Mr. Conable, China continues to expect the Bank to make a strong intellectual contribution to its reform effort, and associates us openly with the process.

19. "Debottlenecking" is still important, and is reflected in China's emphasis in its borrowing for transport and energy. But lending content has shifted, to include institutional questions, pricing issues, and technical assistance to improve planning, policy analysis and management. The quality, timeliness and operational practicality of advice through the ESW program have become more important to link the ESW program to support lending operations, particularly the larger ones and those where a sectoral or policy flavor is more pronounced in support of the reforms.

20. <u>China's Relations with Other Financing Sources</u>. China's dialogue with the IMF has deepened steadily over the years, with a Stand-by Agreement approved for 1986-87. The Fund has worked closely with the Bank, collaborating on many ESW tasks, and we look to the IMF for assistance on technical assistance for improving macroeconomic management, central banking and the financial sector reforms. China has also launched active programs with Japan (Exim Bank and OECF) and has joined the Asian Development Bank. ADB plans a program of around $500 million per year, and we have already had contacts with ADB staff over possible cooperation in future investment projects. For reasons explained below, cofinancing prospects with official lenders are slim. Foreign banks seem to be broadening their contacts beyond the Bank of China, the country's traditional bank for foreign trade, and the China International Trade and Investment Corporation (CITIC), a state body which also provides sovereign guarantees. Their activities now include some loans to provincial trade and investment corporations, generally in coastal provinces, where export and repayment prospects are most secure.

C. <u>Central Development Issues and Policy Agenda</u>

21. <u>The Path Ahead</u>. China's leaders are committed to reform nearly every aspect of China's economy. But these reforms are complicated--especially price reform, recognized as key to the success of the overall reform effort--administratively difficult (enterprise reform), and politically sensitive (reform of wages, government structures and the civil service). They are interlinked. Because of the hyperinflation of the 1940s, China's leaders and citizens alike are extremely sensitive to inflation. Proponents of reform therefore argue that in order not to discredit the whole reform process, further steps in price reform must await progress in macroeconomic stabilization. Reformers also argue that further progress on enterprise reform must accompany, if not precede, price reform, and that some other reforms will be delayed. It would be unwise, for example, to unify tax rates across sectors until product

Got different versions of sequencing from different sources. Now seem to be saying that inflation is okay.

Do we agree? & these [illegible] dangers.

prices are rationalized. But in each area of reform there are some changes which can take place independently of price reform. This is particularly true in the financial and rural sectors, but even in areas such as external trade, China is going ahead with important changes, including expanding direct trading and foreign exchange retention rights in certain sectors.

Prospects?

22. Progress so far has been mixed. If efforts begun in late 1987 to contain 1988 credit growth (and thus public investment) to a level below the 1987 IMF benchmark of 18 percent are successful, and the newly-enacted enterprise law succeeds at making state-owned enterprises more accountable for their losses, the preconditions the authorities consider necessary for a major initiative on price reform should be established. Overall, however, maintaining macroeconomic stability is essential as enterprise and price reforms proceed. But with only rudimentary economic management tools, there is a significant danger of stop-go cycles. Thus although China's commitment to carrying out these reforms is not in doubt, the pace is open to question, owing to decision-makers' preoccupation with two areas of macroeconomic concern: inflation and the budgetary deficit.

23. Inflationary pressures first became noticeable in 1985 with the official retail price index climbing nearly 9 percent and free market prices rising by over 17 percent. The increase in prices slowed during 1986, but last year the tempo quickened again, approaching the 1985 levels. The persistence of inflation can be traced to a number of factors. Repressed demand, backed up by substantial accumulated savings, is very large. Because supplies of quality consumer goods are not growing at a sufficient pace and imports have been restricted, prices are pushed upward in the more liberal environment. Demand switching from scarce consumer goods to foodstuffs, supplies of which have also increased slowly in the past two years, has spread inflation through rural markets. Demand pull has been reinforced by rising labor costs that have far outstripped productivity gains. Monetary policy, attempting to smooth the decentralization process and maintain investment momentum, has also contributed to the price spiral. Total credit grew by 33 percent in 1986 and by over 30 percent in 1987. Since the last quarter of 1987, the authorities have sought to stem credit growth. They are also proceeding cautiously with further efforts at price reform, for fear that inflation might worsen. The danger is that price controls may aggravate supply shortages of foodstuffs and consumer goods, rapid growth of which is necessary to help solve the problem of inflation. And while slowing credit growth will be necessary to dampen inflation, a credit crunch could cause widespread hardship in the enterprise sector, sapping industrial momentum and damaging the often tenuous financial health of collective and state firms alike.

Why? [illegible] Why?

But [illegible] intent to hold down I!

That's the nature of monetary policy

Isn't that the point!

24. Although sequenced to avoid overstraining the administrative apparatus and exceeding the economy's absorptive capacity, the reforms have also led to budgetary stresses. By raising purchase prices without affecting the rates at which goods are sold to consumers, partial price reform has resulted in an escalation of subsidies to enterprises and consumers (accounting for about 30 percent of the budget in 1987). Whereas enterprise earnings used to be the major source of state revenues, industrial reforms permitting greater profit retention by firms have reduced flows into the treasury. This has yet to be counterbalanced by revenues from new indirect and income taxes introduced during 1986-87. The problems faced by many enterprises in adapting to the new environment have also reduced their incomes and hence, tax payments to the state. Finally, revenues have been affected by curbs on the imports of dutiable consumer goods, which were introduced to narrow the trade gap.

25. After dropping to 0.5 percent of GDP in 1985, the budget deficit has risen in each of the last two years, reaching 2.7 percent of GDP by 1987. One third of this was financed through foreign borrowing, the balance by the banking system and the sale of bonds. The budget for 1988 projects a deficit of about 3 percent of GDP. The Government will need to control the drain from subsidies and loss-making enterprises. On the revenue side, it has to refine the tax instruments that have been brought into use so as to increase and stabilize revenues. A number of alternatives are being considered to increase fiscal maneuverability, and these along with improved enterprise performance made possible by the reforms should gradually narrow the gap. A budgetary deficit of between 2-3 percent of GDP is consistent with sound macromanagement so long as it does not generate a serious resource imbalance or precipitate a loss of monetary control. Neither of these is an imminent threat. Despite China's having exceeded the benchmarks for 1987 agreed under the 1986-87 Stand-by Arrangement, the IMF Article IV consultation mission that visited China in November 1987 was broadly supportive of the Government's approach to macroeconomic policy, economic reforms and foreign borrowing.

Sure?

26. Realizing their ambitious targets, in which material incentives are a key component of economic growth, challenges China to improve economic management. Price and fiscal reforms are necessary to create appropriate market signals and to support the state sector. In enterprises, incentives to overinvest need to be reduced through appropriate interest rate and credit policy, while wages and bonuses need to be linked to productivity. Substantial gains are possible if China continues to pursue increased factor efficiency. In addition to reducing energy intensity and raw material utilization in industry, other issues that need to be addressed include more efficient use of foreign technology, greater productivity of labor in the state sector, and better use of the education system to develop China's human capital. Principles of enterprise management need to encourage innovation and productivity, rather than investment and meeting production targets with little regard for quality and the marketplace. China will also be challenged to improve national economic integration, both to benefit from possibilities domestic markets offer for efficiency, and to see that all regions of the country share in this overall growth. Policies will therefore also need to ensure that China's social security system, the envy of many countries at significantly higher income levels, is maintained. With fiscal reform, this would also help contain regional disparities, already substantial between the rich eastern provinces where the benefits of trade and price reforms have been impressive, and the isolated interior areas where resource constraints seriously limit their economic options. The push for foreign trade has exacerbated existing trends for regional economic independence with little regard to comparative advantage, economies of scale, and the possibilities for internal exchange. The inability of transport and energy infrastructure to keep up with growth in demand has enhanced these tendencies.

Is all this being done? Message here is confused. How all this different from last CSP? Non sequitur.

Seem to be moving opposite directions

27. China will also need to put some discipline into the decentralized system of investment planning and enterprise control. Since the transfer in 1984 of management of many previously state-run enterprises to provincial and local governments, along with partial authority for price controls, physical allocation of materials and foreign trade, the creation of multiple levels of control has brought some confusion into the economy. Local interests have restricted movement of raw materials and finished products within China and complicated efforts to maintain economic balance at the national level. The

How confident is the Region that the Chinese leadership has a coherent reform strategy, that we are in essential agreement with that strategy, and that they are capable of carrying it out?

proliferation of administrative controls to enforce or relax regulations has allowed the emergence of special interests that might result in influence peddling and corruption.

How?

28. Carefully designed and well-implemented institutional reform in enterprises and local authorities would help resist this trend and provide the necessary dynamism to the overall reform process. The approaches China is adopting embody the best of modern technology, changes in management and decisionmaking at the enterprise level, and decentralization to provincial and local governments. Increasingly, they rely on prices to improve economic efficiency, by moving toward a hybrid system with state ownership predominant. Yet in the context of China's socialist political system, with its high premium on social goods and maintaining a visibly egalitarian income distribution, some of these changes could induce political tensions: from the public, which is accustomed to stability and a protective government, and from the civil service and enterprise bureaucracies, which have grown used to their present shares of power and influence.

D. Macroeconomic Prospects, Creditworthiness and External Capital Requirements

29. Medium-term Prospects. Over the medium term, we expect China to continue a high rate of GDP growth, around 7-8 percent annually, with exports growing at around 8 percent. To maintain these levels of growth, efforts to promote exports of agricultural products, textiles and machinery will have to be successful. Continuing reforms in the external sector, and especially the gradual shift from import licencing toward use of the exchange rate and demand management policies, are expected to lead to increased imports. After a bigger initial increase, imports are therefore projected to grow at slightly more than 10 percent annually, split between increased imports of capital goods essential for China's modernization program, and additional consumer goods needed to provide households' incentives. A small but sustainable current account deficit is likely to persist. Appropriate interest rate and credit policies are expected to contribute to a modest fall in investment from 39 percent of GDP to 36 percent, while the increased supply of consumer goods from domestic firms and through imports will lead to a decline in gross domestic savings from 39 to 34 percent of GDP. This medium term outlook is consistent with China's stated external borrowing policy, under which China intends to borrow US$5-7 billion annually.

Inflation?

Tautology?

30. China would continue to remain creditworthy provided the economic reform thrust was maintained and the external payments position remains sustainable. The current account balance swung from a $7.5 billion deficit in 1986 to a small surplus in 1987, largely due to a continued surge in exports; this strong growth is expected to continue. If China moves away from a balanced trade posture toward a major reopening of its markets to imports, China's current account deficit could rise to $6.3 billion in 1989 to almost $12 billion by 1995, with a corresponding rise in financing requirements. The overall level of external indebtedness would rise from $25 billion currently to $83 billion, equivalent to 101 percent of projected 1995 exports. Despite the rapid build-up of debt, China's debt service ratio would remain low, rising from 8.3 percent currently to 11 percent by 1995. This import liberalization scenario and the rapid rise in external financing requirements are subject to considerable uncertainty. If China were to move more slowly on economic reform and implement a conservative growth and balance of payments strategy, it might run only minimal current account deficits, averaging around $700-800 million annually. In this case, net financing requirements would be much lower.

What constraints? exports? what assumed about exchange rate & etc. regime?

E. Bank Assistance Strategy

31. The Bank's objectives in China are:

a) to support China's reforms (especially price, finance, trade and enterprise reforms; wages, employment, social services and management; and handle their institution-building implications);

b) to help address the problems reforms are likely to create (poverty, environment, regional disparities and economic integration);

c) to strengthen infrastructure, including in urban areas; and

d) to rationalize and modernize the productive sectors.

Expanding levels of lending to this unique client calls for us to reinforce the policy dialogue and its links to lending, but suggests the need for flexibility as we move to develop new lending instruments.

32. Risks to the Reform Agenda. China's social and economic experiments and reforms may raise internal tensions, both direct (inflation) and indirect (ideological). These will be mitigated by their substantial economic benefits, to which China's leadership will be able to point as Party and civil service reforms proceed in parallel. We expect that the progress on reform will be on the whole satisfactory. China may however face macroeconomic instability both domestically and in its balance of payments if it fails to get a better grip on macroeconomic management. Although the reforms are complex and politically sensitive, it is unlikely that ideological and political tensions could trigger widespread reversals of those already under way, and a subsequent restraint in exchanges with the outside world, including the Bank. More likely, the open door policy will continue to prevail because of the economic results achieved from system reform, and cooperation with the Bank will further increase in terms of policy advice and total borrowing. Even with the $8.1 billion IBRD levels proposed, China does not present any major creditworthiness risk, and despite higher levels of Bank exposure in the late 1990s, China's overall low level of debt and debt service leave the Bank in a safe position.

what's Bank's role here?

33. Of great political importance to China's leaders, we expect that policy-based lending will further enrich our dialogue over major reforms, since it allows us greater involvement in policy design and monitoring than dialogue and technical assistance alone can in China. Policy-based lending in China is unlikely to follow conventional Bank approaches, given that China's reformers normally test new policies before generalizing them nationwide; it is therefore unlikely that traditional "conditionalities" and tranching would be practical. In light of the experience with RSAL, we would need to adapt other SECAL procedures and features to China's unique conditions, but in a way that does not compromise their applicability to other borrowers or in future situations with China. Because the instrument is new for China, and because of the contribution we can make through conventional lending, the FY88-92 program would include only five policy-based operations, representing less than 13 percent of total lending.

34. A diverse and expanded program of lending and ESW would best respond to the challenge to the Bank to make a major contribution to China's development. China wants expanded collaboration with the Bank over global reforms in agriculture, finance and prices, and financing for priority sectors--transport, irrigation and energy--with key pricing, institutional and investment quality issues. There are excellent possibilities for expanded cooperation with willing provincial borrowers as well as opportunities for introducing new, efficiency improving instruments (sector and timeslice lending). Provincial urban, transport and industrial operations could help revitalize Shanghai, China's economically most powerful city. This approach implies an increase in ESW resources to back up sector lending and policy-based operations and analyze provincial economies. Detailed policy and institutional engineering will broaden the impact of our advice to new clients within China; consequently, resources will be needed to expand the pipeline, and to supervise the expanding portfolio. Larger operations will be possible (transport, energy, irrigation, urban) once these new instruments are understood with new partners in the provinces and other agencies at the national level, but emphasis on larger repeater operations would not be fully consistent with China's apparent wish to see us diversify our support for the reforms. Efficiencies should be possible however, if provincial lending allows continuous relationships with provincial planners and thus improves project design. This assumes that efforts on the Chinese side to improve macromanagement and project management and design are successful. Savings should also be possible if we can introduce sector and timeslice lending for infrastructure, and, as Chinese capabilities develop, innovative approaches to procurement, such as higher limits for ICB and Bank review of documents and decisions.

35. Building on our experience in China with traditional project lending--emphasis on which will continue--sector lending would be a cost-effective way to reinforce the dialogue, build working relationships and obtain feedback from experience in lending and sector work. We therefore plan more intensive efforts to combine dialogue on sector issues with support for priority investments. These would remove infrastructural bottlenecks and reorient urban and social sector programs to take more account of planning, cost effectiveness and management issues. As long as economic management remains weak, we will need to focus on the details of sector reforms (finance, social security) and pricing and institutional issues with our major clients (railways, transport, power, urban).

Can sector reforms be effective in a context of weak macro-economic management?

36. Responding to decentralization of planning responsibility and investment decisions, we will also experiment with provincial lending. Reflecting the new political and administrative realities of China, a continuous as well as direct Bank relationship with provinces should result in better predictability on project timing. Work with provincial sector agencies and planners should increase the efficiency of our project preparation, our ability to influence project design much enhanced by becoming involved further upstream. Work has begun with Jiangsu and Shanghai. As we develop confidence in overall provincial investment programs and build up planning abilities, timeslice operations would allow increased project size. Design of provincial projects would take into account national economic priorities and sector strategies.

with no conditionality on market integration, what will be done to assure we don't contribute to segmentation?

Sector Strategies

37. Overview. Our lending will continue to support the reform priorities and investments identified by the Government in the Seventh Five Year Plan. Despite some cooling of public investment in response to the acceleration of inflation in CY87, China's investment needs remain large. We expect to achieve annual lending of $2 billion in FY89, and higher levels thereafter, reaching around $3 billion during the Eighth Plan (after 1991). Even at these expanded levels, the Bank's contribution is small relative to China's investment program. Consequently, our operations will attempt to tackle issues of sector investment priorities, technology transfer and modernization, technical assistance and institutional development. By the end of FY89, work will be nearing completion on three provincial operations, which are designed to get us involved earlier in project design and help provinces develop their new planning and investment responsibilities. Supporting government efforts to develop transport and energy will remain our first priority. Difficulties of access and shortages remain serious constraints to capacity utilization throughout the economy, and China plans sustained investment. There is substantial room for improving efficiency both through improved pricing and use of market mechanisms, and through wider introduction of new technologies. Involvement in industry will continue, with a diversification from the direct support for large industries which we supported in the past to collaboration with provincial industrial agencies. New operations with China Investment Bank will continue our important institution-building role, but in the broader context of the imminent expansion of competition in the financial sector. With the Government's interest in accelerating the pace of rural reforms, we will continue our considerable efforts on agriculture. Our lending in health, education and urban will reach a level of at least three projects per year in FY89 and beyond, reflecting increased Government interest in the Bank's advice on resolving policy issues in these sectors. We plan to coordinate our approaches in the various transport, industrial, urban and water projects under discussion with Shanghai, so as to help one of the world's largest cities, a key player in China's reforms, modernize and cope with growth in China's dynamic coastal zone.

38. Agriculture and Rural Development. Agriculture and rural development remains one of the main sources of growth in the Chinese economy. The sustainability of recent production gains is in question, owing to deterioration of agricultural infrastructure, and uncertainty over the legal and institutional framework in which future agricultural development should take place. Past lending has given us a sufficiently wide understanding of the sector to identify issues and priorities for future operations. A first Rural Sector Adjustment Loan supports the launch of a second phase of rural reforms: new land use, consolidation and land tenure arrangements, deregulation of product prices and elimination of input subsidies, and increased incentives to export of high-value crops rather than grain production for local self-sufficiency. Unfortunately, traditional project proposals still tend toward relatively small multi-component operations focussing on quick-return, export-oriented activities. The selection process, motivated by immediate economic concerns over dropping production levels, has been strongly influenced by considerations related to the foreign exchange system (para. 20) and production of marketable surpluses in food deficit areas.

what is our assessment of the grain situation and prospects?

39. The agricultural lending program would include: (i) land and water resource conservation and development, principally through interregional and on-farm water management and development; (ii) sectoral lending for forestry to help resolve extreme shortages of wood products and promote environmental protection; (iii) support services for agricultural research, education, extension and improved national seed production, slow maturing and less showy than area development projects but important if production gains are to be sustained, productivity increased, and agricultural technologies improved; (iv) provincial multi-component operations, taking into account domestic as well as foreign market possibilities, expansion of rural, off-farm employment, and poverty alleviation in poor areas; (v) further agricultural credit lending, if continuing efforts are successful at strengthening rural credit institutions. Although provincial projects are likely to get most of the government's attention, and indeed offer much potential, we shall aim at a balanced program in which they fit well into a national context which includes national-level support services projects, including water conservancy and forestry. If the first RSAL is successful, we plan a series of policy-based operations every two years in support of the rural reforms as they are implemented. Since investments in the rural sector should be a focal point of both China's plans, and the Bank's lending, a pipeline of three-four projects per year, including agricultural credit and sector adjustment operations in alternate years, would represent around 25 percent of lending volume.

40. Industry and Finance. Operations since FY83 have established an important relationship with China Investment Bank and provided direct lending for fertilizer, machine tools, pharmaceuticals and phosphates. Studies on finance and investment, external trade, and enterprise reform were well received by the highest levels of the Party and the Government, and parts are being implemented. For reasons parallel to those discussed above under the rural sector, expansion of Bank lending for industry has been hampered. As well, surplus commodity issues make large Bank operations for heavy industry with national developmental priorities and immense domestic markets (iron and steel and non-ferrous metals) problematic, despite the potential for Bank involvement to help efforts to reform prices, improve efficiency and upgrade technology.

41. While at the national level we will continue dialogue on industrial sector and subsector policies, we plan to focus on helping provincial industry agencies work out the specifics of enterprise reforms and their own changing responsibilities. Establishing direct relationships with a number of provinces to develop provincial industrial operations could have strong multiplier and demonstration effects. Early experience suggests that the Bank can make a contribution to subsectoral restructuring and technology transfer, improving efforts to promote exports through greater emphasis on quality and marketing, and developing local support institutions. This would encourage local adoption of policy measures already supported at the national level through our ESW program. Bank involvement in the Structural Change exercise, under which Chinese agencies are preparing industrial strategy documents for key subsectors, will help develop an intellectual framework for the integration of now fragmented strategy questions. We are also exploring options for the Bank to play a role in improving the access of non-state industry to formal financial markets and other institutionalized services, including the State Science and Technology Commission's SPARK program, a new channel for credit and support to rural industry. Although there seems to be adequate commercial and bilateral finance for telecommunications development, we plan to explore the Government's interest in

advice on sector planning and management, crucial if China is to have the communications networks necessary to support national economic integration and greater openness to the outside world.

42. Lending in the <u>financial sector</u>, building on the completed ESW on foreign trade and investment, will focus on the evolving financial sector reforms. The financial system is only rudimentary at all levels, and the policy environment is weak. Our experience has underlined the need for greater independence for financial institutions, more competition, and better oversight by the central bank. Work will be needed both on the regulatory institutions and on the banks and other financial agents that are emerging, particularly the "informal" financial instruments and intermediaries in rural areas, operating with approaches to market rates, competition and risk the Government has so far been reluctant to introduce throughout the financial sector. Discussions have begun on a financial sector operation. It would include technical assistance and material support both to the monetary authorities (in collaboration with the Fund) and to selected developing banking institutions. A strong network of financial institutions would reinforce policies to move to market mechanisms and move away from administrative control of the economy. As the Government's intentions become clear on the role of the six new sector investment corporations, likely to play an important role in financing public investments, we shall assess their technical assistance requirements and the Bank's role in their development.

43. In summary, our approach would be a combination of: (i) highly focussed sector work on areas where the economic payoffs to China through technological adaptation, management improvements and regional economic specialization are likely to be high; (ii) dialogue with the central policy-setting bodies on substantive issues such as pricing, trade policy and the climate for private investment, which the industrial ministries and the provincial industrial bureaus have been unable to discuss concretely, supported by policy-based operations if the pace of reforms warrants; (iii) lending to provinces with industrial development programs in subsectors with national priority; and (iv) support for CIB and other financial intermediaries who develop the capacity to appraise industrial projects within overall policies and pricing practices that we find acceptable. Backed up by a strong program of sector work on both national issues and strategic subsectors, and a strong policy dialogue over price reform and financial sector development, we plan three-four projects per year, representing about 20 percent of the lending program, for industry and finance. This would include large loans every two years to CIB and other financial intermediaries, and a series of financial sector development operations if the dialogue is productive.

44. <u>Infrastructure</u>. Rapid growth in demand for energy and transport resulting from the reforms is stretching physical and operational limits, leading to a huge unsatisfied demand in China. Past projects have increased capacity in transport and energy sectors and helped the Ministry of Railways and the Ministry of Water Resources and Electric Power make modest starts on improving their planning and management. The Bank has also helped improve port facilities and management, alleviating one of the bottlenecks to foreign trade. Dialogue on broad sectoral issues is lagging on transport, although well engaged for electric power planning and pricing. This is due to the Government's past reluctance to allow extensive sector work and to the fragmentation of responsibilities between central agencies and local authorities.

45. In **transport**, continuing shortages of capacity imply very high economic returns to further investments in rail, road and water transport, while returns on civil aviation--a new sector for the Bank--would likely be even higher. The Bank's greatest contribution, however, would lie in helping examine long-term strategic options in developing the transport system and associated spatial location of economic activities. At all levels, there is a need to utilize existing capacity better, take advantage of new transport technologies and fully understand how to move toward a more efficient balance among competing modes and introduce integrated intermodal services. We plan to support transport management training and the development of applied research on policy issues and transport technology. The new provincial lending instruments are well-suited to transport: we have proposed, for example, a multi-modal transport study for the Shanghai Economic Zone. In railways and aviation, a central perspective is needed, however, and sector lending will be the preferred instrument. The Ministry of Finance has asked that work begin on sector lending for railways. Civil aviation will initially be addressed through a small sector survey.

46. In **energy**, the impact of unmet demand on industrial efficiency and capacity utilization gives the highest priority to the power subsector. The good working relationship established with all levels of the Ministry of Water Resources and Electric Power, now the Ministry of Energy, and their openness to policy advice augurs well for expanded lending in spite of the reshuffle of responsibility. Efforts to strengthen power institutions and policies for planning, pricing, organization and management will continue. Bank sector work and lending should help China move toward power companies and regulatory models that have a good track record elsewhere and avoid the proliferation of small, suboptimal power projects. Future lending will focus on strengthening the regional grids with large projects and on accelerating subsector investment to eliminate shortages by the end of the century. Priority goes to generation and transmission investments: eventually a sector approach would be appropriate to promote tariff reforms and regional integration. The Bank will continue to mobilize resources needed for technical assistance for the economic, environmental and resettlement aspects of the giant Three Gorges Project. The coal industry is of paramount importance to the energy sector on its own right and because of its strong linkages with power and transport projects. The Bank's operations will deal primarily with these linkages and on measures to improve efficiency of coal use and reduce environmental pollution. In the oil and gas subsector, we would focus on natural gas development operations where the Bank has a comparative advantage on topics of policy formulation, regional planning and coordination between gas producers and end users.

47. For transport and energy, we plan to focus on institutional issues, and in particular the inherent risk of inefficiencies in planning, operations and pricing for natural monopolies with economies of scale. The integration of the two sectors in the China Department will permit a closer look at their linkages, primarily on the issues of coal transport and railway capacity bottlenecks. While large projects beyond FY90 cannot be firmed up until the Eighth Plan is known, discussions continue on project concepts and proposals, we plan to devote about one-third of the lending program to these sectors. and sector lending would be feasible and cost-effective for both.

48. The Urban Sector. Reflecting years of relative neglect, the need is pressing for policy reforms in housing and the financing of public services, and for investment to modernize China's expanding cities. With the reforms, expansion of services and labor-intensive, light industrial production have boosted demand for labor and led to relatively large rises in urban incomes. Increased affluence, combined with public commitment to provide services at standards well above those expected from low income countries, have aggravated pressures on urban health and education facilities. Among the issues China will need to address are: (i) poor resource mobilization and financial management practices, an inadequate revenue base and weak tax administration, all growing out of distortions in prices of goods and services delivered to urban consumers; (ii) inadequate urban infrastructure, and the need to invest to remedy past neglect and catch up with growth-driven demand; (iii) poorly articulated planning, insufficient attention to priorities, budget forecasts and recurrent cost implications, and mounting levels of subsidies for urban services; (iv) uncontrolled urban sprawl and environmental mismanagement; and (v) growing inequality of access to services.

49. We are preparing operations to help translate China's market-oriented model into action on urban issues. They would encourage expanded local responsibility for urban management and financing, accelerate investment in higher-return urban projects, promote more efficient financial intermediation, and pay more attention to environmental problems. This approach includes: more intensive dialogue with the center on finance and tax issues; concentration on the three provincial municipalities (Shanghai, Tianjin and Beijing) which would guarantee visibility for this approach and lending and sector work in areas most affected by rapid rural industrialization, medium-sized cities and new towns, which may be more replicable. Urban projects will be broad-based, rather than concentrated only on water or transport improvements. They would include components to develop planning methodology, improve municipal management and planning, and improve cost recovery. In addition to taking advantage of the organization of AS3PW to integrate health and education components, we will also address environmental and architectural concerns. Sector work will be the principal vehicle for a thorough review of municipal finance and urban financial management, including resource mobilization by local governments. Housing finance shows great potential for developing a major domestic industry without recourse to subsidies. Translating this strategy into lending operations will aim at at least one urban project of about $150 million per year.

50. Education. Following the disarray in education brought about by the Cultural Revolution, four IDA projects have assisted the top priority of reestablishing universities as centers of excellence. The 1985 Education Reform calls for universalizing primary education and strengthening technical and vocational education, and for devolving financial, planning and managerial responsibility for these levels to the provinces. Despite its strong project implementation capacity, the State Education Commission has proved vulnerable to local and provincial pressures to focus on equipment purchase, a narrow view of technology transfer. Following a reevaluation of our approach to support for education, we are diversifying our program to include direct support to provinces, as well as national projects. Our initial work in Gansu has shown that efforts at the provincial level allow more direct Bank involvement, with policy makers as well as professional staff of the educational bureaus. Sector work on planning and finance in two provinces (Jiangsu and Guizhou) will improve our knowledge base for future provincial lending. A project to strengthen research capacity

in science and technology would continue the national focus of prior years, but with greater attention to policy content and institution building. We expect to broaden our policy dialogue at the national level, addressing such issues as the internal efficiency of schooling, more efficient and imaginative civil works planning, design and execution, and better justification and procedures for selecting teaching equipment. Sector work will examine training for the services sector, a new and burgeoning employment area. As government reorganization and reform of enterprise management proceed, we will respond to requests for assistance for programs to train civil servants and enterprise managers.

51. Health. China's past successes in largely eradicating infectious diseases have dramatically increased life expectancy, now at 69 years. Simultaneous reductions in fertility through its family planning program have fundamentally altered its demographic structure. China now needs to refine its health care strategy with greater attention to prevention of chronic diseases, reduction of occupational and environmental hazards and provision of effective emergency care, along with continued emphasis on infectious disease control in rural and poor areas. Cost-consciousness has so far not been a preoccupation. Current and future demands for health care cannot conceivably be met without better coordinated, efficient management of all parts of the health system. Alternative strategies such as preventive services, health education and non-institutional programs can address these problems, and at lower cost. We plan to help build consensus in China for a more financially sustainable approach, including better planning and financial management in health care institutions and national and provincial health bureaus; better use of health system infrastructure; reforms of health insurance programs; and new systems of emergency care, rehabilitative medicine and medical education. Few of the Bank's other borrowers face these problems in health care, and will need such approaches to redirect redirect health investments away from high technology, imports and capital formation toward prevention, appropriate local technologies, and improved efficiency and recurrent cost funding: these are complicated issues which have proved difficult even in advanced countries. Future projects should also address remaining health problems in China's poor areas. Lending would be expanded to a $100-150 million project in alternate years.

52. Cofinancing. China' internal organization does not facilitate cofinancing operations: the Bank, by far the largest donor, works with the Ministry of Finance; Asian Development Bank, much smaller and a newcomer, works with People's Bank of China (the central bank); and the Ministry of Foreign Economic Relations and Trade manages financial relations with Japan. Bilateral programs, generally, less than $50 million per year, aim at smallish projects with reasonable visibility. UNDP has worked closely with the Bank on a number of technical assistance operations, including project preparation, but also has a dispersed program of generally small operations. In addition to these administrative obstacles, the Bank now faces a perception in China that our funds are relatively expensive compared to other sources, particularly the Japanese banks and official agencies, and while there is scope for involving other donors in specific operations, there is also the risk that the Bank would do most of the preparation and appraisal work, while having only a marginal role in the financing package. Our main cofinancing efforts will focus on mobilizing grant technical assistance for project preparation and implementation, a growing need in the industrial sector and one for which both Ministry of Finance and implementing agencies have shown some resistance to borrowing IBRD funds.

53. Bank Exposure. Under a liberalized import scenario, IBRD's share of net public lending would average 20 percent through 1995. Including IDA, the Bank's Group's share of net flows would amount to about one-third of total public net flows. This burden sharing outlook, in which the Bank plays a large role, depends on a rapid rise in total external borrowing requirements predicated on the growing current account deficits associated with an opening up of the economy. If China were to follow a more conservative strategy, combined IBRD and IDA lending at the levels proposed would cover virtually all of the borrowing requirement: this would be inappropriate from a risk management point of view and would probably lead to a scaling down of China's resource requests from the Bank. Under the import liberalization strategy, Bank exposure rises in the outer years of the projection period. The Bank's share of public debt would double to 15.2 percent by 1995 and the share of public debt service would grow to 19.6 percent. Preferred creditors' share in public debt service would rise from 15.7 percent in 1987 to 38.8 percent by 1995; with this dilution of preferred creditor status, China would break through the Bank's exposure guideline in this regard by 1993. The share of China in the Bank's portfolio would rise from 1.6 percent at the end of December 1987 to 7 percent by 1995. These extremely rapid increases in Bank exposure would be justified both by China's low overall indebtedness and by the Bank's support for a strong reform policy effort. Depending on the overall level of Bank lending in the 1990s, and in particular the date at which lending rises to $3 billion, by the year 2000 China could reach 10 percent of the Bank's portfolio.

Fall back in event of slower reforms &/or poorer macro managt?

54. Operational Issues. Short-term action on a number of operational questions would make higher levels of lending in support of our objectives easier to achieve. The concept of market-based onlending and relending rates is gradually being accepted. With agreement with MOF on principles that should guide onlending of Bank resources, we will continue our dialogue with the goal of improving domestic resource mobilization by eliminating subsidization of capital expenditures with interest rates. On pricing, we will provide intellectual support for price reform and analysis of its impact, through dialogue with the central agencies, as well as continued effort through projects in transport and energy, sectors where resolution of pricing questions is central to action throughout the economy. Following a successful effort to improve procurement by introducing ICB, we shall try to ensure that LCB can also be fairer, more efficient and open to suppliers throughout China. Foreign exchange allocation and pricing has tended to bias project selection and location, and gives rise to inefficiencies in project design. In agriculture and industry, the Government's project proposals have often been strongly influenced by considerations related to equipment procurement, export development and repayment ability of the project entity in foreign exchange, with a consequent focus on relatively prosperous eastern China and on export-oriented investments. A lasting solution awaits reform of exchange controls and establishment of foreign exchange markets. We shall continue to seek improvements to the system, and prevent distortions in investment and pricing decisions, while using provincial lending as one way to reduce temptations to balance foreign exchange earning and repayment on a project basis. Disbursement performance has waned over the past few fiscal years, with the rapid growth of the portfolio. We intend to address this problem in future projects by closer supervision of projects with disbursement lags and review with Government general disbursement performance at the next Country Implementation Review in fall 1988.

55. Institutional questions may give rise to short-term disruption in our operations while the reorganization proceeds in the central administration. We intend to adapt to the new structures of government, focussing dialogue with central agencies on essential support to important macroeconomic reforms, while accepting increasing decentralization of investment decisions to provinces and local bodies as a growing feature of our lending work. The quality of Bank advice is important, but there is also the need to develop Chinese planners and managers, more and more in the provinces as well. To meet these needs in a cost-effective manner, the China Department has already taken several important steps. In December 1987, we agreed with the Government on a three-year rolling ESW program (Attachment 2), which gives greater predictability to the timing and content of the ESW tasks. A free-standing TA project was approved in FY87, with the objectives of both strengthening the planning process and financing important study inputs to the Eighth Five Year Plan. We have also diversified our partners in the task of policy analysis. Our collaborators now include agencies at the State Council level, and academic and research organizations. Each year, we mount high-level policy seminars and symposia for senior policy makers and political leaders. As many of these bodies have responsibilities for both policy setting and implementation, collaboration with them supports our efforts to expand lending to China. One area of note, on which continued Bank/Fund collaboration will be essential, is external debt management: the creation of a single agency in MOF should improve overall management and we stand ready to offer technical assistance.

Now resolved?

56. The need for technical assistance in China is large and growing. Already, the Bank has committed considerable resources through our past lending (around $500 million, including three free-standing TA projects), collaboration with UNDP, an active EDI program partially financed with UNDP resources, TA linked with our ESW program, and study/training visits to Bank headquarters. As China proceeds with the next critical phase of reform, demand for technical assistance is growing and far exceeds available resources, even to manage activities funded by other sources. We plan to focus on four areas: institutional development in the core agencies of economic management; planning support to the central line ministries and city governments; support for key training institutes, through EDI and project work; and continued seminars, symposia and study tours on issues of primary interest to government (such as enterprise reform and management, taxation, technology transfer and social security). We intend to use training components of upcoming operations to support the network of training institutions which are working with EDI, thus reinforcing EDI's links to operational work in the China Department. For EDI costs, whose financing through loan/credit proceeds is not permitted, which cannot be financed through EDI's budget, we shall seek UNDP or bilateral funding, along the lines of the current UNDP-supported EDI program. We shall devote more attention to design of technical assistance and training components, both to provide more effective support to the implementing agencies, and to better justify its cost. Following an internal review which we have just completed, **if resources permit a new TA unit in the China Department will be the focal point for coordinating technical assistance design issues, for relations with EDI and for identifying cost-effective sources of financing for training and consultants.** The Ministry of Finance has established its own technical assistance unit to systematize China's approach to Bank-financed technical assistance and identify the most cost-effective sources, including bilateral funding for project-related technical assistance.

57. Poverty Issues. Because of the perception that China has been more successful at meeting basic human needs and (with rare exceptions) preventing famine, than in putting together an efficient, dynamic economic system, the Bank's attention has focussed on incentives, markets and better flows of resources rather than on distributional and poverty issues. China has made impressive progress in reducing absolute poverty: with strong economic growth, there has been strong commitment to improving standards of education, nutrition and health for all. Over the last 10 years, the number of absolute poor has declined dramatically from an estimated 200 million to about 70 million today. Apart from the aged, this group consists largely of unskilled people living in resource-poor areas where prospects for increasing incomes are limited. The current Five Year Plan allocates about $1 billion annually to combat the problems of the very poor. The impact of this funding could be enhanced by fundamental institutional and policy changes including allowing increased labor mobility within and between regions. A broadened approach to poverty along these lines would also be effective against a potential new problem in poverty control: the emergence of "new poor" or those who, existing now at the margin, might lose out in the competitive, market-oriented environment brought about by the reforms. Although Government policies did not appear to be impeding women's participation in development, past Bank projects have been designed to reinforce China's maternal and health system and improve the quality of health and education services and access of women and children to them. As a more market-based system takes hold in China, potential problem areas include employment, resettlement and access of women to land and credit. Enterprise reforms may lead to changes in how social services, particularly health care, housing and pensions, are provided. New ESW tasks and the design and supervision of projects will accordingly be more sensitive to the potential and intended impact, particularly on women. We have sharpened the poverty focus in our ESW and lending. Economic work prior to provincial lending to poorer areas (including another study of a poor province, possibly Guizhou) and a study of rural employment (already accepted in the three-year ESW program) would have a poverty dimension. Appropriately targeted operations could then address the needs of the identified poor in rural areas.

58. The Environment. Environmental issues are receiving increasing attention in China as developmental pressures on natural resources and on air and water quality grow each year. China has established comprehensive and strict pollution guidelines, including environmental assessments for most public investments. The overall impact of the price reforms on environmental policies and practice is unclear. The lack of market prices for water and land have accelerated conversion of suburban farm land to urban uses and excessive tapping of groundwater. Given the volume and high quality of China's coal, it is the obvious energy alternative. But its extensive (and underpriced) use for heating and cooking, and heavy reliance on thermal power generation, have polluted the air of China's cities. The explosive and unplanned growth of rural industry has also been a major factor in water, soil and air pollution. In general, until price reform is completed, neither pollution fees or fines nor administrative regulations are likely to carry sufficient force to encourage treatment of industrial wastes and emissions, or to reduce worker exposure to unhealthy occupational environments. Decision-makers tend to see technology policy as the key to improving environmental standards, but it may not be as effective a mechanism as raising the price paid by users of energy to something approaching its real cost. An upcoming ESW task will examine the environmental implications of development in Jiangsu Province, a candidate for provincial lending.

Mr. Pohl
→ [initials]

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 8, 1988

TO: Files

FROM: Paul M. Cadario, Acting Chief, AS3CO [initials: PMC]

EXTENSION: 72059

SUBJECT: CHINA: Country Strategy Paper -- RVP Review

1. Mr. Karaosmanoglu chaired a meeting on May 26 to discuss the draft CSP, which was circulated under cover of a memorandum of May 19 from Mr. Burki. Present at the meeting were Messrs. Yenal, Wiehen, Kikuchi (ASIVP), Pohl (EAS), Golan (AST), Vorkink (LEGAS), Liebenthal (SPRPA), Rao (FRS), Kupasrimonkol, Gaspar (IFC), Webb (CECMG), Ms. Mann (VPDEC), Burki, Merghoub, Stern, Tidrick, Ecevit, Goldberg, Montfort, Ahmad, Lim and I (AS3). The meeting followed the agenda proposed in Mr. Yenal's May 25 memorandum to Mr. Karaosmanoglu.

2. Format of the Paper. It was agreed that AS3 would reorganize the paper along the lines and in the format suggested in draft OMS 1.12. In particular adding an opening Summary and Conclusions would allow some questions to be handled there, rather than making extensive revisions to the text.

3. Policy Agenda. In response to a concern that the paper might give rather too high prominence to short-term issues of inflation and the budgetary deficit, AS3 staff pointed out that this responded to comments made at the Working Level Review, where some had felt that these short-term issues had been downplayed. This emphasis reflected the preoccupations of Chinese policymakers, that stabilization had to precede growth. They did not, perhaps, view tax reform as important as we did; we hoped, therefore, that the tax/expenditure mission now in the field would be able to raise the visibility of this issue. It was agreed that price reform was the first priority, despite its being the most difficult, but that it was difficult to disentangle price reform from enterprise reform.

4. Bank Strategy. It was agreed that the objectives would be slightly reformulated along the lines suggested in Mr. Yenal's memorandum, with the addition of our wish to help cope with the problems that the reforms were likely to provoke (poverty, environment, regional disparities). Institution building would be explicitly mentioned in this section. Mr. Karaosmanoglu asked that a statement of the nature of the dialogue with China be added, pointing out the leaders' keen interest in discussing sweeping, general issues, and getting institutional advice, but not being able to tie this dialogue to specific operations. China's vast difference from other countries should be highlighted.

5. Size of Lending Program. It was pointed out that the lending program was significantly higher than the one that had been approved in February, 1987, based on the Bank's resource constraints available for operations, and portfolio considerations. Mr. Burki noted that the February scenario had not been our preferred one, and that the November, 1987 version prepared by AS3 was very close to the one in Mr. Vergin's paper. AS3 had

indicated the implications of fewer operations on the lending program, and had been able to deliver in FY88 nearly $75 million more IBRD lending than the earlier scenarios, hardening, incidentally, the IBRD/IDA blend. While hardening the blend was not an objective by itself, it was nonetheless a goal we had agreed with the Chinese, and the level of IBRD lending had risen steadily. The assumptions in the paper forecast a rather slower increase in the outer years. Mr. Golan noted that the complexity of projects in China was increasing, with more components in each project as lending increased. If the number of operations were increasing, the dollar targets seemed to be being met by more complicated projects: he wondered whether the Chinese had the administrative ability to manage them. In response, it was pointed out that the multicomponent projects had good execution and disbursement performance, since the executing agencies generally had made good arrangements for quick project launch and smooth implementation. Provincial lending should further improve project implementation performance. Execution and disbursement lags had arisen in projects where there had been resistance to ICB. It was agreed that the implications of limiting the program to the February scenario should be briefly described in the CSP, and that the case for going above the 14 projects delivered in FY88 should be more explicit.

6. Bank Exposure. Mr. Rao noted that Bank exposure would rise rapidly in the 1990s, and by 1995 would exceed the 15% guideline given the large proportion of preferred creditors. The exposure calculations should be extended to the late 1990s, and to the extent possible tests run on the impact of balance of payments volatility on the ratios under discussion. It was agreed that the CSP discussion would reflect the note recently agreed between AS3 and FRS. Others felt that in the case of China, the Bank's exposure guidelines were very poor indicators of country risk. China borrowed very prudently in the past, and took great care in its borrowing. China had a low debt service ratio during the entire projection period, and there were significant benefits from an expanding lending program to such a responsive and willing borrower, as the CSP pointed out. Some felt that the guidelines did not adequately take into account China's success at mobilizing direct foreign investment, although China's actual record implementing such investments was mixed. The high proportion of Bank borrowing raised issues of burdensharing, however, and the CSP should discuss this issue, and mention China's coolness toward cofinancing. It was also felt that the discussion of policy-based lending should draw a distinction between quick-disbursing operations and others with more protracted disbursements.

7. Operational Issues. Although some operational issues are discussed, the CSP should indicate the progress we expect on such matters as the foreign exchange allocation system and on-lending rates. The persistence of price distortions should be acknowledged, and the impact on project design, dialogue on prices, accounting, etc. Mr. Karaosmanoglu wondered whether CIB was ready for a $400 million operation in FY89, having demonstrated willingness to accept further detailed improvements in their management. It was noted that CIB was changing very rapidly to develop new products, and adapt their management style and operations to these changes.

Cleared with and cc: Messrs. Burki, Yenal, Tidrick, Merghoub

cc: Meeting participants, AS3CO staff, Mr. Pearce

PMCadario:hk

THE WORLD BANK INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 20, 1988

TO: Distribution

FROM: Shahid Javed Burki, Director, AS3 SJ

EXTENSION: 72571

SUBJECT: CHINA Country Strategy Paper -- RVP Review

Mr. Karaosmanoglu will chair a review meeting for the China Country Strategy Paper on Thursday, May 26, at 10:30 a.m. in Room E10076.

Distribution

Messrs./Mmes. O. Yenal, M. Wiehen (ASIVP), K. Inakage (VPCOF),
V. Dubey (EAS), D. Bock (DFS), A. Shakow (SPR),
S. Fischer (VPEDC), J. Baneth (IEC), J. Holsen (CEC),
A. Hamilton (PHR), J. Warford (ENV), V. Vyas (AGR),
A. Churchill (IEN), L. Pouliquen (INU), D.C. Rao (FRS),
A. Vorkink (LEG), R. Picciotto (PBD),
R .H. Frank (CFPVP), J. Parmar (CIOVP).

China Management Group

PMC
PMCadario:hk

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 19, 1988 **CONFIDENTIAL**

TO: **Mr. Attila Karaosmanoglu, Regional Vice President, Asia**

FROM: **Shahid Javed Burki, Director, AS3**

EXTENSION: 72571

SUBJECT: CHINA: Country Strategy Paper

1. I attach for your review and transmittal to the Policy Committee a draft CSP for China, which has been prepared by AS3CO. Notes of the working level review held on April 5 are attached. Paragraph 51 summarizes the decisions sought from senior management.

2. This document is scheduled for Policy Committee review before June 30. We then plan to prepare a sanitized version for discussion with the Chinese during the November talks on the lending and ESW programs.

Attachments

Cleared with and cc: Mr. Merghoub

cc: Messrs/Mmes. O. Yenal, M. Wiehen (ASIVP), K. Inakage (VPCOF),
V. Dubey (EAS)(3), D. Bock (DFS), A. Shakow (SPR)(4),
S. Fischer (VPDEC), J. Baneth (IEC), J. Holsen (CEC),
A. Hamilton (PHR), J. Warford (ENV), V. Vyas (AGR),
A. Churchill (IEN), L. Pouliquen (INU), D.C. Rao (FRS)(2),
A. Vorkink (LEG), R. Ricciotto (PBD), R.H. Frank (CFPVP),
J. Parmar (CIOVP).

PMCadario:hk

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

VP FL GP ~~EDI~~ ~~AR~~ ~~SGS~~ File China (CSP?)

Date: April 5, 1988

To: Mr. Attila Karaosmanoglu, Vice President, ASI

From: Shahid Javed Burki, AS3DR

Ext: 72571

Subject: **Mr. Conable's Visit to China, March 23-30, 1988**

While in Beijing, Mr. Conable met with three of the five members of the Standing Committee of China's Politburo (Messrs. Zhao Ziyang, Secretary General of the Party; Li Peng, Prime Minister; Yao Yilin, Deputy Prime Minister and Chairman of the State Planning Commission); with Li Tieying, Chairman of the Systems Reform Commission and the youngest member of the Politburo; with Finance Minister Wang Bingqian, with Zhu Rongji, Mayor of Shanghai; and with Jia Zhijie, the Governor of Gansu. He and his party then travelled to Xian, Shaanxi where Mr. Conable met with the Vice Governor of the province. Lanzhou, Gansu was the next stop where Mr. and Mrs. Conable saw the implementation of the World Bank's Provincial Development Project. In Lanzhou, there was a wide-ranging discussion with the Party Secretary and two Vice Governors of the Province. At Wuxi in Jiangsu province, the Conables visited a township and saw small factories, schools and farmers houses. The Bank's growing program in the province was discussed with the Vice Governor of Jiangsu and Mayor of Wuxi. In Shanghai, the Conables saw the Suzhou Creek which is being treated under the Bank's Sewerage Project. They also visited a section of the city that is earmarked for a possible housing project. In addition, the Conables visited a township, outside the city proper, which they had seen in 1979 when it was a commune. This site visit in particular provided the Conables with a sense of change in China since their last visit in 1981. There were discussions with the Shanghai officials on the use of resources being provided by the Bank in the form of a three-year provincial development loan. Mr. Conable's last day in China took him to Guangzhou, where he met with the Vice Governor of Guangdong and to Shenzhen where there was a brief meeting with the Deputy Mayor.

This memorandum focuses on three subjects:

- o a brief overview of how China's senior leaders see the evolution of the Chinese economy;
- o a brief assessment of the senior leaders' view of the World Bank's work in China; and
- o the actions we are required to take as a result of the visit.

I. Chinese economic prospects:

Mr. Conable held more than ten hours of discussions with the senior leaders of China. The following are some of the impressions gathered from the meetings.

The role of reforms in China's economic development: Contrary to the conclusions reached by a number of recent articles in the western press, we got the impression of total consensus among China's top leadership about the direction and pace of reform. "Deepening of reforms and emancipation of our minds are the basic objectives of 1988," said Finance Minister Wang. The reform effort will affect the following areas:

- Improvements in fiscal management and constraint on government expenditure to reduce budgetary deficits. Rationalization of tax rates will ensure the same incidence of taxation for all enterprises -- government owned, foreign or privately owned.

- Greater role for the market and expansion in the role of the private sector. Labor, technology, real estate and housing are some of the sectors to be so affected.

- For the financial year beginning January 1, 1988, "aggregate supply will be increased but growth in consumption and investment will be kept in check in order to provide a better macro-economic balance," according to Wang.

The problem of inflation: The Chinese leaders showed concern about inflation, some of which was suppressed and therefore not fully reflected in official statistics. However, in the words of Secretary General Zhao Ziyang, "we are prepared to tolerate even double digit inflation as long as rapid growth can be sustained." Zhao requested the Bank to undertake analytical work that would help China to reconcile growth and inflation.

Coastal regions as the engines of growth: China is abandoning the balanced growth approach of recent years in favor of a big push to come from the coastal regions. The regions will not only bring China into the modern world but will also pull up the poorer parts of the country. Once again, Secretary General Zhao sought the Bank's help in developing the coastal areas and requested that the Bank explore the possibility of a policy-based loan for promotion of exports.

Future prospects: The Chinese leaders are confident that a 7-8 percent annual growth rate can be sustained in their economy through the year 2000. They regard the agenda of reforms announced at the 13th Party Congress and the administrative changes introduced by the 7th National People's Congress as having set the stage for the progressive modernization of the country's economy.

II. <u>The Bank's role in China</u>:

The subject of the Bank's role in China was covered at length by Prime Minister Li Peng. He made the following points:

- o The Bank is well known in China and has a reputation for doing high quality projects and economic work.
- o Projects by the Bank have been successful because they were prepared with great care. "They took time but then their execution was smooth."
- o The Bank could also assist in providing training and managerial expertise to the new investment corporations that were being set up. The Bank could support development of Chinese civil servants and public sector managers by providing fixed-term employment.
- o China needs external resources for undertaking "socialist reconstruction". The Bank can assist in making available such resources.
- o One important pre-requisite for opening to the outside world is to obtain new technology and management practices. Once again, the Bank can help.
- o China will put special emphasis on the development of agriculture, water conservation, irrigation, energy and transport infrastructure. The Bank could assist in these sectors.

The question of the volume of Bank lending was raised in most meetings. In the meeting with Zhao, Mr. Conable indicated that the Bank was gearing itself to achieve $12 billion of lending over the next five years. The Secretary General responded by saying he had all along been in favor of a rapid increase in Bank lending "but his friends in the bureaucracy had proved to be such chickens".

III. <u>Actions required</u>:

The Conable visit resulted in a number of informal agreements which will require actions by the Bank. They include the following:

- o The Bank will prepare a three-year rolling lending program to be discussed with the Chinese authorities in October/November 1988. The first iteration of the program will be for the period FY89-91. The Bank will prepare a paper suggesting the sectors in which it would want to concentrate its resources, the projects it would like to finance, the instruments of lending it would use, and the type of technical assistance it could provide. The rolling plan will be linked directly with the 8th Five Year Plan.

- The IBRD/IDA blend in our lending will harden over the three year period to reach 70:30 by FY91.

- The Bank will examine the possibility of lending for the development of several important sectors and sub-sectors. Forestry, irrigation and export development are some of the possible candidates.

- The Bank will begin work on a series of development loans for Jiangsu province and Shanghai municipality. The total amount of these two series is expected to be $1.2 billion over three years. The series will address requirements in the urban development and industry sectors. Projects to be financed by the two loans will be within sectoral priorities to be agreed between the Bank and the provincial authorities. It was the Bank's expectation that in FY89 it will finance infrastructure projects in Jiangsu and undertake industrial modernization in Shanghai.

- As follow-up to on-going work in Gansu province, the Bank will consider financing the development of irrigation in the Hexi corridor.

- The Bank will prepare a study on the development problems and prospects of another poor province (perhaps Guizhou) in China. The methodology to be followed will be the one used for the Gansu provincial study.

- The Bank's ESW for CY89 will include a study of Jiangsu province's development prospects.

- The Bank will propose a study on poverty alleviation in Guangdong province in the three-year ESW program to be discussed later this year.

- The Bank was hoping to increase both career and fixed-term employees from China and, in this context, its Vice President, Personnel planned to visit China later in the year.

Attached are the detailed notes on Mr. Conable's meetings in Beijing.

Attachments

cc: Mr. Conable
Mesdames Conable, Haug
Messrs. Qureshi, Vergin, Dubey, Ducksoo Lee
Messrs. Alisbah, Asanuma, Cheetham, Kaji, Golan, Wiehen, Yenal, Kabir Ahmed (o/r)
Messrs. Merghoub, Ecevit, Goldberg, Montfort, Stern, Tidrick, D. Ahmad
Messrs. Lim, Pearce, RMC

SJBurki:fvf

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE April 4, 1988

TO Files

FROM David Pearce, AS3CH

EXTENSION

SUBJECT Mr. Conable's Meeting with Minister Wang Bingqian

1. Mr. Conable met with Mr. Wang Bingqian, Minister of Finance at 9:00 a.m. on Thursday, March 24, 1988 at the Great Hall of the People, Beijing. There were present: Messrs. Li Peng, Vice Minister, MOF; Gan Ziyu, Vice Chairman, SPC; Wang Liansheng, Director, External Finance, MOF; Liu Zhentao, Deputy Director, External Loans Bureau, SPC; Xu Naijiong, Executive Director, IBRD; and, accompanying Mr. Conable, Messrs. Burki, Lim, Nicholas and Pearce.

2. Referring to the major changes that had taken place in China since his two previous trips in 1979 and 1981, Mr. Conable outlined the main purposes of his first visit as World Bank President. The Bank was proud to be associated with China's development and reform efforts and hoped that their already fine partnership would become even more rewarding in the future.

3. Minister Wang, welcoming Mr. Conable, said that China's economic and social development in 1987 had been generally satisfactory. Its main economic performance targets had been achieved, indeed some (e.g. industrial output, retail sales and foreign trade) had been exceeded. GNP, at Y1,092 billion, had increased by 9.4% over 1986, with the output value of agriculture and industry (excluding village rural industries) up by 4.7% and 14.6% respectively. Retail sales had expanded by 9.6% in real terms and the foreign trade deficit had declined significantly from over \$12 billion to \$3.7 billion on total volume of \$83 billion (up 12%). The budget deficit had been reduced by keeping the growth of expenditures to 3%, compared to over 20% the previous year. Fixed asset investment, at Y352 billion, had increased 16.5% - about the same as in 1986, but lower than in 1985. There had been progress with enterprise, financial sector and materials allocation reforms; for example, the proportion of steel, cement and timber allocated under the unified plan had been reduced further. In short, the economy's performance had been good, although China's overall economic situation remained stringent. The principal problem was inflation, an issue that would doubtless be discussed at the National People's Congress (NPC) commencing the next day. Retail prices had increased 7.3%, of which about two-thirds was accounted for by basic food items, e.g. pork, poultry and eggs (+ 16.5%) and vegetables (+ 17.7%). The authorities were considering measures to minimise the impact of inflation on basic living standards, e.g. consumer subsidies linked to the retail price index. They realized that the old methods

(administered prices) would not work and that solutions would have to be found through the use of market instruments, based on the laws of supply and demand.

4. Turning to the annual budget and plan to be presented to the NPC, Minister Wang said that the Government's priority in 1988 was to implement the decisions of the 13th Party Congress. Thus, the goal of accelerating and deepening the reform process would guide its work. Specific policy objectives were to increase supply, control excessive investment, and contain consumption. Macroeconomic growth targets for 1988 included: GNP + 7.5%, with the output value of agriculture and industry increasing by 4% and 8% respectively; retail sales and foreign trade were both planned to grow by about 13%. Fixed asset investment, at Y320 billion, would be about 10% less than last year, of which state-owned enterprises would account for about Y220 billion. State revenues were estimated at Y243 billion (Y224 billion in 1987) and state expenditures at Y251 billion (Y232 billion in 1987); the Y8 billion deficit would, as last year, be financed by treasury bonds, of which Y9 billion were planned to be issued (Y6 billion in 1987). Specific reform objectives in 1988, in addition to enterprise management, included the reorganization of the planning and investment, materials allocation, fiscal, housing and foreign trade systems.

5. Regarding budget reforms, Minister Wang said that the central government's financial relationships with local government authorities were not yet fully rationalized. However, new fiscal arrangements, which would include revised revenue retention formuale comprising revenue targets and incentives, still needed to be worked out for 14 out of 39 local government units (provinces, cities and SEZs). Specific tax reform measures under consideration included: the unification of domestic enterprise tax rates; the rationalization of tax rates applicable to joint ventures, co-production companies and wholly-owned foreign enterprises (no increase in tax rates was envisaged); and, the question whether tax rates for enterprises engaged in both domestic and foreign business should be unified. In any event, there was a need to increase state revenues and reduce expenditures. The Government also needed to plan for the rapid development of the coastal areas outlined by Secretary Zhao Ziyang - a strategy that was intended to catalyze growth in the inland (central and western) areas as well. The further development of basic infrastructure (energy and transport), and also of agriculture, rural sideline industries, textiles and other consumer goods industries, remained of high priority.

6. Concluding his presentation, Minister Wang said that, under the upcoming reorganization of the central government, MOF itself would be strengthened: the General Bureau of Taxation would be upgraded to departmental status under the direct supervision of a Vice Minister; a Department of State Assets Administration with corresponding units in provincial and other finance bureaus would be set up, also under a Vice Minister, to manage the disposition (transfer and purchase) of state properties; and, a new Department of State Debt Administration would be established with responsibi-

lity for both domestic and external debt. [Total domestic debt outstanding was currently about Y34 billion; external debt contracted totalled about $27 billion and debt outstanding (disbursed) about $17 billion].

7. Thanking Minister Wang for his comprehensive review of the domestic economic and financial situation, Mr. Conable asked him to address China's external prospects and the Bank's role in China.

8. Minister Wang replied that Bank/China relations were excellent. The Bank was one of China's main sources of foreign capital. To date, almost $6 billion had been committed and $2 billion disbursed; disbursements were rather slow. China hoped to increase its borrowing from the Bank Group to $2 billion annually. Minister Wang said that he appreciated the Bank's efforts to increase slightly China's share of IDA (to the same level as India by 1990); he also agreed that the Bank/IDA blend should be 'hardened' gradually from 60/40 to 70/30 (by the same date). As far as FY1988 borrowing was concerned, it might not in the event be possible to achieve the $1.8 billion level originally planned. He had urged the officials concerned to try to resolve outstanding problems with a view to reaching $1.7 billion, perhaps slightly more. Regarding FY1989, MOF and SPC were actively working together on the program, which should be appropriately balanced.

9. Mr. Conable, noting that Bank/China relations were becoming more sophisticated, said that a diversified range of lending modalities - attuned to China's rapidly changing needs - was required, such as policy-based, sector and provincial operations, in addition to individual project loans. Moreover, in order to improve its efficiency and responsiveness, the Bank wished to develop a more explicit understanding with the Government on the size, content and objectives of a 'rolling' medium-term (3-5 years) lending program, which should incorporate China's developmental priorities and be an integral part of its overall external borrowing requirements. Finally, referring to its international aid coordination role which had become increasingly significant in recent years, Mr. Conable said that the Bank would be happy to collaborate with other multi- and bilateral agencies, such as Japan, that were planning to expand their lending to China substantially.

10. Minister Wang, agreeing with Mr. Conable, said that different lending approaches in China were desirable. He also agreed that a 3-5 year 'rolling' lending program was necessary and said that MOF officials would work with Bank staff towards that end. In this connection, they were starting to think about the 8th Five Year Plan (1991-96). Noting that a national conference to review ongoing Bank operations in China organized by MOF last January had had a very positive outcome, Minister Wang said that Bank/China cooperation should be expanded in all respects.

11. Mr. Conable said that the Bank, with more than 40 years of development experience, had a highly skilled staff; he hoped China would continue to exploit these resources to the fullest possible extent. Drawing attention to the recently appraised Daxing Forestry Rehabiliation project, Mr. Conable

said he understood there might be mutual interest in a large forestry sector operation. The Bank also continued to attach high priority to poverty-alleviating programs of the kind he planned to visit in Gansu. Finally, Bank staff were always open to MOF's specific suggestions about ways in which its operations, including the pace of loan/credit disbursements, could be improved.

12. Minister Wang said that China was indeed interested in future Bank assistance for forestry.

13. Replying to Mr. Conable's remark that Mr. Xu, the Executive Director for China, was playing an important and productive role on the Bank's Board, Minister Wang said that China was also very pleased with the work of the Bank's representative in China.

14. Concluding the meeting, Minister Wang said that the Chinese authorities appreciated Mr. Conable's leadership of the effort to restore growth in the developing world. He hoped that his visit would be an interesting and enjoyable one.

[mbcwangbingqian: 03301988]

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE April 4, 1988

TO Files

FROM David Pearce, AS3CH

EXTENSION

SUBJECT Mr. Conable's Meeting with Acting Premier Li Peng

1. Mr. Conable met with Acting Premier Li Peng at 5:00 p.m. on Thursday, March 24, 1988 at the Great Hall of the People, Beijing. There were present: Messrs. Wang Bingqian, Minister of Finance; Li Peng, Vice Minister, MOF; Gan Ziyu, Vice Chairman, SPC; Wang Liansheng, Director External Finance, MOF; Xu Naijiong, Executive Director, IBRD; and, accompanying Mr. Conable, Messrs. Burki, Lim, Nicholas and Pearce.

2. Welcoming Mr. Conable to Beijing, Premier Li said that the Bank was now well known throughout China and Bank/China cooperation was very fruitful. He had read several of the Bank's economic reports and they were of high quality.

3. Mr. Conable said that Bank/China relations had developed very significantly in recent years and, in his view, were excellent. The Bank's sole objective in China was to support the country's economic and social development and the scope and nature of its activities should be determined entirely by China's own development and reform priorities. He hoped that the Government, and Premier Li himself, would regard the Bank as a neutral, independent source of advice and assistance. Having committed over $6 billion to date, the Bank expected its lending to China to reach $2 billion annually next year. The recent agreement to almost double the Bank's capital base would greatly facilitate its ability to serve the needs of its member countries, including China.

4. Premier Li said that China needed large amounts of financial resources for its development, the bulk of which would have to be generated internally. However, it also required significant external capital to help implement its "open door" policy and, specifically, to obtain technology and management skills and experience from abroad, including the Bank. In this connection, he wanted to address two main issues: China's key development priorities during the next few years; and, related to this, the scope of future cooperation with the Bank.

5. Premier Li, citing four priorities for development during the next 3-5 years (agriculture, water conservation, energy & transport, and basic infrastructure), said first that agriculture was the foundation of China's economy. In this connection, the Government's principal concern was to maintain, if not expand, the supply of foodgrains, currently averaging 400 kgs. per capita. However, with only 1.5 mu of arable land per capita, this would not be easy. For example, with an estimated population of 1.2 billion by the end of the century, annual output would have to increase to 500

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million tons (from 400 million tons at present) simply to maintain foodgrain supply at the current 400 kgs. per capita level. Thus, a major effort to expand production would be needed, for which inter alia improved seed varieties, modern technology, and expanded supplies of high quality fertilizers were necessary. Premier Li said that he hoped the Bank could assist in expanding the production of basic agricultural inputs such as chemical fertilizers, pesticides and plastic sheeting.

6. Second, regarding water conservation, Premier Li said that China's three great rivers were both an asset (e.g. for irrigation and electric power generation) and a liability (i.e. their susceptibility to flooding). Flood control on the Yellow River in Henan Province was a high priority and a very large reservoir near Zhengzhou was planned for this purpose. Third, Premier Li said that the Bank was already knowledgeable about and involved in China's energy and transport priorities; he hoped that this would continue and he would not, therefore, go into any detail. Finally, the fourth main priority was basic infrastructure.

7. Turning to Bank/China cooperation more specifically, Premier Li said that the progress of the Bank-financed projects already underway had in general been successful, thanks to their thorough preparation. He hoped that the high quality of the Bank's feasibility studies and of its project preparation and appraisal work could continue in the future. As far as Bank/IDA lending overall was concerned, he did not propose to discuss the (Bank/IDA) blend question. However, he had been advised that the lack of adequate counterpart (RMB) funds was constraining the rate of growth of Bank/IDA lending. He was thus interested in the possibility of Bank/IDA financing of counterpart funds (i.e. local cost financing) and, specifically, whether future policy-based loans could be considered for this purpose. Regarding procurement, Premier Li said that China was importing large quantities of foreign equipment with Bank/IDA financing and, given its enormous needs, this would necessarily continue for some time. However, the Government's long-term strategy was to promote the domestic manufacture and supply of equipment and goods and, in the short-term, to increase the local value-added of joint venture operations, particularly equipment producers. He therefore hoped that the Bank could accord preference to Chinese suppliers of equipment (under Bank-financed projects).

8. Finallly, Premier Li said that the Government was interested in Bank assistance not only for 'hardware' but 'software' as well. Five new corporations were to be established in the near future to manage state investment programs, one each covering agriculture, energy, iron & steel, light & textile industries, and transport. The Government wanted to learn from the Bank how to set up and operate these investment corporations in the following two ways: through a program of training courses and seminars conducted in China; and, by sending young Chinese professional staff to the Bank (e.g. on fixed-term assignments) to receive on-the-job training and experience. [English language capability had previously been an obstacle in considering such cooperation but was no longer such a major problem].

9. Mr. Conable said that he welcomed the specificity of Premier Li's comments. Replying to the points raised, he said that one approach to the

problem of counterpart funding could be to associate the financial resources of bilateral agencies active in China with Bank/IDA financing of individual projects. The Bank's co-financing and aid coordinating role was becoming increasingly important. With respect to procurement, qualified Chinese suppliers were eligible to receive the standard preference given to local manufacturers and suppliers under international competitive bidding in accordance with the Bank's guidelines. In general, he hoped that Chinese enterprises would be able to participate increasingly in international competitive bidding under Bank-financed projects, not only in China but overseas as well. Regarding technical assistance for the five new investment corporations, Mr. Conable said that China was under-represented on the Bank's staff. The Bank was hoping to increase both career and fixed-term employees from China and its Vice President, Personnel planned to visit China later in the year.

10. Regarding China's medium-term development priorities, Mr. Conable said that he was sure the Bank could be responsive. He agreed that agriculture was of the highest priority; the focus of the Bank's first policy-based loan to China would be rural reform. He also agreed on the importance of water conservation and, from what Premier Li had said, it seemed there was strong potential for an irrigation sector operation linked to food grain production. The Bank, for its part, was interested in further involvement in the forestry sector (mainly in South China), if this fit into the Government's priorities.

11. Premier Li said that he fully endorsed Mr. Conable's views regarding both forestry and irrigation, which were also important in China's western inland provinces. Concluding, Premier Li said that the Government appreciated the very useful role being played by the Bank's Resident Representative in Beijing. Mr. Conable agreed, adding that he had great confidence in both Messrs. Burki and Lim, the former as the Director of Bank's China Country Department and the latter as the Chief of the Resident Mission.

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE April 4, 1988

TO Files

FROM David Pearce, AS3CH

EXTENSION

SUBJECT Mr. Conable's Meeting with Vice Premier Yao Yilin

1. Mr. Conable met with Vice Premier Yao Yilin, Chairman, State Planning Commission (SPC), at 6:00 p.m. on Thursday, March 24, 1988 at the Great Hall of the People, Beijing. There were present: Messrs. Wang Bingqian, Minister of Finance; Li Peng, Vice Minister, MOF; Gan Ziyu, Vice Chairman, SPC; Wang Liansheng, Director, External Finance, MOF; Liu Zhentao, Deputy Director, External Loans, SPC; Xu Naijiong, Executive Director, IBRD; and, accompanying Mr. Conable, Messrs. Burki, Lim, Nicholas and Pearce.

2. Vice Premier Yao, welcoming Mr. Conable, said that Bank/China relations were very good, indeed they were excellent. Citing the the Bank's two basic economic reports and its lending in support of China's capital investment program, Vice Premier Yao said that the only issue was how to continue to strengthen further our relationship.

3. Mr. Conable, agreeing with Vice Premier Yao, said that the Bank wanted to have a more explicit understanding with the Government on the size, content and objectives of a medium-term (3-5 year) 'rolling' lending program, linked directly to China's 8th Five Year Plan priorities and integrated into its overall external borrowing requirements. Such an understanding, in addition to being a more orderly way of managing our lending relationship, would permit SPC to prepare the 8th Plan on the basis of an assured source of foreign capital and enable the Bank to strengthen the programming of its budgetary and staff resources (for the China program). In this connection, the Bank was developing new lending approaches designed to respond to China's rapidly evolving circumstances and needs: policy-based lending, such as the proposed Rural Sector Adjustment Loan (RSAL) now under preparation; sector-wide operations, e.g. for forestry and irrigation; and, provincial loans, initially in Jiangsu, Shanghai and Tianjin.

4. Mr. Conable said that, following the 8th Replenishment of IDA last year and the recent agreement on a General Capital Increase (GCI), the Bank could now contemplate a significant expansion of its lending to China and to other developing countries. The Bank's overall aid coordination effort was also assuming greater importance and it would be pleased to collaborate with bilateral agencies, such as Japan, that were planning to increase their lending to China. Regarding IDA specifically, Mr. Conable said that China would be its largest recipient by 1990; in this connection, we were aiming to 'harden' the existing Bank/IDA blend to about 65/35 this year and to 70/30 by the same date.

5. Replying to Mr. Conable's remarks, Vice Premier Yao said he agreed that a five-year 'rolling' lending program was a good idea; it would facilitate forward planning by both sides. In addition to establishing quantitative lending objectives, such a medium-term plan should also incorporate agreed understandings with respect to, for example, the Bank/IDA blend, an appropriate balance between policy-based, sector, provincial and conventional project lending, and sectoral priorities and composition.

6. Vice Premier Yao said that more policy-based loans were desirable. They had several advantages: they permitted focussed single sector involvement or comprehensive multi-sector coverage, according to the circumstances; their proceeds could be utilized indirectly to finance the completion of ongoing projects without the necessity for Bank re-appraisal; and, the proceeds of policy-based loans could, in general, be used more flexibly. Vice Premier Yao commented at this point that China would borrow only as much as it could repay. He was concerned about a possible peak in its debt service payments commencing in 1992 and had begun to make plans to meet these payments.

7. Finally, regarding cofinancing and coordinating the use of foreign capital in general, Vice Premier agreed that this question should be considered further.

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE April 4, 1988

TO Files

FROM David Pearce, AS3CH

EXTENSION

SUBJECT Mr. Conable's Meeting with Minister Li Teiying

1. Mr. Conable met with Mr. Li Teiying, Chairman, System Reform Commission (SRC) and concurrently Minister of Electronic Industries at 11:30 a.m. on Friday, March 25, 1988 at the Diaoyutai State Guest House. There were present: Messrs. Gao Shangquan, Vice Minister, SRC; Li Peng, Vice Minister, MOF; Gan Ziyu, Vice Chairman, SPC; Wang Liansheng, Director, External Finance, MOF; Xu Naijiong, Executive Director, IBRD; and, accompanying Mr. Conable, Messrs. Burki, Lim, Nicholas and Pearce.

2. Welcoming Mr. Conable, Minister Li said that the progress achieved during the past eight years had created a favorable environment for the further restructuring of the economic system. The 13th Party Congress last October had set the stage for accelerating and deepening the reform process during the next five years. Outlining SRC's functions, which were to advise the Government on reform during the transition from the old, centrally-planned system to the new, socialist market economy and to initiate and monitor the results of experimental reforms, Minister Li said that SRC appreciated its cooperation with the Bank. He was personally interested that it should continue and hoped that SRC's relationship with the Bank would strengthen. Noting that economic reform was now a fundamental trend not only in China but also in almost all socialist countries, Minister Li said that reform would be a predominant feature of all the Government's work. The main task ahead was to institutionalize the process, in which connection SRC, which was responsible directly to the State Council, had established system reform units in each ministry at the central level and in each provincial government.

3. In his introductory remarks, Mr. Conable said that the Bank valued highly its relationship with the SRC. Referring to the Bank's own recent reorganization, he said that the main objective had been to make the institution more responsive to the rapidly changing needs of its members, including China. In this connection, there was a relatively recent trend towards policy-based loans, the first example of which in China - in support of the second stage of rural reforms - was now under preparation. In addition to Minister Li's views on reform, he was interested in his advice on the potential for, including the objectives of, additional policy-based lending in China.

4. Replying that Vice Minister Gao would answer Mr. Conable's question more specifically later, Minister Li then reviewed briefly the background to, and history of the reform process to date. Describing the current status of enterprise reform in some detail, Minister Li said that the main problem

being addressed in this respect was the inefficiency and low technological standards of state enterprises which, because they lacked financial and managerial autonomy, had no incentive to improve their performance. Until appropriate self-regulating (market) mechanisms had been devised to guide their behaviour, they would continue to "eat from the same big pot" and be a drain on state revenues. Thus, one key element of enterprise reform was the separation of their management and ownership functions and responsibilities through, for example, leasing, share-holding and contracting. Other aspects of reform currently being tried out included: the development of alternative means of providing social security and financing the cost of welfare services (e.g.health and education) currently provided by state enterprises; the application of performance criteria ("each according to his work") in the administration of their profit-sharing and wage and benefit systems; and, as the next step, the commercialization of housing. Enterprise reform would need to take into account the diversified patterns of ownership already prevalent in China (e.g. state, collective, and private enterprises and joint ventures).

5. Referring to the coastal areas development strategy, Minister Li said that, in addition to the 14 "open" port cities and 4 Special Economic Zones (SEZs), comprehensive reform measures were to be introduced in six pilot areas (Guangdong, Fujian, Zhejiang and Jiangsu provinces and the Shandong and Liaoning peninsulas). The basic goal of this strategy was to develop an export-oriented economy, which would not only accelerate growth in the coastal provinces themselves but also catalyze the development of the central and western regions.

6. Minister Li said that science, technology and education would have to be expanded; and, their organization and management systems needed further reform to ensure that they served the needs of China's rapidly changing economy. Finally, the structure of the central government itself would be rationalized, commencing with the State Council, and individual ministries would be reorganized. The objectives of these administrative reforms were to develop a structure that reflected the Government's changing functions and responsibilities, and to improve efficiency. Reforms in various cultural and social institutions consistent with economic reforms were also envisaged.

7. Mr. Conable, replying to Minister Li's presentation, said that these were exciting times to be living in China! It was clear from the Minister's remarks that the reform process was pervasive and would impact on all aspects of the economy and society. Some reforms would obviously proceed faster than others and he wondered which were the priorities?

8. Minister Li said that the main priorities for reform in 1988 were: enterprise management; the investment, planning and financial systems (the latter including tax reform); the materials supply and allocation system; and, the foreign trade system. In addition, emphasis would be given to improving the macro-management of the economy, including price stabilization, and the coastal areas development strategy.

9. Vice Minister Gao, referring to Bank/SRC cooperation, said that General Secretary Zhao Ziyang had recently re-affirmed the importance he

attached to SRC's relationship with the Bank. Premier Li Peng's pending appointment as Chairman of the SRC also underlined the significance of the Bank's cooperation with SRC. He hoped that Mr. Lim and other staff of the Resident Mission would continue to work closely with SRC. The Bank's future assistance should focus on two areas: comparative experiences of economic system reform in other countries of relevance and interest to China, through the organization of symposia and visits by international experts; and, strengthening SRC and the basic infrastructural framework for the entire reform process, including staff development and training and the development of domestic and international information networks.

10. Mr. Conable, responding to Vice Minister Gao, said that what was happening in China might be unique. He was not sure there were precedents or that similar examples existed, although there might be some parallels in other countries. However, he was confident that Messrs. Burki and Lim, the China Department and Resident Mission managers respectively, would continue their cooperation with SRC. For his part, he would try to ensure that, as long as the present good cooperation continued, adequate Bank resources were available to support China's reform and development efforts. Minister Li could be assured that the Bank's management at headquarters paid special attention to the China program.

11. Concluding, Minister Li said he could like to see a high-level Bank-SRC meeting held every year to review Bank-China cooperation in the area of reform, similar to that held with MOF/SPC on lending operations.

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FROM IBRD ... WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE April 4, 1988

TO Files

FROM David Pearce, AS3CH

EXTENSION

SUBJECT Mr. Conable's Meeting with Secretary General Zhao

1. Mr. Conable met with Mr. Zhao Ziyang, Secretary General of the Chinese Communist Party at 6:30 p.m. on Friday, March 25, 1988 at the Diaoyutai State Guest House. There were present: Messrs. Wang Bingqian, Minister of Finance; Li Peng, Vice Minister, MOF; Gan Ziyu, Vice Chairman, SPC; Wang Liansheng, Director, External Finance, MOF; Xu Naijiong, Executive Director, IBRD; and, accompanying Mr. Conable, Messrs. Burki, Lim, Nicholas and Pearce. The meeting was followed by an informal dinner, which continued until 9:30 p.m.

2. Warmly welcoming Mr. Conable, Secretary Zhao said that Bank/China relations were excellent and that the Chinese authorities were very satisfied with Bank/China cooperation. Bank staff, including Mr. Lim, the resident representative, had done an outstanding job in China. He attached great importance to the relationship. He had met Messrs. McNamara and Clausen and he appreciated the opportunity to get to know Mr. Conable this evening.

3. Reciprocating, Mr. Conable said that 1987 had been a good year for the Bank as well as for China. The 8th Replenishment of IDA resources and the Bank's General Capital Increase (GCI) had been successfully negotiated and the Multilateral Investment Guarantee Agency (MIGA) had been established. Noting that these developments would all help the Bank Group to help its customers, including China, better, Mr. Conable thanked Secretary Zhao for China's support. He then asked Secretary Zhao to outline China's development priorities and his views on the Bank's role in that context.

4. Secretary Zhao said that China's economic performance in 1987 had been basically satisfactory. While there were problems, there had also been good progress with reform. The balance of payments had improved significantly and several key projects had been completed. Although the growth rate was high, it was healthy, balanced growth - unlike 1985, when the economy had been over-heated. There were good prospects that China was about to embark upon a lengthy period of sustained economic growth, with GNP increasing at an annual average rate of 7-8% Some destablizing factors existed, but these were improving. The main sectoral priorities continued to be: basic infrastructure, energy and transport.

5. Secretary Zhao said that the principal preoccupation of the population at large was inflation, which would doubtless be an issue at the National People's Congress (NPC) that had convened earlier that day. With continued high rates of growth, double-digit inflation was possible, perhaps even inevitable; but, if the people's real incomes and standards of living

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improved, inflation need not necessarily be a major problem. In any event, it was not possible to revert to the old system of administered prices and a solution would have to be found through the use of market instruments and the laws of demand and supply. This meant that, if agricultural output, for example, was to expand, the price of food would have to be adjusted. The same was true for industrial goods, whose prices must relect the true costs of production. Secretary Zhao said that, although some people favored tighter economic policies to contain inflation, this might result in slower economic growth, which would create its own set of problems; he hoped that price stability could be achieved along with a fairly rapid rate of growth, as well as an acceleration and deepening of reforms. The relationship between growth and inflation could be an interesting subject for collaborative (Bank/China) study and research: specifically, the question whether, in circumstances of rapid economic growth, inflation was inevitable.

6. Turning to Bank/China cooperation, Secretary Zhao said that, in addition to project financing, Chinese agencies and the Bank's staff had undertaken several collaborative economic and sector studies. These studies had produced useful results and he hoped they would continue. As far as financial cooperation was concerned, the Bank and the Government had agreed on a goal of $2 billion annually some time ago. He was aware that policy-based lending would be initiated this year, with the proposed rural sector adjustment loan (RSAL), and that a financial sector operation was under consideration. There had been very good progress in this respect.

7. Concluding, Secretary Zhao said that the Government's coastal areas development strategy would benefit not only China; it could also help other countries as well. Owing to increasing labor costs, some advanced countries had been readjusting their industrial structures and moving labor-intensive industries to places where labor costs were low. In this context, China's coastal areas were attractive to foreign investors because their labor costs were low and export prices would thus be internationally competitive. The development of an export-oriented economy in these areas would facilitate the further "opening" of the economy as a whole; it would not involve trade protection measures. Secretary Zhao enquired whether the Bank would be able to support China's coastal development strategy through a policy- based loan.

8. Mr. Conable, replying to Secretary Zhao's comments, said that, based on his experience as a former United States Congressman, the issue of growth and/or inflation was essentially a political one. However, he would be glad to have Bank staff study the question together with the Chinese officials concerned. The Bank's role was to alleviate poverty and one thing was certain: that poverty could only be eradicated in the context of economic growth, not stagnation. In his view, it should be possible to minimise inflation and still have growth.

9. Mr. Conable said that the Bank attached high priority to collaborative economic and sector studies and they would continue in the future. Following the GCI, the Bank intended to expand its lending world-wide at an average rate of about 10% annually. In this context, he hoped that Bank/IDA lending to China during the five year period FY1988-92 would total about $12 billion which, assuming that China was interested in borrowing of this

magnitude, implied annual commitments of at least $2 billion annually. Bank/IDA lending during the current year (FY1988) was currently estimated to reach $1.7-1.8 billion. [Vice Chairman Gan noted at this point that $12 billion over five years implied an average of $2.4 billion annually; in practice, it would require a gradual increase from the current level of $1.7-1.8 billion to about $3 billion annually by 1992]. Mr. Conable said that, in addition to committing Bank/IDA resources, the Bank could help in coordinating official external aid from other sources. It could also assist in encouraging foreign investment in China.

10. Pointing out that most, if not all, of the $5.5 billion committed to date had financed individual projects, Mr. Conable said that the time was now ripe for more sophisticated forms of lending such as policy-based, sector and provincial loans. In this connection, the Bank had already made several policy-based loans for export promotion and development in other countries; the question of such an operation in China, in connection with the export--oriented development strategy of the coastal areas, could certainly be considered. It would be prepared to undertake the necessary studies required, which might take some time, and be an active partner in bringing them to fruition. In conclusion, Mr. Conable said that the Bank would like to develop a medium-term (3-5 year) "rolling" plan for Bank/IDA lending.

11. Secretary Zhao, agreeing that a medium-term plan for Bank/IDA lending was a good idea, said that it should be possible to develop one with the agencies concerned. He appreciated Mr. Conable's very positive attitude, repeating that Bank/China cooperation was of great significance. China was the largest developing country and, if the Bank's activities were successful in the long-term, it would have contributed to the well-being over 1 billion people - a goal that was consistent with the Bank's mission and for which purpose it existed. By that stage, China's experience, and the Bank's experience of development in China, could then be shared with other developing countries.

[mbczhao: 04011988]

THE WORLD BANK INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: April 4, 1988

TO: Distribution Below

FROM: For: Paul M. Cadario, SCPO, AS3CO

EXTENSION: 72059

SUBJECT: CHINA: Country Strategy Paper -- Standard Attachment

Attached are the standard tables, which were not ready when the CSP was distributed. Mr. Peter Dittus (x73846) and Mr. T. Raparla (x73541) prepared them.

Distribution:

Messrs. Burki, Yenal, Ecevit, Goldberg, Montfort, Stern, Ahmad, Tidrick, K. Ahmed
Messrs. Inakage, Dubey (3), J. Wood, Bock, Picciotto, Shakow (4), Fischer, Holsen, Baneth, Willoughby, Warford, Vyas, Churchill, Pouliquen, Rao (2), Vorkink (4), R. Frank, Parmar
Mmes. Hamilton, Schaeffer

cc: AS3CO Staff, Mr. Lim

1986 Per Capita GNP in US$:
Mid-1986 Population (Mill):

A. National Accounts Indicators as Shares of GDP/GDY (%):

	Historical (shares of GDP in Current Prices)							Prelim	Projected (shares of GDY in Constant 1980 Prices)						
	1965	1973	1980	1982	1983	1984	1986	1987	1988	1989	1991	1992	1993	1994	1995
Gross Domestic Product m.p.							100.0	99.8	100.0	100.1	100.0	99.9	99.9	99.9	99.8
Net Indirect Taxes							0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Agriculture							30.7	30.0	29.2	28.3	26.2	25.3	24.3	23.4	22.5
Industry							46.2	46.6	47.3	48.3	50.2	51.1	52.0	53.0	53.8
(of which Manufacturing)							46.2	46.6	47.3	48.3	50.2	51.1	52.0	53.0	53.8
Services							23.1	23.2	23.5	23.6	23.6	23.6	23.6	23.5	23.5
Resource Balance							2.8	0.2	0.3	1.6	1.6	1.6	1.7	1.8	2.0
Exports of GNFS							10.9	11.2	11.3	11.4	11.5	11.5	11.6	11.6	11.7
Imports of GNFS							13.7	11.4	11.6	13.0	13.0	13.1	13.3	13.5	13.6
Total Expenditures							102.8	100.0	100.2	101.8	101.6	101.5	101.6	101.7	101.8
Total Consumption							64.0	60.4	60.6	62.2	64.1	65.0	65.1	65.2	65.3
Private Consumption							50.4	46.9	47.1	48.8	50.8	51.9	52.1	52.3	52.5
General Government							13.6	13.5	13.5	13.5	13.2	13.1	13.0	12.9	12.7
Gross Domestic Investment							38.8	39.6	39.6	39.5	37.5	36.5	36.5	36.5	36.5
Fixed Investment							32.2	38.0	38.0	37.7	35.7	34.7	34.7	34.7	34.7
Changes in Stocks							6.6	1.7	1.6	1.8	1.8	1.8	1.9	1.9	1.9
Capacity to Import	—	—	—	—	—	—	10.9	11.4	11.3	11.2	11.5	11.6	11.6	11.7	11.8
Terms of Trade Adjustment	—	—	—	—	—	—	0.0	0.2	0.0	-0.1	0.0	0.1	0.1	0.1	0.2
Gross Domestic Income	—	—	—	—	—	—	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Gross National Income	—	—	—	—	—	—	99.9	99.9	100.0	100.0	99.9	99.8	99.7	99.7	99.6
Gross National Product							99.9	99.8	99.9	100.1	99.8	99.8	99.7	99.5	99.4
Gross Domestic Saving							36.0	39.6	39.4	37.8	35.9	35.0	34.9	34.8	34.7
Net Factor Income							-0.1	-0.1	0.0	0.0	-0.1	-0.2	-0.3	-0.3	-0.4
Net Current Transfers							0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Gross National Saving							36.1	39.7	39.5	37.8	35.9	34.9	34.7	34.6	34.4

B. National Accounts Growth Rates (%) at Constant Prices:

	Actual							Prelim.	Projections			
	1965-73	1973-80	1980	1982	1983	1984	1986	1987	1988	1989	1986-90	1990-95
Gross Domestic Product m.p.								7.1	7.0	7.8	7.4	8.0
Net Indirect Taxes								0.0	0.0	0.0	0.0	0.0
Agriculture								5.0	4.0	4.0	4.2	4.0
Industry								8.0	8.5	10.0	9.1	10.0
(of which Manufacturing)								8.0	8.5	10.0	9.1	10.0
Services								8.0	8.0	8.0	8.0	8.0
Exports of GNFS								10.5	7.5	8.4	8.5	8.5
Imports of GNFS								-10.8	8.6	20.8	7.7	9.1
Total Expenditures								4.3	7.2	9.2	7.3	8.1
Total Consumption								1.3	7.3	10.5	7.4	8.7
Private Consumption								-0.3	7.4	11.5	7.5	9.2
General Government								7.0	7.0	7.0	7.0	7.0
Gross Domestic Investment								9.4	7.0	7.3	7.2	7.0
Fixed Investment								26.5	7.0	6.8	10.2	6.9
Changes in Stocks								-73.3	6.3	18.4	-16.4	8.7
Capacity to Import								12.1	6.4	6.6	8.2	8.8
Terms of Trade Adjustment								**********	-68.0	-401.6	-126.3	129.7
Gross Domestic Income								7.3	6.9	7.6	7.4	8.0
Gross National Income								7.3	6.9	7.6	7.4	8.0
Gross National Product								7.1	7.1	7.8	7.4	7.9
Gross Domestic Saving								17.9	6.3	3.1	7.4	6.8
Net Factor Income								1.0	-37.0	-45.3	-56.7	-44.5
Net Current Transfers								-8.2	-6.2	-2.4	-2.2	2.9
Gross National Saving								17.8	6.4	3.1	7.4	6.6

C. Price Indices (1980=100):

	Actual					Prelim	Growth Rates (% p.a)		
	1980	1982	1983	1984	1986	1987	1965-73	1973-80	1980-85
Consumer Prices (IFS 64)									
Wholesale Prices (IFS 63)									
Implicit GDP Deflator					100.0	110.0			
Implicit Expend. Deflator									
Deflators for Sector VA:									
Agricultural Sector									
Industrial Sector									
Services Sector									

D. Other Indicators:

	1965-73	1973-80	1980-85	1986-95
Growth Rates (% p.a.)				
Population				1.0
Labor Force				n.a
Gross Nat'l Income p.c.				6.7
Private Consumption p.c.				8.0
Import Elasticity:				
Imports (G+NFS)/GDP(mp)				1.2
Marginal Savings Rates:				
Gross National Savings				29.5
Gross Domestic Savings				30.2
ICOR (period averages)				5.6

	1965	1973	1980	1986	1991
Share of Total Labor Force in:					
Agriculture				n.a	n.a
Industry				n.a	n.a
Services				n.a	n.a
Total				n.a	n.a

E. National Accounts (millions of LCUs at 1980 Prices):

	Actual						Prelim.	Projections							
	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Gross Domestic Product m.p.						938000	1004404	1075008	1158601	1249395	1348048	1455279	1571877	1698701	1836698
Net Indirect Taxes						0	0	0	0	0	0	0	0	0	0
Agriculture						287868	302261	314352	326926	340003	353603	367747	382457	397755	413666
Industry						433794	468498	508320	559152	615067	676574	744231	818654	900520	990572
(of which Manufacturing)						433794	468498	508320	559152	615067	676574	744231	818654	900520	990572
Services						216338	233645	252337	272524	294325	317871	343301	370765	400427	432461
Resource Balance						26182	1657	3035	18758	20043	21432	22931	26842	31312	36417
Exports of GNFS						102060	112759	121243	131410	142474	154518	167630	181906	197453	214387
Imports of GNFS						128241	114416	124278	150168	162518	175950	190561	208748	228766	250804
Total Expenditures						964182	1006061	1078044	1177360	1269439	1369480	1478211	1598718	1730014	1873115
Total Consumption						599982	607560	651755	720118	788549	863770	946478	1024013	1108546	1200747
Private Consumption						472726	471396	506060	564224	621743	685287	755501	819667	889897	966792
General Government						127256	136164	145695	155894	166807	178483	190977	204345	218650	233955
Gross Domestic Investment						364200	398501	426288	457241	480890	505710	531733	574706	621467	672368
Fixed Investment						302000	381900	408637	436343	458191	481047	504925	545557	589761	637869
Changes in Stocks						62200	16601	17651	20898	22699	24663	26808	29149	31706	34499
Capacity to Import						102060	114403	121768	129826	142327	154801	168414	183234	199403	217576
Terms of Trade Adjustment						0	1644	525	-1584	-147	283	784	1327	1950	3189
Gross Domestic Income						938000	1006048	1075534	1157017	1249248	1348331	1456063	1573204	1700651	1839887
Gross National Income						937179	1005218	1075011	1156731	1248082	1346311	1453330	1569168	1694903	1832749
Gross National Product						937179	1003574	1074486	1158315	1248229	1346028	1452546	1567840	1692953	1829560
Gross Domestic Saving						338018	398488	423778	436899	460699	484561	509586	549191	592105	639140
Net Factor Income						-821	-830	-522	-286	-1166	-2021	-2733	-4036	-5749	-7138
Net Current Transfers						1404	1288	1208	1180	1313	1377	1443	1512	1585	1464
Gross National Saving						338601	398947	424464	437792	460846	483917	508295	546667	587942	633466

CHINA - EXTERNAL TRADE

Attachment 3b

A. Volume, Value and Prices	Actual						Prelim.	Projections							
	1980	1981	1982	1983	1984	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Merchandise Exports						Volume Index 1986=100									
Food						100.0	56.7	58.4	60.2	62.0	63.8	65.7	67.7	69.7	71.8
Petroleum						100.0	86.7	91.0	95.6	100.4	105.4	110.7	116.2	122.0	128.1
Commodity 3						0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commodity 4						0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufactures						100.0	127.4	137.6	150.7	165.0	180.6	197.8	216.6	237.2	259.7
Other Exports						100.0	121.9	131.7	142.2	153.6	165.8	179.1	193.4	208.9	225.6
Total Merch. Exports FOB						0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Merchandise Exports						Value-Current Prices (million US$)									
Food						4121	1837	1981	2073	2274	2349	2427	2507	2590	2675
Petroleum						3091	3160	3328	3333	3780	4076	4395	4740	5111	5512
Commodity 3						0	0	0	0	0	0	0	0	0	0
Commodity 4						0	0	0	0	0	0	0	0	0	0
Manufactures						16484	22219	25340	29246	31896	35345	39167	43403	48096	53297
Other Exports						2060	2890	3012	3074	3543	3933	4367	4848	5383	5976
Total Merch. Exports FOB						25756	30105	33660	37726	41492	45703	50356	55498	61180	67461
Merchandise Imports						Volume Index 1986=100									
Food						100.0	163.3	177.7	193.3	210.3	228.8	249.0	270.9	294.7	320.6
POL and Other Energy						100.0	75.1	75.1	75.1	75.1	75.1	75.1	75.1	75.1	75.1
Other Imports						100.0	82.1	89.4	110.6	119.8	129.8	140.6	154.4	169.7	186.5
Other Consumer Goods						100.0	82.4	89.7	109.4	119.0	129.5	140.9	153.3	166.7	181.4
Intermediate Goods						100.0	82.3	90.7	115.2	129.0	144.5	161.8	181.2	203.0	227.3
Primary						100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufactures						100.0	82.3	90.7	115.2	129.0	144.5	161.8	181.2	203.0	227.3
Capital Goods						100.0	81.8	88.7	109.7	116.3	123.3	130.6	143.2	157.1	172.5
Total Merch. Imports CIF						100.0	85.3	92.8	113.5	122.9	133.1	144.2	158.1	173.5	190.5
Merchandise Imports						Value-Current Prices (million US$)									
Food						1396	1792	2041	2256	2614	2853	3113	3398	3708	4046
POL and Other Energy						419	371	372	355	383	394	404	415	427	438
Other Imports						33081	28746	33058	43090	46477	50953	55878	62105	69050	76799
Other Consumer Goods						13190	11499	13211	16988	18409	20270	22318	24574	27057	29791
Intermediate Goods						6282	5469	6365	8519	9504	10772	12209	13838	15685	17778
Primary						0	0	0	0	0	0	0	0	0	0
Manufactures						6282	5469	6365	8519	9504	10772	12209	13838	15685	17778
Capital Goods						13609	11777	13482	17582	18564	19911	21350	23693	26309	29230
Total Merch. Imports CIF						34896	30908	35471	45701	49475	54199	59395	65918	73184	81283
Country Indices						Price Indices 1986=100									
Merchandise Exports						100.0	105.5	110.0	113.6	115.2	116.9	118.7	120.5	122.2	124.1
Merchandise Imports						100.0	103.8	109.5	115.4	115.4	116.7	118.1	119.4	120.8	122.3
Merch. Terms of Trade						100.0	101.6	100.4	98.5	99.8	100.2	100.5	100.8	101.2	101.5
EPD/ERS Indices															
Merchandise Exports								—	—	—	—	—	—	—	—
Merchandise Imports								—	—	—	—	—	—	—	—
Merch. Terms of Trade								—	—	—	—	—	—	—	—

	B. Share of Total X or M (%) at current prices						C. Growth Rates (%) at constant prices				
	1965	1973	1980	1986	1991	1995	1965-73	1973-80	1980-85	1986-90	1990-95
Merchandise Exports											
Food				16.0	5.1	4.0				-8.6	3.0
Petroleum				12.0	8.9	8.2				1.1	5.0
Commodity 3				0.0	0.0	0.0				0.0	0.0
Commodity 4				0.0	0.0	0.0				0.0	0.0
Manufactures				64.0	77.3	79.0				12.4	9.5
Other Exports				8.0	8.6	8.9				10.6	8.0
Total Merch. Exports FOB				100.0	100.0	100.0				8.6	8.6
Merchandise Imports											
Food				4.0	5.3	5.0				18.0	8.8
POL & Other Energy				1.1	0.7	0.5				-5.6	0.0
Other Imports				94.8	94.0	94.5				6.8	9.3
Other Consumer Goods				33.0	37.4	36.7				6.5	8.8
Intermediate Goods				18.0	19.9	21.9				8.8	12.0
Primary				0.0	0.0	0.0				0.0	0.0
Manufactures				18.0	19.9	21.9				8.8	12.0
Capital Goods				33.8	36.7	36.0				6.1	8.3
Total Merch. Imports CIF				100.0	100.0	100.0				7.2	9.2

CHINA - BALANCE OF PAYMENTS Attachment 3c

(US$ millions at Current Prices)

	Actual						Prelim.	Projections							
	1980	1981	1982	1983	1984	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
A. Exports of Goods & NFS						29583	34502	38803	43541	47634	52390	57636	63422	69807	77468
1. Merchandise (FOB)						25756	30105	33660	37726	41492	45703	50356	55498	61180	67461
2. Non-Factor Services						3827	4397	5143	5815	6142	6687	7280	7925	8627	10007
B. Imports of Goods & NFS						37172	34506	39603	50363	54392	59547	65215	72254	80087	89298
1. Merchandise (FOB)						34896	30908	35471	45701	49475	54199	59395	65918	73184	81283
2. Non-Factor Services						2276	3598	4132	4663	4917	5348	5820	6336	6902	8015
C. Resource Balance						-7589	-4	-800	-6822	-6757	-7157	-7579	-8831	-10279	-11831
D. Net Factor Income						-238	-237	-159	-89	-327	-540	-697	-982	-1334	-1795
1. Factor Receipts						986	1001	1251	1376	1633	1741	1871	2013	2190	2389
2. Factor Payments						1224	1238	1410	1465	1960	2281	2568	2995	3525	4184
(interest payments)						1014	1039	1107	1162	1657	1978	2265	2692	3221	3880
E. Net Current Transfers						379	368	368	368	368	368	368	368	368	368
1. Current Receipts						516	505	505	505	505	505	505	505	505	505
a. workers' remittances						266	125	125	125	125	125	125	125	125	125
b. other current trans.						250	380	380	380	380	380	380	380	380	380
2. Current Payments						137	137	137	137	137	137	137	137	137	137
F. Current Account Balance						-7448	127	-591	-6544	-6716	-7330	-7908	-9445	-11246	-13258
G. Long-Term Capital Inflow						7750	1569	2975	8792	7234	7901	9446	10625	12661	15061
1. Direct Investment						1875	1401	1331	1331	1331	1331	1331	1331	1331	1331
2. Official Capital Grants						0	0	0	0	0	0	0	0	0	0
3. Net LT Loans (DRS data)						5522	1518	1644	7461	5903	6571	8116	9295	11331	13731
a. Disbursements						6890	3060	3193	9135	7769	8634	10456	13061	15654	18863
b. Repayments						1368	1541	1549	1674	1866	2063	2340	3766	4323	5132
4. Other LT Inflows (net)						353	-1351	0	0	0	0	0	0	0	0
H. Total Other Items (net)						-339	1301	0	0	0	0	0	0	0	0
1. Net Short Term Capital						-1532	1301	0	0	0	0	0	0	0	0
2. Capital Flows N.E.I.						1193	0	0	0	0	0	0	0	0	0
3. Errors and Omissions						0	0	0	0	0	0	0	0	0	0
I. Changes in Net Reserves						1260	841	-1670	-3429	-1434	-1736	-1888	-2367	-2651	-3129
1. Net Credit from IMF						-731	0	0	0	0	0	0	0	0	0
2. Other Reserve changes						1991	841	-1670	-3429	-1434	-1736	-1888	-2367	-2651	-3129
(- indicates increase)															
Shares of GDP (Current US$):															
1. Resource Balance						-2.8	0.0	-0.2	-1.8	-1.7	-1.6	-1.6	-1.7	-1.8	-1.8
2. Total Interest Payments						0.4	0.3	0.3	0.3	0.4	0.4	0.5	0.5	0.6	0.6
3. Current Account Balance						-2.7	0.0	-0.2	-1.7	-1.6	-1.7	-1.6	-1.8	-2.0	-2.0
4. LT Capital Inflow (line G)						2.9	0.5	0.9	2.3	1.8	1.8	2.0	2.0	2.2	2.3
5. Net Credit from the IMF						-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Item:															
GDP (____ of Current US$)						271889	298308	342585	386578	407701	443412	482513	525342	572270	664547
Foreign Exchange Reserves:															
1. Int'l. Reserves (IFS 11d)								—	—	—	—	—	—	—	—
2. Gold (end yr London price)								—	—	—	—	—	—	—	—
3. Gross Reserves incl. Gold								—	—	—	—	—	—	—	—
4. Gross Res. in Months Imports								—	—	—	—	—	—	—	—
Exchange Rates (LCU/US$):															
1. Nom. Off. X-Rate (IFS rh)								—	—	—	—	—	—	—	—
2. Real Eff. X-Rate (1980=100)								—	—	—	—	—	—	—	—
3. X-Rate for GNP Conversion								—	—	—	—	—	—	—	—

CHINA - EXTERNAL CAPITAL AND DEBT

(US$ millions at Current Prices)

	Actual						Prelim.	Projections							
A. Disbursements	1980	1981	1982	1983	1984	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
1. Public & Publicly Guar. LT						6890	3060	3193	5430	5624	5964	6823	8020	9268	10649
Official Creditors						1229	1403	2567	3148	3673	4208	4540	4866	5208	5442
Multilateral						659	674	1316	1850	2235	2617	2930	3233	3542	3742
of which IBRD						324	361	622	853	1076	1321	1554	1774	2004	2132
of which IDA						282	261	373	501	537	585	618	649	674	689
Bilateral						570	729	1251	1298	1438	1591	1610	1633	1666	1699
Private Creditors						5661	1657	626	2301	1951	1756	2282	3154	4060	5208
Suppliers						100	98	49	9	3	0	0	0	0	0
Financial Markets						5560	1559	577	2293	1948	1756	2282	3154	4060	5208
2. Private Non-Guar. LT						0	0	0	3686	2146	2670	3634	5041	6386	8213
3. Total LT Disbursements						6890	3060	3193	9135	7769	8634	10456	13061	15654	18863
4. IMF Purchases						731	0	0	0	0	0	0	0	0	0
5. Net Short-Term Capital						-1532	1301	0	0	0	0	0	0	0	0
6. Total incl. IMF & Net ST						6089	4361	3193	9135	7769	8634	10456	13061	15654	18863
B. Repayments															
1. Public & Publicly Guar. LT						1368	1541	1549	1674	1866	2063	2340	3029	3157	3432
Official Creditors						181	431	448	470	520	598	855	1095	1237	1574
Multilateral						36	82	99	124	156	244	372	517	704	929
of which IBRD						0	7	24	48	81	203	331	437	580	758
of which IDA						0	0	0	0	0	0	2	3	7	11
Bilateral						145	349	349	346	364	354	482	579	533	645
Private Creditors						1187	1110	1100	1205	1346	1464	1486	1933	1920	1858
Suppliers						148	211	232	356	251	218	183	201	88	72
Financial Markets						1038	900	868	848	1095	1247	1302	1733	1831	1786
2. Private Non-Guar. LT						0	0	0	0	0	0	0	737	1166	1700
3. Total LT Repayments						1368	1541	1549	1674	1866	2063	2340	3766	4323	5132
4. IMF Repurchases						0	0	0	0	0	0	0	0	0	0
C. Interest															
1. Public & Publicly Guar. LT						1014	1039	1107	1162	1358	1546	1704	1903	2156	2479
Official Creditors						282	356	395	478	593	732	890	1057	1237	1426
Multilateral						77	120	156	224	318	433	562	704	858	1018
of which IBRD						66	105	137	182	240	310	387	475	575	678
of which IDA						8	12	13	14	17	20	24	28	32	37
Bilateral						205	236	239	254	275	299	327	353	378	409
Private Creditors						732	683	711	684	765	814	814	846	919	1053
Suppliers						177	135	126	109	82	63	50	34	21	15
Financial Markets						554	548	586	575	683	750	765	812	898	1037
2. Private Non-Guar. LT						0	0	0	0	299	432	561	789	1066	1401
3. Total LT Interest						1014	1039	1107	1162	1657	1978	2265	2692	3221	3880
4. IMF Service Charges						0	0	0	0	0	0	0	0	0	0
5. Interest on ST Debt						0	640	744	744	744	744	744	744	744	744
6. Total incl. IMF & Net ST						1014	1679	1851	1906	2401	2722	3009	3436	3965	4625

Memorandum Item:
Available information on arrears and rescheduling should be reported as memorandum items.
The Debt Compilers Working Group with representatives from the main agencies concerned,
is now working on standards for reporting in these areas.

(continued on next page)

CHINA - EXTERNAL CAPITAL AND DEBT

	Actual						Prelim.	Projections							
D. External Debt (DOD)	1980	1981	1982	1983	1984	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
1. Public & Publicly Guar. LT						17193	17936	19580	23356	27143	31040	35583	40552	46625	53842
Official Creditors						6958	7930	10048	12727	15910	19519	23265	27013	30946	34813
Multilateral						1959	2550	3766	5493	7572	9945	12563	15256	18056	20868
of which IBRD						755	1109	1708	2513	3508	4626	5849	7186	8610	9983
of which IDA						774	1035	1408	1909	2446	3030	3645	4291	4957	5636
Bilateral						5000	5380	6282	7234	8338	9575	10702	11757	12890	13945
Private Creditors						10234	10006	9532	10629	11233	11521	12318	13538	15679	19029
Suppliers						1824	1711	1528	1180	932	711	527	327	239	167
Financial Markets						8410	8295	8004	9448	10301	10810	11790	13212	15440	18862
2. Private Non-Guar. LT						0	0	0	3686	5832	8500	12134	16437	21657	28171
3. Total Long-Term DOD						17193	17936	19580	27041	32974	39541	47717	56989	68282	82012
4. IMF Credit						0	0	0	0	0	0	0	0	0	0
5. Short-Term Debt						8000	9301	9301	9301	9301	9301	9301	9301	9301	9301
6. Total incl. IMF & Net ST						25193	27237	28881	36342	42275	48841	57018	66290	77583	91313
Percent of Total LT DOD:															
1. On Concessional Terms						36.1	37.8	40.7	34.6	33.2	32.2	30.5	28.5	26.3	24.0
2. With Variable Int. Rates						48.9	46.2	40.9	48.6	48.9	48.8	50.1	52.0	54.3	57.3
E. Bank and IDA Ratios															
Share of Total LT DOD (D.3)															
1. IBRD as % of Total						4.4	6.2	8.7	9.3	10.6	11.7	12.3	12.6	12.6	12.2
2. IDA as % of Total						4.5	5.8	7.2	7.1	7.4	7.7	7.6	7.5	7.3	6.9
3. IBRD+IDA as % of Total						8.9	12.0	15.9	16.4	18.1	19.4	19.9	20.1	19.9	19.0
Share of LT Debt Serv (B.3+C.3)															
1. IBRD as % of Total						2.8	4.3	6.1	8.1	9.1	12.7	15.6	14.1	15.3	15.9
2. IDA as % of Total						0.4	0.5	0.5	0.5	0.5	0.5	0.6	0.5	0.5	0.5
3. IBRD+IDA as % of Total						3.1	4.8	6.5	8.6	9.6	13.2	16.2	14.6	15.8	16.5
F. DOD-to-Exports Ratios (a)															
1. Long-Term Debt/Exports						55.8	50.3	48.7	60.0	66.8	72.9	80.0	86.9	94.7	102.5
2. IMF Credit/Exports						0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3. Short-Term Debt/Exports						25.9	26.1	23.1	20.6	18.8	17.1	15.6	14.2	12.9	11.6
4. LT+IMF+ST DOD/Exports						81.7	76.4	71.9	80.7	85.6	90.0	95.6	101.1	107.6	114.2
G. DOD-to-GDP Ratios															
1. Long-Term Debt/GDP						6.3	6.0	5.7	7.0	8.1	8.9	9.9	10.8	11.9	12.3
2. IMF Credit/GDP						0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3. Short-Term Debt/GDP						2.9	3.1	2.7	2.4	2.3	2.1	1.9	1.8	1.6	1.4
4. LT+IMF+ST DOD/GDP						9.3	9.1	8.4	9.4	10.4	11.0	11.8	12.6	13.6	13.7
H. Debt Service/Exports (a)															
1. Public & Publicly Guar. LT						7.7	7.2	6.6	6.3	6.5	6.7	6.8	7.5	7.4	7.4
2. Private Non-Guar. LT						0.0	0.0	0.0	0.0	0.6	0.8	0.9	2.3	3.1	3.9
3. Total LT Debt Service						7.7	7.2	6.6	6.3	7.1	7.4	7.7	9.9	10.5	11.3
4. IMF Repurchases+Serv.Chgs.						0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
5. Interest only on ST Debt						0.0	1.8	1.9	1.7	1.5	1.4	1.2	1.1	1.0	0.9
6. Total (LT+IMF+ST Int.)						7.7	9.0	8.5	7.9	8.6	8.8	9.0	11.0	11.5	12.2
I. Interest Burden Ratios															
1. Total Interest/GDP						0.4	0.6	0.5	0.5	0.6	0.6	0.6	0.7	0.7	0.7
2. Total Interest/Exports (a)						3.3	4.7	4.6	4.2	4.9	5.0	5.0	5.2	5.5	5.8

(a) Ratio to "Exports" with latter defined to include merchandise, all services and workers remittances.

CHINA - PUBLIC FINANCE, MONEY AND CREDIT

Attachment 3e

	Actual					Prelim.	Growth Rate (% p.a.)		
	1980	1982	1983	1984	1986	1987	1980-84	1986	1987
I. Public Finance (% shares of GDP)									
Government Budget (Level)									
A. Total Current Receipts									
1. Indirect Tax Revenues									
(of which from public sector)									
2. Direct Tax Revenues									
(of which from public sector)									
3. Non-Tax Current Receipts									
(of which from public sector)									
B. Total Current Expenditures									
1. Interest Payments									
2. Subsidies (of prices)									
(of which to public sector)									
3. Other Transfer Payments									
(of which to public sector)									
4. Goods and Services									
C. Current Budget Balance									
D. Capital Receipts									
E. Capital Expenditures									
1. Financial Investments & Grants									
(of which to public sector)									
2. Budgetary Real Investment									
F. Overall Balance Financed by:									
1. Official Capital Grants									
2. External Borrowing (net)									
a. disbursements									
b. repayments									
3. Domestic Financing									
a. non-bank borrowing (net)									
b. borrowing from banks									
G. GDP at Current Market Prices (in ____ of LCUs)							—	—	—
II. Money and Credit (Monetary Survey Data from IFS)									
A. In Millions of LCUs at end year:									
Money Supply									
Money + Quasi-Money									
Total Net Domestic Credit									
To Government (net)									
To Official Entities									
To Private Sector									
Net Foreign Assets							—	—	—
Net Other Assets & Liabilities							—	—	—
B. Offsets to Expansion of M&QM(%):									
Net Foreign Assets							—	—	—
Credit to Government							—	—	—
Credit to Official Entities							—	—	—
Credit to Private Sector							—	—	—
Net Other Assets & Liabilities							—	—	—
Increase in Money + Quasimoney							—	—	—

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. Dubey
file room

DATE: March 28, 1988

TO: Distribution Below

FROM: Baelhadj Merghoub, Acting Director, AS3

EXTENSION: 72639

SUBJECT: CHINA Country Strategy Paper -- Working Level Review

You are invited to a meeting on Tuesday, April 5 at 2:30 p.m. in room C6010 to discuss the attached CSP.

Please give any comments before the meeting to Mr. Paul Cadario, C9037.

Distribution:

Messrs. Burki, Yenal, Ecevit, Goldberg, Montfort, Stern, Ahmad, Tidrick, K. Amhed
Messrs. Inakage, Dubey (3), J. Wood, Bock, Picciotto, Shakow (4), Fischer, Holsen, Baneth, Willoughby, Warford, Vyas, Churchill, Pouliquen, Rao (2), Vorkink (4), R. Frank, Parmar
Mmes. Hamilton, Schaeffer

cc: AS3CO Staff, Mr. Lim

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Country file ~~OEG~~ ~~DGP~~ ~~DIH~~ File

December 17, 1987

TO: Mr. J. Baneth, IECDR

FROM: Ishrat Husain, IECFI

SUBJ: **China and India Debt Mission: Back-to-Office Report**

Executive Summary and Recommendations

China

1. The mission, during its visit to China, was able to accomplish the following tasks:

   (a) Update and reconcile the 1985 and 1986 external debt statistics (with the exception of original amounts on new commitments for 1986).

   (b) Review and understand the new external debt data reporting and collection system.

   (c) Deliver seminars and hold discussions (i) on the relationship between balance of payments and external debt, (ii) the rationale for an integrated debt management system and (iii) the World Bank Debtor Reporting System.

   (d) Help in identifying technical assistance needs of the State Administration for Exchange Control (SAEC) in setting up the new registration system.

2. Although the mission was unable to reach a specific timetable for future debt reporting by Chinese authorities, some tentative understandings were reached with the working level staff that are still subject to approval by higher authorities in the Chinese government.

3. The mission recommends an upgrading of China from Category IIIa to Category II in terms of O.M.S. 3.11. subject to review in March, 1988.

India

4. The mission reviewed the data collection system, especially on external commercial borrowing, that is being developed with the assistance of the Commonwealth Secretariat and agreed with the Indian authorities on an action plan aimed at improving the quality and timeliness of commercial debt reporting by India to the World Bank.

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5. The mission also recommends upgrading India from Category IIIa to Category II in terms of O.M.S. 3.11. subject to review of the situation by the end of the current fiscal year and subject to compliance with agreements reached.

Japan

6. The mission was able to update the recent data on Japanese official resource flows to developing countries disaggregated on a country-by-country basis.

Hong Kong

7. The mission reviewed the foreign operations of the Bank of China to the extent that they created sovereign debt obligations for the Chinese Government.

Full Report

8. In accordance with the terms of reference dated October 26, I visited China and India and made brief stop-overs in Tokyo and Hong Kong on the way. In China I was joined by Ms. Nancy Stavrou. Ms. Christine Wallich, Senior Economist of China Operations Division participated in almost all the meetings except the wrap-up and Mr. Paul Cadario, Senior Country Program Officer on China, attended several meetings including the wrap-up. In India Mr. Jim Hanson of the New Delhi office attended the substantive meetings held with the Indian officials. A list of officials met is attached at Annex I. A note on the presentation made at the wrap-up meetings held on November 20 and 21 is attached as Annex II.

CHINA

1986 Debt Profile

9. China's external debt has almost quadrupled since 1980 from an estimated \$5.4 billion to \$21.5 billion consisting of \$16.71 billion in long-term and \$4.77 billion short-term debt at the end of 1986. 1/. This represents an increase of about \$5.7 billion or 26.5 percent above the 1985 Disbursed and Outstanding debt (DOD). The new commitments during the year amounted to \$8.716 billion. Preliminary estimates also show that at least 65 percent of the total debt outstanding is from commercial banks on non-commercial terms and at variable interest rates.

10. At present, China's reported debt in relation to GNP and its debt service payments relative to exports of goods and services are not large in comparison to a number of other developing countries. However, if commercial borrowing is pursued at the 1985 and 1986 level, its sustainability over the medium term would become questionable.

1/ China's officially reported figures resulting from the national debt survey conducted by SAEC.

11. The most important borrowing entity was the Bank of China which had claims of over $10.427 billion against it, representing almost one-half of China's DOD. The direct debt owed by the Central Government was 20 percent of the total outstanding. The share of the Peoples' Bank of China was 5 percent and that of the wholly State-owned enterprises 6.7 pecent. Sino-Foreign joint and cooperative enterprises and foreign owned enterprises had contracted about 5.4 percent. Other financial institutions such as CITIC and provincial ITICs owed about 11.5 percent of the total DOD.

12. In regard to the use of external borrowing, heavy industry sector was allocated 43 percent of total loans while transport and communication sector received about 10 percent. China's debt was denominated mainly in US dollars (45 percent) and Japanese Yen (38 percent).

13. The major discrepancy between China's debt numbers reported officially and by other sources such as OECD lies in the estimates of short-term debt (S.T.debt). While other sources estimate S.T. debt in 1986 around $7.1 billion out of the total DOD of $24.7 billion the official report produced by the Chinese Government places it at $4.8 billion out of $21.5 billion. The large difference in these two estimates of S.T. debt ($2.3 billion) explains most of the variation in the total outstanding debt stock. The State Administration of Exchange Control (SAEC) had carried out a comprehensive nationwide survey to prepare the 1986 external debt estimates. The SAEC has been more than cooperative and provided the mission with the raw data on each individual loan. The mission then cross-checked this data with information available from creditor sources and attempted a reconciliation. Although the treatment of S.T. debt is as a general rule quite problematic the basis of the official report i.e. the nationwide credit survey (which covered all the banking and financial institutions that provided the short-term credit during the year) appears to us more reliable than other sources. The mission has thus accepted China's short-term debt to be $4.8 billion. Our estimate of China's total DOD for 1986 which we are publishing in WDR is thus $22.7 billion. Table 1 reproduces the evolution of China's external debt over 1980-86 period.

External Debt Statistics System

14. China entered international financial markets only a few years ago and therefore the system of compiling external debt statistics has been going through a process of evolutionary development. Until 1985, the Ministry of Finance (MOF)'s Debt Management Division was given the responsibility of collecting and publishing the data on China's external debt but in fact their coverage extended to only direct Central Government borrowings and borrowings from multilateral agencies. Peoples' Bank of China (PBC) carried out the transactions with the IMF and ADB, the Ministry of Foreign Economic Relations and Trade (MOFERT), with the bilateral governments and Bank of China (BOC) with the commercial banks. These agencies maintained detailed records in respect to their own borrowings and only provided summary information to the MOF. The reporting frequencies as well as format varied considerably and therefore the debt picture up to 1984 may not be considered either accurate or complete.

Table 1
Outstanding External Debt 1980-1986
(In millions of US$ dollars)

Creditor Type	1980	1981	1982	1983	1984/1	1985/2	1986/2
Bilateral	446	926	1,479	2,216	2,727	3,634	4,937
Multilateral	-	47	97	568	593	1,185	2,631/3
Financial Institutions	3,754	2,620	1,870	4,489	4,520	8,130	9,475
Bond Issues	-	-	40	60	62	1,000	2,700
Suppliers	1,038	1,108	1,590	1,592	1,600	1,736	1,112
Other Trade Credits				687	2,039	...	144
Leasing Co.					38	140	485
Other Including IMF	195	1,085	982	-	508	...	
TOTAL	**5,433**	**5,785**	**6,058**	**9,608**	**12,085**	**15,825**	**21,484**
Of Which: Short-Term	/5 ...	...	...	3,984	5,600	6,419/4	4,769/4
Short-Term as a % to exports				15.9	19.5	21.7	15.8
Short-Term as a % of Reserves				20.1	26.3	38.0	29.0

/1 IMF estimates 1980-1984.
/2 Official reported 1985-1986.
/3 Includes IMF.
/4 Suspected to exclude non-Bank trade credits.
/5 ... Not available.

15. In 1985, the SAEC was assigned the responsibility for preparing a consolidated statement of all external debt transactions including amounts outstanding, disbursed, repayments made, interest paid etc. by all the agencies and enterprises in the country. SAEC has carried out two nationwide surveys for 1985 and 1986 and already published a comprehensive report for 1985 and is in the process of publishing the 1986 report. As the reporting requirements to SAEC did not stem from any statutory or regulatory powers it was always possible that some of the borrowing may have remained unmonitored and unreported.

16. An attempt to remedy this situation has now been made and the State Council has promulgated a new regulation entitled "Provisional Regulations for Statistics and Supervision of External Debt" on August 27, 1987 (Annex III). These regulations empower the SAEC as the sole agency in charge of compiling and publishing the statistics and supervision of the external debt of the country. Each borrowing unit is required to register the debt with SAEC within 15 days of signing the loan agreement. The main features of China's external debt system, including a review of availability and limitations of debt data are described in Annex IV.

Debt Statistics Reporting to the World Bank

17. The mission reviewed the current status of the debt statistics reporting requirements to the World Bank in terms of O.M.S. 3.11. While a major breakthrough has been made in compiling and submitting the data for 1985 and 1986 there is some uncertainty in regard to the 1987 data (both Forms 1 and 2) and new commitments for 1986. The mission was encouraged by the perceptible commitment of the Chinese officials in setting up the new system of debt registration and seeking technical assistance from the World Bank for this purpose. Although we recognize that it would take some time before the new system is fully in place we suggested an alternative for the interim duration that would enable China to fulfill its reporting requirements to the Bank.

18. The mission proposed that until such a time as the staff of the branches of the SAEC are fully trained to set up and operate the registration system and adequate computing facilities are in place the SAEC may submit Forms 1 and 2 on the basis of reports compiled by nine major borrowers who together account for 80-90 percent of total external borrowing of China. The year-end report to the Bank can be updated to incorporate the complete information as compiled through the branches of SAEC. This proposal was discussed with the working level staff of the MOF and SAEC but was not approved by the higher authorities. The mission briefed the Resident Representative and left a note for him, seeking his assistance. The mission recommends that a letter be sent to the Vice Minister of Finance and the Vice Governor of Peoples' Bank of China incorporating this proposal and seeking their concurrence.

19. In view of (a) our having obtained debt data for the period ending December 1986, (b) the establishment of a comprehensive debt registration

system and (c) possible technical assistance by the Bank to Chinese, the mission recommends a qualified upgrading of China from Category IIIb to Category II in terms of O.M.S. 3.11. This position should be reviewed in March 1988 in light of the response to our letter and further developments on the T.A. request.

Seminars on Debt Management

20. The MOF organized a series of seminars that the mission presented on the relationship between balance of payments and external debt, the rationale for an integrated debt management system, international experience and approaches to debt regulation, control and monitoring; and the World Bank Debtor Reporting System (DRS). In addition, Mr. Peter Dittus, Country Economist on China presented a demonstration of RMSM model. The seminars were attended by about 30 officials from the MOF, SAEC, PBC, BOC, MOFERT, CITIC, State Planning Commission, Systems Reform Commission etc. Most of the discussion was focussed on specific country experience and examples of well managed systems of debt management. There was a clear feeling that China should avoid the mistakes of highly indebted countries. A paper prepared for the seminar on integrated debt management systems that brings together the best practices prevalent in a cross section of member countries will be circulated separately. In view of the keen interest expressed in comparative country experiences the Division should attempt to put together such experiences in a more systematic manner and make these findings available to the member countries.

Technical Assistance for Debt Component

21. The Chinese officials discussed the possibilities of T.A. for helping SAEC in installing the new system of debt reporting and trainable staff. Ms. Wallich and Mr. Cadario prepared a proposal for a subproject under the Special Studies Credit and SAEC indicated that they would send a formal request to Mr. Burki after obtaining higher level approval.

INDIA

Debt Profile

22. India's external DOD by the end of 1987 fiscal year was estimated at $35.1 billion, of which two-thirds was concessional. The share of public and publicly guaranteed debt was over 90 percent. The debt service ratio has risen from 21.2 percent to 25.8 percent primarily due to IMF repurchases. The repurchases which peak over the next three years raise the debt service ratio by about 5 to 6 percentage points. Export performance in the first half of calendar year 1987 has been quite impressive and if the present trend is sustained India should have little difficulty in servicing its debt with annual new commitment levels of $6.5-7.5 billion. These inflows are consistent with the current account and external reserves targets set out in the Seventh Plan.

External Debt Reporting

23. The external debt management system in India is highly centralized and every private, public enterprise or state government planning to borrow abroad requires prior approval of the Ministry of Finance (MOF). /The approvals are made on a case-by-case basis and in case of public sector, the inclusion of the project in Five year Plan or the Annual Budget is a major criterion governing the approval decision. For the private sector, the foreign exchange saving or earning resulting from the investment is a primary consideration./ The all-pervasive exchange controls ensure that all disbursements and debt servicing transactions are within the knowledge of the Reserve Bank of India (RBI) who, in turn, inform the MOF.

24. The Indian officials informed the mission that they are current on direct government borrowing as they have submitted Forms 1 for the period ending September 1987. The situation, in regard to the commercial and suppliers' credits, has improved considerably since the installation of the Commonwealth Secretariat Data Monitoring system (CS-DMS). The system which will be operated both in the MOF and the RBI is a significant improvement in the compilation and collation of debt statistics on non-official borrowing. Despite the highly centralized and regulated system, information on transactions on these loans, particularly private non-guaranteed, was available in individual borrower files and was not systematically collated. The MOF officials therefore explained that the discrepancy between their reported data and those published by the creditor sources or trade publications could be attributed to a host of factors including incomplete coverage of data in the MOF files.

25. Under the new system, the database for these loans has been suitably expanded to cover the key variables and the database is commonly shared by the MOF and RBI. In instances where the borrowers may not directly report the drawdowns and repayments to the MOF the exchange of diskettes between the two institutions will fill in the gap. The RBI has complete information on all inward and outward transactions of foreign exchange and will record all foreign borrowing transactions on the CS-DMS database and send the diskette containing the updated information to the MOF every month. The MOF will compare it with their database, fill in the gaps, if any, and send the reports to the Bank. Annex IV presents the description of reports that are proposed to be produced by CS-DMS regularly for specific use of the World Bank and IMF.

26. The mission conveyed its concern to the MOF that there was an urgent need to integrate the two independent debt monitoring systems taking shape in the Ministry - one for direct official borrowing maintained by the Controller of Aid Accounts and Foreign Aid Policy Coordination Division while the other for commercial borrowing by the External Commercial Borrowing Division. As the commercial borrowing data includes publicly guaranteed debt there is a need to present the public and publicly guaranteed debt in an integrated manner irrespective of the source of finance - whether official or commercial. The current presentation also does not provide adequate information to the Indian managers in respect to the composition, average maturities, grace period and interest rate of the consolidated external debt

of the country, Thus the use of this information in designing the borrowing strategy is severely constrained. The Indian authorities recognized the importance of integrating the two sets of data and indicated that they are seeking the Commonwealth Secretariat (CommSec) assistance to resolve this problem. As I understand, the rationale for creating two independent data bases stems from the limited capability of CS-DMS itself. We should inquire from CommSec about their future plans in India.

27. The mission was able to reach agreement with the Indian officials on the following plan of action:-

(a) Forms 1 on direct government borrowing will be sent to the Bank every quarter as stipulated in the DRS.

(b) Forms 2 on direct government borrowing will now be prepared on the calendar year basis (i.e. closing date December 31) and forwarded to the Bank by March. As the accounts are closed on March 31 (India's fiscal year) these forms would be updated to reflect the final accounts and sent to the Bank by end-July.

(c) Forms 1 on commercial borrowing and suppliers' credits (which covers both publicly guaranteed and private non-guaranteed) for the year 1987 will be sent to us by end-February 1988. From then onwards, the Forms 1 will be sent initially with a delay of two to three months after each quarter to allow verification and reconciliation procedures with the Reserve Bank of India (RBI) to be in place. Once these procedures are clearly established, the Indian officials believe that submission of Forms 1 for commercial borrowing and suppliers' credits can also be scheduled on the same basis as that of the direct government borrowing.

(d) Forms 2 on commercial borrowing and suppliers' credits for 1987 will reach us, at the latest, by March 1988 and then on a regular basis.

28. On the basis of the current status of official debt reports (current till September 1987) and the plan of action agreed with the Indian authorities in respect of external commercial borrowing, the mission recommends upgrading of India from Category IIIb to Category II in terms of O.M.S. 3.11 subject to a review of the situation by the end of current fiscal year and subject to compliance with agreements reached.

<u>JAPAN</u>

29. The mission had very useful discussions with the OECF, Ex-Im Bank, and the Ministry of Foreign Affairs on the flows of resources to LDCs and the future plans of the Japanese Government. We were able to obtain end-1986 data on Japanese loans and grants on a country by country basis. This information will be used in the preparation of a resources transfer paper for the Development Committee.

30. The meetings with the Bank of Tokyo and Industrial Bank of Japan provided an insight into Japanese commercial bankers' attitude towards different categories of borrowing countries. Most of the banks rely on the country analysis prepared by the Japan Center for International Finance (JCIF) for their risk evaluation and country exposure limits.

HONG KONG

31. The mission met with the Deputy General Manager, Bank of China (Hong Kong) and discussed the mode of foreign operations of the BOC and the use of overseas deposits raised by BOC in international financial markets by the Chinese entities.

IBRD Borrowing

32. I would like to touch upon an important issue that may be quite familiar to the operational staff working on India and China but which we found a bit disturbing. We were struck by the apparent similarity in the reservations of Chinese and Indian officials towards borrowing from IBRD. In both Beijing and New Delhi the foreign commercial bankers, whom we met echoed the same sentiments as the officials. This close concordance between the views of the bankers and the government officials may not be simply coincidental. Both China and India have managed their economies resonably well, have demonstrated potential for economic growth, are attempting to liberalize their economies and attract foreign investments, have modest debt ratios with above-average level of external reserves, and rank quite high on the relative scale of political stability. These characteristics of the two countries are a vivid contrast to the other highly indebted countries of Latin America where the commercial bankers are heavily exposed. The fast growing East Asian countries, especially Korea, Malaysia and Thailand, are for the time being shut out for the commercial bankers as they are not so keen to increase their debt. Thus the commercial banks are focussing on China and India as their next target zone. Though still cautious due to their experience in the Highly Indebted Countries (HICs), I heard the following line of argument that is being presented by the bankers (presumably also to the policy makers in India and China).

(a) The cost of borrowing from IBRD including the commitment charges is at least 100-150 basis points higher than commercial bank (CB) borrowing.

(b) The CB borrowing is not encumbered by any rigid conditionalities and subsequent supervision that infringe upon the sovereignty of the country.

(c) The CB borrowing does not require the cumbersome international competitive bidding procedures and can be utilized in a more flexible manner according to the preference of the countries.

(d) IBRD does not favor investment in some critical sectors of the economy such as iron and steel, heavy industries, automobiles, which are so essential for the take-off of India and China while CB loans can be applied for any project that the country deems fit.

33. In both these countries I discerned a distinct feeling that the IBRD resources need to be sweetened with a much larger proportion of IDA money to make the Bank lending relatively attractive.

34. I am sure the operations staff in these countries are doing their utmost to respond to these arguments but I thought I would lay them down for the benefit of staff concerned with strategic issues in the Bank.

cc: Messrs. Fischer, Karaosmanoglu, Alisbah, Burki, Yenal, Shakow, Bock, Dubey, Merghoub, Ritchie, Tidrick, Greene, Cadario, Lim, Hanson, Steer, Pfeffermann, Ms. Wallich, Ms. Oakes-Smith

IHusain:gr

List of Persons Met

CHINA

Ministry of Finance

1. Mr. Zhu Fulin, Director, General Planning Department
2. Mr. Zhang Jialun, Deputy Director
3. Mr. Mei Jiamuo, Chief, Debt Management Division
4. Mr. Wei Wei, Debt Management Division

State Administration of Exchange Control

1. Mr. Ling Zeti, Deputy Director
2. Mr. Qiao Rui, Chief, External Debt Division
3. Mr. Tang Shi Min, External Debt Division

State Planning Commission

1. Mr. Zhong Guangquan, Division Chief, Bureau of External Loans (BEL)
2. Ms. Liu Xuhong, Deputy Division Chief, BEL

CITIC

Mr. Dou Jianzhong, Vice President

Bank of China

Mr. Mai Guoping, General Manager, International Finance

Systems Reform Commission

Mr. Mao Minxian, Director

Ministry of Foreign Economic Relations and Trade

Mr. Chen Kongming, Divisiosn Chief, Foreign Financing Administration

INDIA

1. Mr. J. L. Bajaj, Joint Secretary, Ministry of Finance
2. Mr. Madhav Lal, Deputy Secretary, Ministry of Finance
3. Mr. Anil Beesen, External Commercial Borrowing Division, Ministry of Finance

JAPAN

1. Mr. Mitsuhiro Sasanuma, Managing Director, OECF
2. Mr. Yoichi Aki, Deputy Managing Director, OECF
3. Mr. Masahiro Hirano, Deputy General Manager, Industrial Bank of Japan
4. Mr. Yoshio Osawa, Joint General Manager, Industrial Bank of Japan
5. Mr. Takuo Oi, Deputy General Manager, Bank of Tokyo
6. Mr. Yasuharu Kawasoe, Assistant Manager, Bank of Tokyo
7. Mr. Masatsugu Norimoto, Senior Manager, Ex-Im Bank

HONG KONG

Mr. Semo Lau, Assistant General Manager, Bank of China

ANNEX II

Wrap-up Meeting held at the Ministry of Finance, Beijing on Friday Nov 29, 1987 on the External Debt Mission Findings

Debt Data Collection System

1. The mission was favorably impressed by the keen awareness of the officials in the Chinese Government that they should be prudent in their external borrowing policy, they should monitor the debt carefully and they should avoid the mistakes and pitfalls made by other countries. The balance between the desire to liberalize the economy and decentralize decision-making, on one hand, and to adopt a centralized and coordinated approval control, and information system on external debt is always difficult to strike in actual practice. Even countries where the debt and foreign exchange management has been more centrally controlled by the authorities than in China have suffered from non-availability of adequate and timely information on the magnitude of their external liabilities.

2. In China, the foreign exchange retention system whereby the enterprises and entities can service their own debt obligation without reference to the Central Bank creates a strong counter pressure against complete and timely reporting of debt. We welcome the new regulation promulgated by the State Council on the registration and supervision of external debt and would like to follow the progress in implementation of this regulation with keen interest. The mission would, however, like to suggest that the SAEC does not have to play only a passive role and await the borrowers to register and record their transactions. They do need to play an active role by creating a network of secondary sources of information, intelligence and data on external borrowing by strengthening their supervision of the banking system and the borrowing entities. As is the case in many developing countries, the Central Bank does send inspection teams to visit the commercial banks and authorized foreign exchange dealers to find out, among other tasks, the up-to-date status of foreign exchange transactions particularly the debt servicing repayments, new commitments and drawdown. We would like to suggest that in addition to the registration system, the Bank of China, Central Government, CITIC, five provincial ITICs and a few other financial institutions which are the major borrowers should be asked to submit regular reports on external debt as they do now. The SAEC must also actively collect information on approvals of all projects requiring foreign exchange made by the State Planning Commission or the local planning authorities. We have also provided a sample of loan-by-loan data published by the International Financing Review on all commercial borrowings made by various entities in the international markets. This source, along with OECD Creditor Reporting data information that we would try to provide will be an additional source for cross-checking, verifying and updating the debt information. We fully realize that the implementation of these suggestions, of course, require increased manpower, both at the headquarters and branches of SAEC, training of staff, setting up of systems, procedures and increased use of computerized

data management systems. But the mission believes that the costs of the additional expenditure involved in the strengthening of SAEC will be far exceeded by the benefits that the country would derive from an alert, active and updated debt information system that provides the appropriate signals to the decisionmakers. We are impressed by the way the MOF manages and collects data on Central Government debt. We hope that the SAEC would be able to consolidate and collect the total external debt information in a similar manner. The initial stages of registration system are also important and the habits and attitudes that are formed at these stages are likely to persist in future. Thus, if action is not taken at early stages against the defaulters and those not reporting their obligations according to the regulation subsequent compliance of the regulation may become problematic. A vigilant monitoring of the registration by everyone at the SAEC at the early stages is imperative.

3. While we are confident that the new system will meet with success, we would like to point out three particular areas of debt creation which have a higher probability of escaping notice. The first, that has been discussed at length, is the guarantees provided by the 77 institutions authorized to do so. While we recognize that the PBC or China does not assume sovereign risk by delegating the authority to issue guarantees, we have seen cases where in event of foreign exchange crisis, the Central Banks had to ultimately assume the responsibility for providing foreign exchange for private transactions, some of them even non-guaranteed. The creditors insist on settlement of such debts as part of the comprehensive settlement of debt. We would therefore advise you to collect and monitor information on guarantees in a systematic manner, while holding on to the legal position that you have taken. Even in advanced countries,a watchdog function is performed by the State on the activities of the institutions such as ITICs and SAEC would be well advised to regulate and monitor the performance of these institutions on a regular basis.

4. The second area of possible concern is the leasing arrangements that are being increasingly entered into by a number of Chinese enterprises and corporations with foreigners. The obligations under these arrangements are very much of the same nature as creating debt and therefore should be fully covered in all reports. If there is a lack of clarity on this issue the entities entering into such arrangements must be advised to report and disclose all such transactions to the SAEC.

5. The third possible area which requires special attention is the financing of investment by overseas individual deposits. We believe that while major and respectable financial institutions such as BOC may be keeping a full track of these deposits and financing other smaller institutions and joint ventures, especially in Special Economic Zones, may not be fully aware of the need to report and record this type of financing. The SAEC may have to perform an educational task in this respect and advise their branches, especially in the Economic zones, to be vigilant about this mode of financing and collect information on this type of debt.

6. Finally, the recording of short term debt is notorious in almost all developing countries. It suffers from problems of conceptual, presentational

and accounting nature. So long as the BOC was the only institution allowed to raise S.T. debt the recording and bookkeeping would have been relatively easy but with the authorization powers confined to new institutions, it is essential that SAEC must improve recording of its short-term debt.

7. In this connection we would particularly like to draw attention to the borrowing activities of joint ventures and 100 percent foreign owned enterprises. While their freedom to invest in China should not be impaireed in any way, the SAEC should maintain a complete statistical record of their debt obligations and include them in any projection of the country's debt service.

Debt Management System

8. The mission has found, during its visit that the essential ingredients of a debt management system or some components of it are scattered throughout the various organs of the Chinese government. Some ingredients are lacking or are not in full effect. We think that the State Council should continue to approve the annual external borrowing program after it has considered the impact of such borrowing on the balance-of-payments, public sector budget, domestic credit creation etc. As I showed in my presentation, there is a need to explicitly recognize that the decision to borrow resources abroad is very much part of macroeconomic decision-making and unless careful thought is given to the consequences and implications of borrowing for other macro aggregates, there may arise potential for some inconsistencies.

9. The mission felt quite satisfied that the project approval process in China and the determination of its borrowing needs take place in a systematic manner and the central and local planning authorities have a very good picture of the projects' total borrowing needs. But the mission has a feeling, which may be corrected if it is wrong, that the consistency between the project needs on an aggregate basis and the external borrowing determined from the BOP projection is not always struck. While the adherence to the original plan targets is very desirable from a purely plan discipline viewpoint a more flexible approach that revises or modifies these targets in light of new domestic or external developments is equally important these days in a world ridden with a lot of uncertainties and unknowns. If you permit me I would illustrate this point through the current year's experience in China. Exports in China have expanded by 14-15 percent this year while the imports have declined as against the original plan targets of 7 and 8 percent growth respectively. This has led to current account suprlus and accumulation of reserves up to 5 months level. A question then arises: whether the original target of external borrowing envisaged for the year 1987 should be pursued or the reserves drawn down to finance some essential imports such as capital goods, machinery and equipment. If the average financial return on reserves is lower than the cost of borrowing abroad it may be in the interest of the country to use some of the excess reserves (i.e. beyond the minimum target level) for financing imports rather than keep on borrowing and incur future debt servicing charges. We understand that CITIC, for example, borrows at market rates abroad in order to provide equity funds for its share in Sino-foreign joint ventures. This mode of financing may not be in the best

interest of CITIC or China and perhaps some initial equity funds may be provided out of the reserves if the underlying projects are economically viable. CITIC should be asked to generate dividends and profits in foreign exchange and pay a return on Chinese Government's invested equity. This is more or less the practice followed in a number of developing countries.

10. The mission also noticed that a number of borrowing windows such as MOF, BOC, CITIC have been authorized to enter the international financial markets. As I submitted in my seminar presentation, it is quite important that management of market access is carefully carried out. Borrowing can be much more expensive if several borrowers from the same country approach the same market simultaneously. The timing of entering the market, and the choice of which particular market to enter are of great importance. Second, lenders must get to know borrowers intimately. International capital markets are segmented, so a good reception in one market does not guarantee a welcome elsewhere. Bond investors - usually individuals and nonbank financial institutions - may have perceptions of a country's creditworthiness quite different from those of commercial bankers. Countries can gradually gain access to markets by borrowing on a small scale through the institutions which have established a good name and reputation for themselves at a time when money is not urgently needed. The other way is to develop market specialization where BOC, most successful and familiar with the Tokyo market, carries out the issue in Japan while CITIC may have a comparative advantage in Singapore market - and the MOF may like to concentrate on Frankfurt market.

11. As I submitted earlier, an advisory unit has performed useful functions in many countries by monitoring market developments, market access and penetration, maturity profiles, dispersal of risks, currency and interest rate swap options, diversified lender base etc. and then they advise the various borrowing windows about the lender volume, timing and instruments to choose. We feel that the expertise required for such functions may be available in various institutions in China such as BOC or CITIC that have been market players for a long time but this expertise needs to be assembled and located centrally for the larger benefit of China and its analysis and advice should be available and shared by everyone who is planning market floatations or any other form of commercial borrowing. It should be recognized that skills needed to man such an advisory unit are highly specialized and different from those required for borrowing from official sources. Their remuneration packages may have to be made more attractive and competitive. The savings they can bring to the country through their sound advice will be hundred times more than the cost involved in paying them higher salaries.

12. The other missing element in the mission's opinion is that we did not find if there iwas some institution or unit that was the overall manager of the borrowing program. MOF has complete control of Central Government borrowings. SAEC plays a very important role in supervision and data collection and the planning authorities in project approvals, but we did not have a feeling that there was one single unit which we called Control Unit in our presentation that had the overall responsibility for planning, programming, monitoring and feedback to policymakers. We are not suggesting such a manager should carry out all these functions itself but at least ensure

that these are carried out by various parts of the government, which have the responsibility to do so. Perhaps an internal study by the Systems Reform Commission or some other body so designated may be able to strengthen and sharply define the role, responsibilities, functions, procedures, skills required of the various actors participating in the integrated management of debt and designate some unit or agency to act as the overall manager of the borrowing program.

Debt Reporting to the World Bank

13. As I explained, the World Bank debt reporting requirements from its member countries have been revised with effect from July 1, 1987. Countries unable to make timely and accurate reports on their debt status are classified in Category 3 and their loan signing is delayed until such time as their debt reporting status is improved. Regrettably, but for the reasons we fully understand, China has not been able to submit the quarterly debt reports in the past on a timely basis. During this mission, we are grateful to the MOF and SAEC for providing us with updated raw data on 1985 and 1986 debt which will enable us to bring China up to date till the end of 1986.

14. We fully realize that the government has now put into place a new system of debt registration and reporting and it will take some time before the results of this system are known. We have suggested earlier the specific steps that should be taken by SAEC to compile information from other sources. In the interim, until the results of the new system are available, data from other alternative sources could form the basis of quarterly reports to the World Bank. We appreciate that these reports will suffer from lack of 100 percent coverage, but it can be remedied when the year-end report is submitted to the Bank which will incorporate the results of loan-by-loan registration system.

15. As we discussed, the success of the new system will depend upon development of a satisfactory system and procedures, training of staff and availability of suitable software and hardware in sufficient quantities. The Bank, as Mr. Cadario will outline, is willing to assist the Chinese authoriteis in these tasks. We would like to reiterate that the debt report should also include complete information on guaranteed debt as well. The mission, therefore would recommend to the Bank that until such time the new registration system is entrenched, the Ministry of Finance will send its quarterly reports after a few months delay on the basis of information available from the nine major borrowing windows. We estimate that the interim reports will result in a coverage of at least 70-80 percent of all transactions. The end-year report will incorporate the full coverage from all sources.

16. We would like to know if the above proposal is acceptable to you for the interim period and if so, when you could send us the 1987 data and agree on a timetable for subsequent reporting periods.

Provisional Regulations for Statistics and Supervision of External Debt

These were approved by the State Council on June 17, 1987, and promulgated by the State Administration of Exchange Control on August 27, 1987.

Article 1. These provisional regulations are formulated to enable up-to-date information on the country's external debt to be collected exactly and completely so as to control the size of external borrowing effectively, raise the efficacy of using foreign funds and expedite national economic growth.

Article 2. The country pursues the policy of managing external debt by registration.

The State Administration of Exchange Control (SAEC) is in charge of establishing and perfecting the statistics on and supervision of the external debt of the country and publishing figures on the external debt.

Article 3. External debt herein mentioned refers to all the debts which are guaranteed by repayment contracts in foreign currency and are borrowed from international financial institutions, foreign governments, financial institutions, enterprises or other institutions located outside the People's Republic of China by State enterprises, government establishments, financial institutions or other institutions (borrowing units) in the People's Republic of China. It includes the following:

A. International financial institution loans.

B. Foreign government loans.

C. Foreign bank and financial institution loans.

D. Buyer's credits.

E. Foreign enterprise loans.

F. Securities issued in foreign currency.

G. International financial leases.

H. Deferred payments.

I. Debts repaid directly in foreign cash in compensation trade.

J. External debt in other forms.

Funds borrowed in foreign currency by borrowing units from banks with foreign capital and Chinese and foreign joint banks which are registered in China are regarded as external debt.

Article 4. The registration of external debt is divided into two forms: case-by-case registration and periodic registration.

The "registration certificate for external debt" shall be formulated, signed and issued by SAEC.

Article 5. Chinese and foreign joint ventures, Chinese and foreign co-operative enterprises and enterprises with foreign capital, are required, while borrowing, to register at and obtain a case-by-case registration certificate for external debt from a branch office of SAEC by submitting a duplicate of the loan agreement to the office within 15 days of the formal agreement's signature.

In reference to international financial institution loans, foreign government loans, external borrowing by the Bank of China or other authorized banks and financial institutions, the borrowing units concerned are required to register at and obtain a periodic registration certificate for external debt from a branch office of SAEC. Indirect lending is not included in the registration mentioned above in this paragraph.

Apart from the borrowing units mentioned above in this article, other borrowing units are required to register at and obtain a case-by-case registration certificate for external debt from a branch office of SAEC by submitting an approval certificate for external borrowing and a duplicate of the loan agreement to the office within 15 days after the formal agreement is signed.

Article 6. Borrowing units are required, while transferring their extenal loan from other countries to China, to open special foreign cash accounts for external debts with the Bank of China or other banks authorized by SAEC (banks) against the registration certificate for external debt. Borrowing units with approval to keep their external loan abroad and others whose loan does not have to be transferred into China are required to open special foreign cash accounts for external debt to cover repayment and servicing, presenting their registration for external debt.

Banks are not permitted to open special foreign cash accounts for external debt or special foreign cash accounts for external debt repayment and servicing and to remit principal and interest abroad for borrowing units that do not obey the registration certificate provisions.

Article 7. When borrowing units making a case-by-case registration repay and service their external debts, banks should, upon presentation of both the registration certificate for external debt and the approval certificate from concerned offices of SAEC provided by the borrowing units, conduct receipt and payment operations through the special foreign cash account for external debt or the special foreign cash account for external debt repayment and service. The borrowing units are required to fill in, in accordance with certificates of receipt and payment from banks, a feedback form on external debt changes with items of receipt and payment and submit a duplicate of the form to the office of SAEC which signed and issued the registration certificate for external debt.

The borrowing units making periodic registration are required to submit monthly materials concerning signatures, withdrawal usage and rapayment and service of external debts to the SAEC offices which signed and issued the registration certificate for external debt.

Borrowing units with approval to keep their loans abroad are required to submit periodically the materials covering changes in their deposits to the concerned office of SAEC that signed the approval.

Article 8. Once borrowing units fully clear their external debts as recorded in the registration certificate for external debt, banks should cancel the special foreign cash accounts for external debt or the special foreign cash accounts for external debt repayment and service of such borrowing units. The units, in turn, are required to submit the registration certificate for external debt for cancellation to the local SAEC branch office within 15 days.

Article 9. The SAEC branch offices are empowered to fine, according to the circumstances, any unit that violates these regulations in any of the following ways, by an amount not exceeding 3 per cent of the external debt concerned.

A. Purposely not registering or delaying registration for external debt.

B. Refusing to submit, concealing, fraudulently submitting or, without special cause, repeatedly delaying submitting the feedback form on external debt changes to SAEC.

C. Forging or altering the registration certificate for external debt.

D. Opening or keeping special foreign cash accounts for external debt or special foreign cash accounts for external debt repayment and service without approval.

The body concerned is permitted to lodge an appeal against such an adjudication with the higher authorities of SAEC.

Article 10. These regulations shall be explained by SAEC.

Article 11. These regulations shall come into force from the day of promulgation.

Borrowing units with uncleared external debts are required to register at local SAEC branch offices within 30 days of the promulgation of these regulations.

CHINA: Main features of External Debt System

Authorization Process

1. Approval for foreign borrowing is essentially a two-stage process. At the first stage, individual projects are proposed by the central and provincial governments to the State Planning Commission (SPC), which looks at the overall balance of the aggregate investment program and then approves the overall number of projects. Massive projects are managed by the central government. Cut-off lines are sector specific: ¥ 30 million could be a major (central) project for heavy industries, ¥ 5 million could be a major project for textiles, etc.

2. The number of projects approved by each region (approximately 30 provinces) depend on its autonomous pace of development. For approved projects that require foreign borrowing, the next stage is authorization by the State Council. The PBOC, which is responsible for overall balance of payments, recommends to the State Council the maximum amount of foreign borrowing that should be undertaken for a specific period. The State Council can empower executing agencies to borrow directly, but generally these agencies will approach the specialized state agencies to undertake foreign borrowing.

3. When the SPC and the various ministries have decided which projects will be supported by borrowed funds, the projects are proportioned to specialized borrowing agencies depending on the type of financing that is proposed. For instance, the People's Bank of China (PBOC) has the responsibility for negotiating purchases from the IMF; the Ministry of Finance (MOF) borrows from the World Bank and other multilateral agencies; the MFERT borrows from bilateral agencies and especially from Japan's OECF; and the Bank of China borrows from financial markets. Thus the overall borrowing plan is the sums that are assigned to the specialized agencies.

Recording of Debt

4. Prior to 1986, no central institution was specifically charged with the authority for monitoring or controlling foreign borrowing. Individual borrowers kept records of disbursements, principal and interest payments. These data were reported to SAEC in an aggregated form, which is part of PBOC, but only for the purpose of compiling BOP statistics.

5. Following the large increase in external debt in 1985, the Chinese authorities became aware of the potential problems associated with large volumes of foreign borrowing, took a number of measures to contain foreign commercial borrowing including short-term debt and to centralize the monitoring of all debt so as to ensure that the total volume and its composition did not result in future debt servicing difficulties.

6. In April 1986, the State Council appointed the State Administration of Exchange Control (SAEC) within the People's 'Bank of China as the sole agency responsible for monitoring China's external debt. The Debt Office was also instructed to develop new reporting and control procedures. In addition, approval procedures have been revised to ensure that total borrowing and its composition are consistent with China's overall macroeconomic objectives and also in protecting China's creditworthiness for future borrowing. The revised approval and procedures were not formalized in terms of comprehensive written regulations or administrative circulars until August 1987. In August 1986, the Debt Office provided training for headquarter's staff and staff of SAEC branches responsible for collecting debt statistics; subsequently, the Debt Office undertook a national debt survey.

7. In August 1987, the State Administration for Exchange Control promulgated regulations for the registration of all external borrowing. These require all debt to be registered within 15 days of signing and any debts incurred prior to the effectiveness of regulation must be registered as of October 1, 1987. Regardless if borrowed according to plan or outside the plan, all borrowing must be approved by SAEC. The registration of external debt is divided into two forms: Case-by-case registration and periodic registration. Chinese and foreign joint ventures, Chinese and foreign cooperative enterprises and enterprises with foreign capital are required, while borrowing, to register and obtain a case-by-case registration certificate for external debt from a branch office of SAEC by submitting a duplicate of the loan agreement to the office within 15 days of the formal agreement's signature.

8. In reference to foreign government loans, international institutions, externál borrowing by the Bank of China or other authorized banks, the borrowing units concerned are required to register and obtain a periodic registration from a branch office of SAEC. A periodic registration required that the borrowing agencies report the transactions of various loans monthly. (Periodic registration excludes indirect lending). Borrowing units are also required while transferring their external loans from other countries to China, to open special foreign cash accounts with the Bank of China or other banks authorized by SAEC. Borrowing units with approval to keep their loans abroad are required to open special foreign cash accounts for external debt to cover amortization and interest.

9. When borrowing units, in a case-by-case instance, are servicing their debt; they are required to present to the banks both the registration certificate and the approval certificate from SAEC. The borrowing units at that point are also required to fill in a feedback form on external debt charges such as payments, and submit a duplicate of the form to the office of SAEC which signed and issued the registration certificate.

10. The borrowing units in periodic registration instances are required to submit monthly materials concerning disbursements, usage and debt service of their debt to the SAEC offices which signed and issued the Registration Form.

11. Banks are not permitted to open special foreign cash accounts for foreign debt and to remit principal and interest abroad for borrowing units that do not obey the registration certificate provisions.

12. Borrowing units that (a) purposely do not register or delay registration; (b) for altering the registration; (c) refusing to submit, concealing, fraudulently submitting or delaying submission of the feedback form to SAEC; (d) opening or keeping special foreign cash accounts without approval, are fined according to the circumstances by amounts up to three percent of the external debt concerned.

Availability and Limitations of Debt Data

13. The mission obtained, for the first time since China joined the World Bank, comprehensive loan-by-loan information on all debt, disbursed and outstanding or repaid as of end-1985 and as of end-1986. Thus the information covers flows and outstanding amounts on debt going as far back as 1978 and 1979. The mission was also given aggregated tables for 1986 broken down by purpose, borrower and type of debt with debt service payments to 1991.

14. The mission opted to accept the above mentioned loan-by-loan information in the format of the original working ledger in Chinese rather than the customary standard Forms 1 and 2 for the following reasons: (i) it eliminated the need to transcribe data for some 2200 individual loans to our standard forms, a time-consuming exercise, especially for the individual that has to translate everything from Chinese; and (ii) the ledger information is classified by borrowing units, i.e. BOC, MOFERT, MOF, province by province, etc. That way, the information with newly assigned debt numbers will be stored in our database in an orderly manner; for instance, certain debt number series will be dealing with the debt, i.e. of BOC, Shanghai province, etc.

15. The mission's biggest disappointment was its failure to obtain information on loan commitments (amounts and dates) signed in 1986 and the first three quarters of 1987. The data are available except that SAEC was advised to omit these items in their design for use in their microcomputers.

16. Apparently, the IMF is not interested in loan commitments. As far as they are concerned, a loan does not become debt until fully or partially disbursed. Thus, a consultant helped the Chinese design their system accordingly. The importance of knowing the undisbursed portion of a loan for any meaningful analysis has not been stressed. The mission was told that this omission would be corrected in the future. However, experience shows that once programs are designed and proved workable, it becomes difficult to introduce changes. Doubts also exist as to the willingness of the Chinese Authorities to go through all the trouble of digging original documents to satisfy this particular World Bank Debtor Reporting requirement.

Computerization of Debt Data

17. The mission inspected the computer facilities available in the SAEC offices. The SAEC has recently acquired a Borroughs A3 computer. This is a

medium-size computer, equivalent to IBM's 4321, with two megabytes of main memory and it would be running under a virtual operating system (VOS) which is equivalent to IBM's OS/VS1. Peripheral equipment include two hard disk drives, two tape units, one line printer, one card reader, three floppy disk drives and eight video data terminals type B-25.

18. As is noted before, there are eight microcomputers in SAEC's headquarters with terminal emulation capacity ready to be connected to the mainframe.

19. It was the mission's impression that proper software for the mainframe (such as aggregation, projections and analytical capabilities systems) it is at the initial stage. It was also our impression that SAEC has opted for "custom design software" tailored to PBOC's specific needs rather than choosing among the already existing software packages such as UNCTAD, the Commonwealth Secretariat, etc.

20. Even though SAEC has acquired the hardware machinery, there is still an enormous work to be done in the area of developing and testing the right software for the implementation of the system. This is the area where SAEC needs help. Perhaps the debt module from the Revised Minimum Standard Model (RXD) with expanded options available in the International Finance Division could be made available and explained to them. It would give them an immediate, enhanced ability to analyze foreign borrowing options.

21. In the interim, the Debt Office, awaiting for the mainframe to be put in place, currently is using the eight available microcomputers for data entry and storage of the 2200 some loans with individual repayment schedules.

22. The microcomputers operate on the so-called "symphony" software. This system provides the user with flexibility to design his own tables, specifying the sorting criteria and hierchy to be used for generating aggregate debt data. The Chinese foreign debt database, however, is voluminous and it has to be kept in various diskettes. Software written for micro-computers is limited in scope. Therefore, the priority of the Debt Office would be to develop the relevant software for the mainframe as soon as possible.

<u>1986 External Debt Breakdown by Creditor Type</u>

	\$ billion	Percent
Bilateral official	4.937	23
Financial institutions	4.084	19
Overseas individual deposits	3.91	18.2
Bond issues	2.7	12.6
Multilateral officials	2.631	12.2
Deferred payments	1.11	5.2
Buyers' Credit	0.755	3.5

N. Stavrou
12/10/87

ANNEX V

INDIA: External Commercial Borrowing System

Reports produced by CS-DMS

World Bank

360	Form 1 of World Bank Debtor Reporting System
361	Form 2 of World Bank Debtor Reporting System
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REVIEW DRAFT
FOR OPERATIONS POLICY SUB-COMMITTEE
CONFIDENTIAL

Country Program Paper

CHINA

October 8, 1985

East Asia and Pacific Regional Office

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CONFIDENTIAL
REVIEW DRAFT
October 3, 1985

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			1,913.0	8,086.9	9,485.0

Current population growth rate: 1.1% p.a.

	FY80-84	FY85-89 /b	FY86-90
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 $)	FY80-84	FY85-89	FY86-90
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
	Approved	Proposed	Proposed/Approved
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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CHINA

COUNTRY PROGRAM PAPER

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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.

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

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 macroeconomic 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 inter-linkage 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

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.

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.

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.[1/]

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.

1/ 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.

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.

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	80.0	1
Education	650.0	3	430.0	3
Health	100.0	1	85.0	1
Other	-	-	10.0	1
Total	3,395.0	23	3,014.9	30
(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.

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

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

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 creditworthiness 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

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

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-

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-

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

Table 5. INTERNAL RESOURCE REQUIREMENTS
(Staff-weeks)

	Actual					Projected	
	FY81	FY82	FY83	FY84	FY85	FY86	FY87
China							
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
Selected Comparators							
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.

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

CHINA: ACTUAL AND PROPOSED LENDING OPERATIONS THROUGH FY90
(US$ million)

		Actual					Current	Proposed				Total	Total	Total
		FY81	FY82	FY83	FY84	FY85	FY86	FY87	FY88	FY89	FY90	FY80-84	FY85-89	FY86-90
Agriculture														
North China Plain	IDA	-	60.0	-	-	-	-	-	-	-	-			
Heilongjiang 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	-	-	-	-	-			
Energy														
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	FY80-84	FY85-89	FY86-90
Education														
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			
Health														
Rural Health & Medical Education	IDA	-	-	-	85.0	-	-	-	-	-	-			
Health II	IDA	-	-	-	-	-	65.0	-	-	-	-			
Health III	IDA	-	-	-	-	-	-	-	75.0	-	-			
Health IV	IDA	-	-	-	-	-	-	-	-	-	100.0			
Others														
Technical Cooperation I	IDA	-	-	-	10.0	-	-	-	-	-	-			
Technical Cooperation II	IDA	-	-	-	-	-	20.0	-	-	-	-			
Technical Cooperation III	IDA	-	-	-	-	-	-	-	-	25.0	-			
LENDING PROGRAM	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
	Total	200.0	60.0	613.5	1,039.5	1,101.9	1,260.0	1,640.0	1,885.0	2,200.0	2,500.0	1,913.0	8,086.9	9,485.0
	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)
Lending program in constant FY85 commitment $	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
	Total	247.8	72.1	701.9	1,115.3	1,101.9	1,175.4	1,433.6	1,552.7	1,716.1	1,853.2	2,137.1	6,979.7	7,731.0
Commitment deflator (FY85 = 100)		80.7	83.2	87.4	93.2	100.0	107.2	114.4	121.4	128.2	134.9			
Standby projects	Total						405.0	660.0	700.0	700.0	..			
	Number						4	5	5	5	..			

* = Standby project.

East Asia and Pacific Regional Office
August 1985

TABLE 3A

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

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

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

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

CHINA - ECONOMIC INDICATORS

Indicator	Amount - 1984 (million US$ at current prices)/b	Annual growth rates (%) Actual 1980	1981	1982	1983	1984/a	Projected 1985	1986	1987	1988	1989	1990	1995
NATIONAL ACCOUNTS /a													
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
PRICES													
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

	Share of GDP at market prices (%) (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

	As % of GDP 1957	1970	1980	1983	1984
PUBLIC FINANCE					
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

	1960-70	1970-75	1975-80	1980-84	1984-89	1989-94
OTHER INDICATORS						
GNP growth rate (%)	6.1	5.1	6.4	9.2	7.2	6.6
GNP per capita growth rate (%)	3.5	2.9	5.2	7.9	6.1	5.5
Energy consumption growth rate (%)	-0.3	9.2	5.8	4.1	5.3	4.8
ICOR	3.3	4.7	5.1	3.8	4.0	4.6
Marginal savings rate	0.4	0.4	0.3	0.3	0.2	0.3
Import elasticity	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.

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
BALANCE OF PAYMENTS										
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
EXTERNAL CAPITAL AND DEBT /d										
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.

East Asia and Pacific Regional Office
September 30, 1985

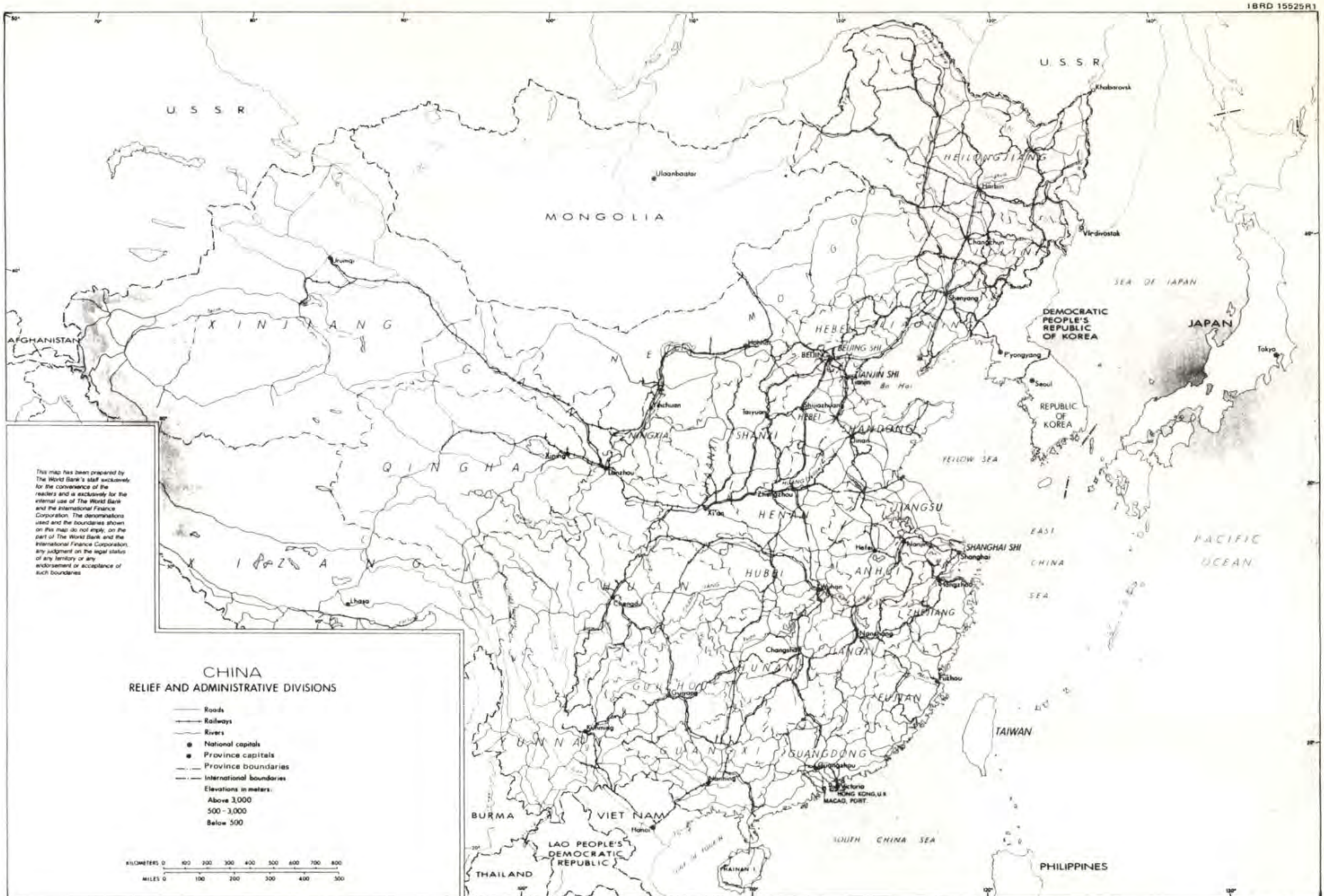
CHINA

Economic and Sector Work Program by Task, FY85-87

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

Task/aim and coverage	Man. div.	Total staffweeks required		
		FY85 (Actual)	FY86 (Projected)	FY87 (Projected)
EIS/OPS-MANAGED				
SECTOR REPORTS (SRA)				
Energy Sector 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.	EGY	62	0	0
Regional Cement 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.	35330	25	0	0
Phosphate Development Study of major alternatives for phosphate mining, processing and transport.	35310	0	15	40
Industrial Study 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.	35320	0	0	50
Rural Health Issues 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.	30620	20	15	0
Urban Health Services Analysis of future investment and policy choices in urban health with special emphasis on financial issues.	30620	0	0	40
Subtotal EIS-Managed Staffweeks		107	30	130
TOTAL STAFFWEEKS - CHINA		745	685	860

IBRD 15525R1



OCTOBER 1985

Confidential

CHINA

COUNTRY PROGRAM PAPER

Postscript

99. This paper was reviewed at a meeting chaired by Mr. Clausen on February 12, 1982. The meeting noted that substantial progress has already been made in developing the Bank Group's relations and programs with China. China has absorptive capacity for sizeable IBRD borrowing and the effective limits to the level of IBRD lending to China in the long run derive from Bank portfolio considerations. With respect to IDA, however, severe constraints on IDA availability make it necessary not to raise the expectations of the Government unduly.

100. It was agreed that:

(a) the Region could proceed generally along the lines proposed in the CPP; O.K.

(b) the lending program for FY82-86 would be set at $4695 million;

(c) total lending would be held to $1500 million in each of FY85 and FY86 as a planning figure pending clarification of IDA-7 amounts and allocations;

(d) the possibility of restoring China's IDA allocation in the IDA-6 period to $400 million would be discussed further between the Senior Vice President, Operations and the Region; and

(e) the proposal to create a special fund for China not be pursued and the establishment of a consultative group for China would be premature.

101. A revised lending program is attached. The next CPP review will be held in about a year.

Attachment

East Asia & Pacific Region
March 4, 1982

C84549/J91083/D2069/12-19

Population: 977 million (mid-1980)
GNP [per] capita: $290 (1980)
Ar[ea]: 9,597,000 sq km
L[iteracy] rate: 66.0% (1979)

CHINA: ACTUAL AND PROPOSED PROGRAM OF LENDING OPERATIONS THROUGH FY87
($ million)

		FY81	Current FY82	FY83	FY84	FY85	FY86	FY87	Total FY72-76	Total FY77-81	Total FY82-86	Total FY83-87	Reserve projects
AGRICULTURE												1,355.0	
State Farms I (Heilongjiang)	IBRD			80.0								(10)	
State Farms II	IBRD							200.0					
Integrated Rural Development I	IDA							150.0					
North China Plain I	IDA		50.0										
North China Plain II	IDA						100.0						
Rural Credit I	IBRD				100.0								
Rural Credit II	IBRD/IDA						100/100						
Education and Research I	IDA			75.0*									
Education/Research/Extension II	IDA						150.0*						
Tropical Tree Crops I (Rubber)	IDA					150.0*							
Tropical Tree Crops II	IDA							150.0*					
ENERGY												1,855.0	
Coal I (Luan/Jincheng)	IBRD				205.0							(11)	
Coal II (Jungar or Yuanbaoshan)	IBRD					200.0							
Coal III	IBRD						250.0						
Petroleum I (Daqing)	IBRD			150.0									
Petroleum II (Dongpu I)	IBRD			100.0									
Petroleum III (Dongpu II)	IBRD				150.0								
Petroleum IV (Offshore or Qaidam)	IBRD						100.0*						
Power I (Lubuge Hydro)	IBRD				150.0*								
Power II (Tianshengqao Hydro)	IBRD					200.0							
Power III (Shuikou Hydro)	IBRD						150.0*						
Power IV (Interconnection/Shuoxian)	IBRD							200.0					
HUMAN DEVELOPMENT												1,200.0	
E[duca]tion I (University Dev. I)	IBRD/IDA	100/100										(6)	
[Educat]ion II (TV Univ./Basic Colleges)	IBRD/IDA				75/75*								
[Educati]on III (University Dev. II)	IDA					300.0							
[Educat]ion IV (Tech./Voc. Training)	IDA						300.0						
Education V	IDA							200.0*					
Health (Education/Rural)	IDA					100.0							
Health (Water Supply)	IDA							150.0					
INDUSTRY												1,200.0	
China Investment Bank I	IBRD			100.0								(6)	
China Investment Bank II	IBRD/IDA					100/100*							
China Investment Bank III	IBRD							350.0*					
Energy Efficiency/Modernization I	IBRD					150.0*							
Energy Efficiency/Modernization II	IBRD							200.0					
Subsector I	IBRD							200.0*					
TRANSPORT												1,150.0	
Rail I (Shanxi)	IBRD				150.0							(7)	
Rail II (Henan-Shandong)	IBRD					200.0							
Rail III (Yunnan-Hunan)	IBRD						150.0						
Ports I (Three Ports)	IBRD		135.0										
Ports II (Yangtze)	IBRD				100.0								
Ports III	IBRD						100.0*						
Major Corridors	IBRD							200.0					
Unidentified	IBRD							250.0					
LENDING PROGRAM	IBRD	100.0	135.0	430.0	930.0	850.0	850.0	1,600.0	-	100.0	3,195.0	4,660.0	
	IDA	100.0	50.0	75.0	75.0	650.0	650.0	650.0	-	100.0	1,500.0	2,100.0	
	Total	200.0	185.0	505.0	1,005.0	1,500.0	1,500.0	2,250.0	-	200.0	4,695.0	6,760.0	
	Number	1	2	5	7	8	9	11	-	1	31	40	
	(Of which IDA)		(1)	(1)	(-)	(3)	(3)	(4)		(-)	(8)	(11)	
Lending program in constant FY81 commitment $		200.0	172.7	442.6	829.2	1,166.4	1,100.5	1,557.1	-	200.0	3,711.4	5,095.8	
Commitment deflator (FY81=100)		100.0	107.1	114.1	121.2	128.6	136.3	144.5					
Standby projects	IBRD		-	225.0	250.0	350.0	550.0	-					
	IDA		75.0	75.0	250.0	150.0	350.0						
	TOTAL		75.0	300.0	500.0	500.0	900.0						
	Number		1	2	3	4	4	-					

* S[tandb]y projects.

East Asia and Pacific Regional Office
February 17, 1982