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WORLD BANK OPERATIONS EVALUATION DEPARTMENT



China

An Evaluation of World Bank Assistance



OPERATIONS EVALUATION DEPARTMENT

ENHANCING DEVELOPMENT EFFECTIVENESS THROUGH EXCELLENCE AND INDEPENDENCE IN EVALUATION

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China

An Evaluation of World Bank Assistance



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FOREWORD

This Country Assistance Evaluation (CAE) by the Operations Evaluation Department (OED) of the World Bank builds on evaluations of projects, nonlending services, and sector assistance programs to assess the development effectiveness of Bank assistance to China during the past decade (FY93–02). Although it focuses on these years, it also includes some references to developments in the earlier years of the relationship and to more recent events.

Chapter 1 provides an overview of the achievements and shortcomings of China's reforms since 1978. Chapter 2 summarizes the development of the relationship between the Bank and China in the 1980s in order to provide a context for the period under review, and then outlines the evolution of the relationship and the Bank's assistance strategy in the past decade. Chapter 3 analyzes China's development progress and the Bank's impact on the main objectives of the Bank's assistance. Chapter 4 reviews the use of lending and other instruments in achieving these objectives, compares outcomes in China with those in other countries, and examines some cross-cutting issues. Chapter 5 draws on the previous two chapters to provide a summary evaluation of the Bank's assistance, and chapter 6 summarizes the main lessons and recommendations.

The assistance of peer reviewers in providing detailed comments on an earlier draft is gratefully ac-

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PREFACIO

La presente Evaluación de la Asistencia al País (EAP) se basa en proyectos, servicios no crediticios y programas de asistencia sectorial a fin de evaluar la eficacia del desarrollo de la asistencia que el Banco Mundial prestó a China durante el último decenio. Esta Evaluación se concentra en el período comprendido entre los ejercicios económicos 1993 y 2002, pero hace referencia a acontecimientos sucedidos en los primeros años de la relación y a hechos más recientes.

El Capítulo 1 ofrece una descripción general de los logros y de las deficiencias de las reformas implementadas en China desde 1978. El Capítulo 2 resume el desarrollo de la relación entre el Banco y China en la década de los ochenta a fin de brindar un contexto para el período sometido a análisis y luego examina cómo ha evolucionado la relación y la estrategia de asistencia implementada por el Banco durante la última década. El Capítulo 3 analiza el avance y el impacto del Banco en los objetivos principales trazados para la asistencia. El Capítulo 4 examina el uso del financiamiento y de otros instrumentos para lograr estos objetivos. También compara los resultados logrados en China con los de otros países y examina algunos temas transversales. El Capítulo 5 se basa en los dos capítulos anteriores y ofrece un resumen de la evaluación de la asistencia del Banco, y el Capítulo 6 resume las principales lecciones y las recomendaciones.

Deseamos expresar nuestro profundo agradecimiento a los colegas

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AVANT-PROPOS

La présente Évaluation de l'aide par pays (CAE) s'appuie sur les évaluations des projets, des services hors prêts et des programmes d'aide sectorielle pour évaluer l'efficacité au niveau du développement de l'aide de la Banque mondiale en faveur de la Chine au cours des dix dernières années. La CAE est centrée sur la période EF93-02 mais comporte quelques références aux développements réalisés au cours des premières années de la relation et à des événements plus récents.

Le chapitre 1 offre une vue d'ensemble des réussites et des insuffisances des réformes en Chine depuis 1978. Dans le chapitre 2 figure une synthèse du développement de la relation entre la Banque et la Chine dans les années 80 afin que cela serve de contexte pour la période étudiée puis y sont retracées l'évolution de la relation et la stratégie de la Banque en matière d'aide au cours des dix dernières années. Sont analysés au chapitre 3 l'avancement et l'impact de la Banque sur les principaux objectifs de l'aide de la Banque. Est étudié au chapitre 4 le recours aux prêts et à d'autres instruments pour atteindre ces objectifs. Y sont également comparés les résultats de la Chine avec ceux d'autres pays et y sont examinées certaines questions multidisciplinaires. Le chapitre 5 est la récapitulation des deux chapitres précédents qui permet de donner une évaluation synthétique de l'aide de la Banque. Figure au chapitre 6 la

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knowledge. Their comments, as well as other comments received during OED's management review meeting, have been taken into account in the evaluation. The factual and editorial comments of the Bank's East Asia and Pacific (EAP) Region and the Government of China (Ministry of Finance) on an earlier draft of the CAE have been taken into account in this draft, the comments of the Bank's Regional staff are attached as Annex N, and the China government's comments are included as Annex O.

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revisores por los comentarios pormenorizados que formularon a un borrador previo del presente trabajo. Tanto éstos como otros comentarios que hemos recibido durante el análisis de la gestión del Departamento de Evaluación de Operaciones han sido tomados en cuenta en la evaluación. La Región de Asia Oriental y Pacífico del Banco y el Gobierno de China (Ministerio de Economía) también han hecho comentarios sobre un borrador de la Evaluación de la Asistencia al País. El Departamento de Evaluación de Operaciones ha tomado en cuenta los comentarios objetivos y de redacción realizados sobre este borrador. En el Anexo N, se presentan los comentarios efectuados por el personal regional. En el Anexo O, se detallan los comentarios del Gobierno.

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synthèse des principales leçons et recommandations.

Nous tenons à remercier les réviseurs-pairs pour avoir bien voulu apporter des commentaires détaillés sur une version antérieure du document. Il a été tenu compte dans l'évaluation de ces commentaires, ainsi que d'autres commentaires reçus au cours de la réunion de réexamen de la direction de l'OED. La Région Asie orientale et Pacifique de la Banque et le Gouvernement chinois (Ministère des finances) ont tous deux également offert leurs commentaires sur le projet de CAE. L'OED a tenu compte des commentaires factuels et rédactionnels apportés sur le projet de document. Les commentaires du personnel de la région figurent à l'annexe N. Les commentaires des gouvernements sont reproduits à l'annexe O.

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EXECUTIVE
SUMMARY

Since opening to the outside world and embarking on a program of economic reform in 1978, China has had one of the highest rates of sustained economic growth in the world, quadrupling per capita income in about 20 years and lifting more than a quarter-billion people out of poverty. During the 1990s, however, several shortcomings and challenges emerged. Poverty reduction has slowed, and inequality and vulnerability have increased. China faces severe environmental problems, in part because of the strains of high growth. And while a strategy of gradual reform has promoted both growth and stability, the unfinished reform agenda poses fiscal, financial, and social risks that could undermine the achievement of the past 20 years.

This Country Assistance Evaluation (CAE) focuses on the period FY93–02. The World Bank's assistance strategy had four main objectives during this period: (i) promoting market-oriented system reform and better macroeconomic management; (ii) poverty reduction; (iii) supporting infrastructure development for growth and market integration; and (iv) environmental protection. Although China is the Bank's largest International Bank for Reconstruction and Development (IBRD) borrower and the second-largest recipient of International Development Association (IDA) credits, Bank lending accounts for only a small share of China's resource flows—about 0.6 percent of

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RÉSUMEN

Desde que en 1978 China decidió emprender su apertura hacia el mundo exterior e iniciar un programa de reformas económicas, ha logrado uno de los índices de crecimiento económico sostenido más altos del mundo, cuadruplicando el ingreso per cápita en 20 años y rescatando más de 250.000 millones de personas de la pobreza. Junto con estos logros también surgieron algunas dificultades y desafíos en la década de los noventa. La reducción de la pobreza ha desacelerado su marcha y la desigualdad y vulnerabilidad han ido en aumento. China enfrenta serios problemas ambientales en parte, debido al desgaste que produjo el alto nivel de crecimiento. Y si bien la estrategia de reformas graduales ha promovido tanto el crecimiento como la estabilidad, la agenda de reformas inconclusa genera riesgos fiscales, financieros y sociales que podrían socavar los logros alcanzados durante los últimos veinte años.

La Evaluación de la Asistencia al País se concentra en el período comprendido entre los ejercicios económicos 1993 y 2002. La estrategia de asistencia del Banco Mundial se propuso cuatro objetivos principales para este período: (i) promover una reforma del sistema con orientación hacia el mercado y un mejoramiento de la gestión macroeconómica, (ii) reducir la pobreza; (iii) apoyar el desarrollo de la infraestructura para el crecimiento y la integración del mercado; y (iv) proteger el medio ambiente. A pesar de que China es el prestatario del BIRF más grande del Banco y el segundo beneficiario en

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RÉSUMÉ
ANALYTIQUE

Depuis qu'elle s'est ouverte au monde extérieur et a démarré

un programme de réforme économique en 1978, la Chine a l'un des taux les plus élevés au monde de croissance économique soutenue, multipliant par quatre le revenu par habitant sur environ 20 ans et en hissant plus de 250 millions de gens hors de la pauvreté. À côté des ces réussites sont apparus au cours des années 90 des insuffisances et des défis. La réduction de la pauvreté s'est ralentie tandis qu'augmentaient l'inégalité et la vulnérabilité. La Chine se trouve confrontée à de graves problèmes environnementaux en partie dus à l'astreinte de la forte croissance. La stratégie de réforme graduelle a promu tout à la fois la croissance et la stabilité mais le programme de réforme en suspens pose des risques fiscaux, financiers et sociaux qui pourraient saper les réussites des 20 dernières années.

La présente Évaluation de l'aide par pays est centrée sur la période EF93-02. La stratégie d'aide de la Banque avait pour objectif au cours de cette période les quatre principaux objectifs suivants : (i) promotion de la réforme du système axé sur le marché et d'une meilleure gestion macroéconomique, (ii) réduction de la pauvreté, (iii) soutien du développement de l'infrastructure pour l'intégration de la croissance et du marché, et (iv) protection de l'environnement. Bien que la Chine soit le plus gros emprunteur BIRD de la Banque et le deuxième bénéficiaire des crédits IDA, les prêts de la Banque ne représentent qu'une pe-

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GDP at its maximum in the early 1990s. The Bank has therefore not tried to achieve its objectives primarily through the direct impact of its lending or through conditionality. Rather, the Bank has relied mostly on variants of persuasion and example. These included a dual-track approach of (i) building trust through lending while promoting policy dialogue through sector work and (ii) relying on the demonstration effect of successful project experience in introducing new technologies, management methods, or policy reforms to leverage policy outcomes.

The overall outcome of the Bank's assistance strategy has been satisfactory. In macromanagement and system reform, the Bank played an important role in supporting the acceleration of reforms in the early 1990s, including macromanagement reforms that helped stabilize the economy. With respect to system reform more generally, the Bank helped identify the critical nexus of enterprise–financial sector–fiscal reforms needed to underpin high growth with stability, but it was less successful in promoting implementation of some of the components. Incomplete enterprise and financial sector reforms create heavy fiscal contingencies and pose significant risks to China's accomplishments.

The Bank made several significant contributions to poverty reduction in the 1990s. Most important, the Bank has helped establish successful models of targeted interventions through integrated rural development projects. Where the Bank has been less successful—despite writing good reports on the issues—is in persuading the gov-

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importancia de los créditos de la AIF, los créditos del Banco representan sólo una pequeña parte de los flujos de recursos con que cuenta China: alrededor de un 0,6 por ciento del PIB como máximo a comienzos de la década de los noventa. Por este motivo, el Banco no ha procurado alcanzar sus objetivos mediante el impacto directo de su financiamiento o a través de la imposición de condicionalidades. Por el contrario, el Banco ha recurrido fundamentalmente a variantes de persuasión y ejemplos, entre las que se incluyó un modelo dualista, que procura generar confianza mediante el financiamiento promoviendo al mismo tiempo una política de diálogo a través del trabajo sectorial, y confianza en el efecto de demostración de las experiencias exitosas en la introducción de nuevas tecnologías, métodos de gestión o las reformas de políticas para la potenciación de resultados.

En términos generales, el resultado de la estrategia de asistencia del Banco ha sido satisfactoria. En cuanto a la reforma de la gestión pública y del sistema, el Banco ha tenido un papel preponderante en el apoyo a la agilización de las reformas a comienzos de la década de los noventa, incluidas las reformas introducidas en la gestión pública que ayudaron a estabilizar la economía. En un plano más general, con respecto a la reforma del sistema, el Banco ayudó a determinar el nexo crítico de reformas que era necesario introducir en el área de las empresas públicas, el sector financiero y la política fiscal para poder sostener el alto índice de crecimiento con estabilidad, pero su labor no fue tan exitosa al promover la implementación de alguno de sus componentes. Las reformas incon-

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tite part des apports de ressources de la Chine — environ 0,6 % du PIB au plus au début des années 90. La Banque n'a par conséquent pas tenté d'atteindre ses objectifs principalement par le biais de l'impact direct de ses prêts ou au travers de la conditionnalité. La Banque a plutôt dépendu dans une grande mesure de variantes de persuasion et d'exemple. Celles-ci comportaient une approche double qui consistait à renforcer la confiance par le biais des prêts tout en favorisant le dialogue de politique par le biais des travaux sectoriels, et à dépendre de l'effet de démonstration de l'expérience de projets réussis en introduisant de nouvelles technologies, méthodes de gestion ou réformes stratégiques pour donner un pouvoir multiplicateur aux résultats des stratégies.

Le résultat d'ensemble de la stratégie d'aide de la Banque est satisfaisant. La Banque a joué un rôle important en matière de réforme macrogestion et système en soutenant l'accélération des réformes au début des années 90, y compris les réformes de macrogestion qui ont aidé à stabiliser l'économie. En ce qui concerne la réforme système vue de façon plus générale, la Banque a aidé à identifier le lien crucial entre les réformes entreprises/secteur financier/fiscales nécessaires pour soutenir la forte croissance et la stabilité mais elle a moins bien réussi à promouvoir la mise en œuvre de certains des éléments. Des réformes incomplètes au niveau des entreprises et du secteur financier créent des impondérables fiscaux importants et posent de graves risques aux réussites de la Chine.

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ernment of the implications of broader development policies for poverty and inequality. The mismatch between intergovernmental fiscal resources and responsibilities exacerbated regional inequality and led to unequal access to health services; grain policy penalized farmers in some of the poorer areas; and migration restrictions have limited economic integration.

China had a lot to gain from international experience in infrastructure development in the early 1990s, and the Bank had a lot to offer. Bank support was highly successful in promoting better project management, competitive bidding, and technical improvements. Even resource transfer from the Bank was of some importance for breaking infrastructure bottlenecks during this period. In addition, the Bank's dual-track strategy of promoting sector policy and institutional reform was successful, particularly in power, though less so in transport (or water). The main question looking forward is whether the Bank can still contribute significant value added in the sector, or whether the Bank finance that the government still desires is a substitute for reforms that could open up other modes of finance.

The Bank has made some visible contributions to improving environmental protection, but there have been shortcomings as well. Bank-supported projects in natural resource management, forestry, power (both thermal and hydro), and multipurpose dams have had a direct and favorable impact and have also influenced design and implementation of non-Bank projects. The

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clusas del sector financiero y de las empresas públicas han generado serios imprevistos fiscales y ponen en riesgo de manera importante los logros alcanzados por China.

En la década de los noventa, el Banco contribuyó en forma significativa en la lucha contra la pobreza. Más aun, el Banco ha ayudado a crear modelos exitosos de intervenciones dirigidas a través de proyectos integrados de desarrollo rural. Sin embargo, la labor del Banco ha sido menos exitosa — a pesar de que se escribieron muy buenos informes sobre estos temas — a la hora de persuadir al gobierno sobre las implicancias de adoptar políticas de desarrollo más amplias para la lucha contra la pobreza y la desigualdad. La disparidad entre las responsabilidades y los recursos fiscales intergubernamentales exacerbaron la desigualdad regional y contribuyeron a generar inequidad en el acceso a los servicios de salud; la política de granos penalizó a los granjeros en algunas de las zonas más pobres; y las restricciones a la migración limitaron la integración económica.

China tenía mucho por ganar de la experiencia internacional en el desarrollo de infraestructura a comienzos de la década de los noventa y el Banco tenía mucho para ofrecer. El apoyo del banco resultó muy exitoso en su objetivo de promover una mejor gestión de proyectos, las licitaciones públicas y las mejoras técnicas. Incluso la transferencia de recursos del Banco tuvo importancia para permitir superar las limitaciones de la capacidad de infraestructura durante este período. Además, la estrategia dualista del banco para promover la reforma de políticas sectoriales e institucionales resultó

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La Banque a contribué de diverses manières importantes à la réduction de la pauvreté au cours des années 90 ; et ce qui est le plus important, la Banque a aidé à créer des modèles réussis d'interventions ciblées au travers de projets intégrés de développement rural. Là où la Banque a moins bien réussi — bien qu'elle ait écrit de bons rapports sur le sujet — c'est à persuader le gouvernement des répercussions de politiques plus vastes de développement en ce qui concerne la pauvreté et l'inégalité. Le décalage entre les ressources et les responsabilités fiscales intergouvernementales a exacerbé l'inégalité régionale et a conduit à un accès inégal aux services de santé, la politique des céréales a pénalisé les fermiers dans certaines des zones les plus pauvres, et les restrictions des migrations ont limité l'intégration économique.

La Chine avait beaucoup à gagner de l'expérience internationale en matière de développement de l'infrastructure au début des années 90 et la Banque avait beaucoup à offrir. Grâce à son soutien, la Banque a très bien réussi à promouvoir une meilleure gestion des projets, des appels d'offre concurrentiels et des améliorations techniques. Même le transfert de ressources provenant de la Banque a eu une certaine importance dans la résolution des goulots d'étranglement de l'infrastructure durant cette période. En outre, la stratégie double de la Banque de promotion de politiques sectorielles et de réformes institutionnelles a été couronnée de succès, tout particulièrement en ce qui concerne l'électricité, mais toutefois moins pour les transports (ou l'eau). La principale

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Bank has helped mainstream environmental concerns in a number of sectors, notably energy, where China has made significant progress in improving energy efficiency. Environmental safeguard policy has been highly variable, ranging from best practice to a rebuke from the Inspection Panel for not applying the Bank's own safeguard procedures. Overall, the Bank has had a positive impact on the environment, but improving coordination of environmental policy, especially water resource management, remains a considerable challenge.

The Bank's assistance strategy and activities have been relevant in the large, if not always in the small—at the broadest level of strategic focus and allocation of resources, the Bank has done the right things. Relevance at the level of sector or regional allocation or the choice of project components has always been constrained by the project repayment system. Projects were often skewed toward components that generated revenue, sometimes at the expense of higher-return public goods components. With the loss of IDA, Bank lending for social sectors and poor regions has become increasingly constrained.

The Bank's record on efficacy—doing things right—has been mixed. China has the best project outcome and other ratings of any large country. Project implementation has been excellent in most sectors. But efficacy also depends on achieving policy and institutional change within sectors and on achieving coordination across sectors and levels of government for crosscutting objectives. This has been successful in some

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también exitosa, especialmente en el área de energía, aunque los resultados no fueron tan alentadores en las áreas de transporte o agua. El primer interrogante que se plantea es si el Banco puede seguir aportando un valor agregado significativo en el sector, o si el financiamiento del Banco que el gobierno sigue esperando constituye un sustituto de las reformas que podrían dar lugar a la apertura de otras formas de financiamiento.

El Banco ha hecho aportes visibles al mejoramiento de la protección ambiental, pero aquí también hubo algunas dificultades. Los proyectos respaldados por el Banco en materia de manejo de recursos naturales, forestales, energéticos (tanto energía termoeléctrica como hidráulica), y las represas para múltiples propósitos han tenido un impacto directo y positivo y también han influido en el diseño e implementación de proyectos que no recibieron el financiamiento del Banco. El Banco ha contribuido a inculcar responsabilidad por la protección del medio ambiente en un número de sectores, especialmente en el sector energético en donde China ha hecho un avance importante en el mejoramiento de la eficacia energética. La política de protección ambiental ha sido muy variable: por un lado se aplicaron prácticas óptimas y por otro hubo una presentación de queja por parte del Grupo de Inspección por no haber aplicado los procedimientos del Banco en materia de protección ambiental. En general, la acción del Banco ha tenido un impacto positivo en el medio ambiente. Sin embargo, el mejoramiento de la coordinación de la política ambiental, en especial el manejo de los recursos

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question si l'on regarde l'avenir est de savoir si la Banque peut encore contribuer une valeur ajoutée non négligeable ou si le financement de la Banque que le gouvernement souhaite encore se substitue aux réformes qui pourraient ouvrir la voie à d'autres types de financement.

La Banque a visiblement contribué dans certains cas à l'amélioration de la protection de l'environnement mais il y a également eu des insuffisances. Des projets soutenus par la Banque dans le domaine de la gestion des ressources naturelles, de la foresterie, de l'énergie (tant thermique qu'hydroélectrique) et des barrages polyvalents ont eu un impact direct favorable mais ils ont également influencé la conception et la mise en œuvre de projets autres que ceux de la Banque. La Banque a apporté son aide pour des questions environnementales dominantes dans un certain nombre de secteurs, notamment le secteur énergétique où la Chine a progressé de façon notable en ce qui concerne l'amélioration du rendement énergétique. La politique de mesures de protection environnementales est très variable, allant de la meilleure pratique à un blâme de la part du Groupe d'inspection pour ne pas avoir appliqué les propres procédures de protection de la Banque. La Banque a dans l'ensemble eu un impact positif sur l'environnement mais l'amélioration de la coordination de la politique environnementale, tout particulièrement la gestion des ressources en eau, demeure un défi considérable.

La stratégie et les activités d'aide de la Banque ont été pertinentes dans les grandes lignes, quoique pas toujours dans le détail — au niveau le plus

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areas (power sector and social security reform), but less so in others, particularly in areas that primarily depend on the demonstration effect of projects at the local level. Similarly, the Bank has been more effective in coordina-

tion where there is a high-level government coordination body.

The main strength of the Bank has been its sustained support of an activity or program over a number of years. Because of the Bank's long-term involvement, it has been able to have a substantial cumulative impact in a number of areas, its views gain a respectful hearing, and it has sometimes been well-placed to take advantage of opportunities when China is looking for support for change. Could the Bank have accomplished more if it had been more ambitious or aggressive in pushing its own agenda through conditionality? That seems unlikely. The Bank has clearly played an advisory role in China and could not have expected to achieve more through conditionality than through persuasion and demonstration. Persuasion can be improved, however. The Bank's view on issues has sometimes been less than fully transparent. Looking forward, the Bank should give more attention to trying to promote and participate in a much broader debate on policy and sector issues, not only among officials, but also among researchers and other stakeholders.

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hídricos, sigue siendo un gran desafío.

La estrategia y las actividades de ayuda del Banco han sido importantes en el plano general, aunque no siempre en temas más específicos. En general, con respecto a la

orientación estratégica y a la asignación de recursos el Banco ha tenido un buen desempeño. En este sentido, la relevancia en materia de asignación sectorial o regional de recursos o la elección de los componentes de los proyectos siempre estuvo limitada por el mecanismo de pago del proyecto. Casi siempre los proyectos se orientaban a incorporar componentes que generaran ingresos, y en algunas situaciones en desmedro de los componentes de bienes públicos de mayor rentabilidad. Con la desaparición de la AFI, se son cada vez mayores las limitaciones del financiamiento del Banco para los sectores sociales y las regiones pobres.

La evaluación de eficacia del Banco, es decir las cosas que se hicieron bien, es bastante heterogénea. De todos los países grandes, China es el que ha logrado obtener los mejores resultados en materia de proyectos y otras calificaciones. La implementación de los proyectos ha sido excelente en la mayoría de los sectores. Pero la eficacia también depende de los cambios tanto políticos como institucionales que se puedan introducir dentro de los sectores, como así también de lograr coordinación entre los sectores y los niveles de gobierno para la consecución de objetivos transversales. Si bien en algunas áreas esto se logró (como por ejemplo, la reforma del sector energético y de seguridad social) no ha sucedido lo mismo en otras, en especial en aquellas que dependen principalmente

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large de focalisation stratégique et d'affectation des ressources, la Banque a fait ce qu'il fallait. La pertinence au niveau de l'affectation sectorielle ou régionale ou du choix des éléments des projets est toujours freinée par le système de remboursement des projets. Les projets penchent souvent au profit des éléments qui génèrent des revenus, parfois aux dépens d'éléments de biens publics à meilleur rendement. Avec la perte d'IDA, les prêts de la Banque au profit des secteurs sociaux et des régions pauvres sont de plus en plus restreints.

Les résultats de la Banque en matière d'efficacité —de bien faire les choses— sont mélangés. La Chine a le meilleur résultat de projets et autres notations par rapport aux autres grands pays. La mise en œuvre des projets est excellente dans la plupart des secteurs. Mais l'efficacité dépend également de la capacité à effectuer des changements institutionnels et de politique au sein des secteurs et à parvenir à coordonner entre les secteurs et les niveaux de gouvernement en ce qui concerne les objectifs multidisciplinaires. Ceci a été couronné de succès dans certains domaines (la réforme du secteur énergétique et de sécurité sociale) mais a moins bien réussi dans d'autres, notamment dans les domaines qui dépendent principalement de l'effet de démonstration des projets au niveau local. Dans le même ordre d'idées, la Banque est plus efficace en matière de coordination là où il y a un organisme de coordination du gouvernement à haut niveau.

Le principal point fort de la Banque est son soutien durable en faveur d'une activité ou d'un pro-

ESPAÑOL

del efecto demostración de los proyectos en el plano local. De la misma manera, la coordinación del Banco ha sido más eficaz cuando existe un cuerpo de coordinación en las altas esferas del gobierno.

La fortaleza principal del Banco ha sido su apoyo sostenido a una actividad o programa a lo largo de una serie de años. Debido a la participación prolongada del Banco, el impacto logrado en algunas áreas es acumulativo, sus opiniones son muy respetadas, y esto le ha permitido aprovechar las oportunidades en que China busca apoyo para implementar cambios. ¿Podrían haber sido mayores los logros del Banco si hubiese sido más ambicioso o agresivo e imponer su propia agenda mediante condicionalidades? Esto parece improbable. El Banco ha desempeñado claramente una función de asesoramiento en China y no hubiese obtenido más logros con la imposición de condicionalidades que los que alcanzó mediante la persuasión y la demostración. No obstante, la persuasión puede mejorar. En algunas oportunidades, la opinión del Banco en cuanto a los problemas no ha sido totalmente transparente. De cara al futuro, el Banco debería hacer más hincapié en tratar de promover un debate mucho más amplio en temas sectoriales y de políticas que cuente con su participación y no hacerlo sólo entre los funcionarios de gobierno, sino también entre los investigadores y otras partes interesadas.

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gramme sur un certain nombre d'années. Grâce à sa participation sur le long terme, la Banque peut avoir un impact cumulatif important dans un certain nombre de domaines, ses points de vue reçoivent une attention

respectueuse et elle s'est parfois trouvée en bonne position pour tirer parti d'occasions où la Chine cherchait un soutien pour le changement. La Banque aurait-elle pu mieux réussir si elle avait été plus ambitieuse ou audacieuse en imposant son propre ordre du jour au travers de la conditionnalité ? Cela semble peu probable. La Banque joue clairement un rôle à caractère consultatif en Chine et n'aurait pu s'attendre à mieux réussir par le biais de la conditionnalité que par le biais de la persuasion et de la démonstration. Il est toutefois possible d'améliorer la persuasion. L'avis de la Banque sur certaines questions n'est pas toujours totalement transparent. La Banque devrait à l'avenir prêter une plus grande attention à tenter de promouvoir et de participer à un plus vaste débat sur les questions sectorielles et de politique, non seulement entre les fonctionnaires mais également entre les chercheurs et autres parties prenantes.



Gregory K. Ingram

Director-General, Operations Evaluation

ACRONYMS AND ABBREVIATIONS

AAA	Analytical and advisory activities
ADB	Asian Development Bank
AIDS	Acquired immunodeficiency syndrome
CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
CCICED	Chinese Council for International Cooperation on Environment and Development
CPPR	Country performance portfolio review
DEC	Development Economics and Chief Economist Vice Presidency
DECRG	Development Research Group
DFID	Department for International Development (United Kingdom)
EAP	East Asia and Pacific Region
EBF	Extrabudgetary fund
EIA	Environmental impact assessment
ESMAP	Energy Sector Management Assistance Program (IFC)
ESW	Economic and sector work
FDI	Foreign direct investment
FSTAP	Financial Sector Technical Assistance Project
GDP	Gross domestic product
GEF	Global Environment Facility
GNI	Gross national income
HIV	Human immunodeficiency virus
IBRD	International Bank for Reconstruction and Development (The World Bank)
ICB	International competitive bidding
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
IP	Inspection Panel
LGPR	Leading Group for Poverty Reduction
LOC	Line of credit
MDG	Millennium Development Goal
M&E	Monitoring and evaluation
MFMP	Multilateral Fund for the Montreal Protocol
NGO	Nongovernmental organization
NPLs	Nonperforming loans
MIGA	Multilateral Investment Guarantee Agency
NRM	Natural resource management
O&M	Operations and maintenance
ODA	Official development assistance
ODS	Ozone-depleting substances
OED	Operations Evaluation Department, World Bank
PBC	People's Bank of China
PER	Public Expenditure Review
PPP	Purchasing power parity
PTI	Poverty-targeted interventions

QAE	Quality at entry
QAG	Quality Assurance Group
QSA	Quality of supervision assessments
RSA	Rapid supervision assessment
RSAL	Rural Sector Adjustment Loan
RWSS	Rural water supply and sanitation
SCORES	State Council Organization for Reform of the Economic System
SEPA	State Environmental Protection Agency
SIDD	Self-Financing Irrigation Development Districts
SOEs	State-owned enterprises
TA	Technical assistance
TVE	Township and village enterprise
UNDP	United Nations Development Program
VAT	Value added tax
WBI	World Bank Institute
WHO	World Health Organization
WRM	Water resource management
WS	Water supply
WTO	World Trade Organization
WUA	Water users association
WWTP	Wastewater treatment plants

Note: All dollar amounts are U.S. dollars unless otherwise indicated.



Introduction

China's Achievements in a Quarter-Century of Reform

In December 1978, China reversed its development strategy of the previous 30 years and launched a process of economic reform and opening up to the outside world. The results of China's strategic shift have been dramatic.

Growth. Since 1980, China has had one of the highest sustained rates of growth of per capita income in the world (see figures 1.1 and 1.2). While there is a lively debate on the accuracy of official statistics, there is widespread agreement that per capita gross domestic product (GDP) in constant domestic prices doubled between 1980 and 1990 and then approximately doubled again between 1990 and 2000.¹ In constant dollars and current purchasing power parity (PPP) terms (see table 1.1), the increase was even greater, owing to exchange rate movements. Exports in current U.S. dollars increased from \$18 billion in 1980 to \$249 billion in 2000—a nearly 14-fold increase.

Poverty reduction. Between 1990 and 2000, the number of people living on a dollar a day fell by 170 million—during a period when total population rose by more than 125 million. Over the past two decades, China accounted for 75 percent of poverty reduction in the developing world.

Stability. China also avoided the instability and output declines of most other transition

economies. This stability is often attributed to China's gradualist approach to economic reform (“crossing the river by feeling the stones”), in which institutional changes have preceded or accompanied policy changes.²

Shortcomings and Challenges

Despite China's enormous achievements in growth, poverty reduction, and stability, there have been shortcomings as well, especially in the 1990s.

- **Rising inequality and vulnerability.** The rural reforms of 1979–84 reduced inequality, as well as poverty. Since the late 1980s, however, inequality and vulnerability have increased, and since the mid-1990s, poverty reduction has slowed.³ In the second half of the 1990s, the share of people in poverty stagnated, despite an overall growth rate of more than 8 percent.

Since 1980, China has had one of the highest sustained rates of growth of per capita income in the world.

Table 1.1 China: Selected Indicators, 1980-01

Indicator	1980	1990	1995	2000	2001
Population, total (million)	981	1,135	1,205	1,262	1,272
GDP per capita (constant 1995 US\$)	167	350	581	825	878
GNI per capita, PPP (current international \$)	430	1,300	2,460	3,690	3,950
Exports of goods and services (current US\$ billion)	14	62	168	280	299
Exports of goods and services (% of GDP)	8	18	24	26	26
Manufactures exports (% of total exports)	50	74	86	90	90
Gross domestic savings (% of GDP)	35	38	43	39	40
Gross capital formation (% of GDP)	35	35	41	36	38
Overall budget balance (% of GDP)		-1.9	-1.7	-3.6 ^c	-3.3 ^c
Revenue (% of GDP)	26	20	11 ^b	15	17
External debt, total (current US\$ billion)		55	118	146	170 ^c
Reserves (current US\$ billion)	2	29	105 ^b	166	212
Poverty headcount (million) ^d	490 ^a	375	212	204	
Poverty incidence (%) ^d	51 ^a	33	17 ^b	16	

Note: One billion = 1,000 million. PPP = purchasing power parity.

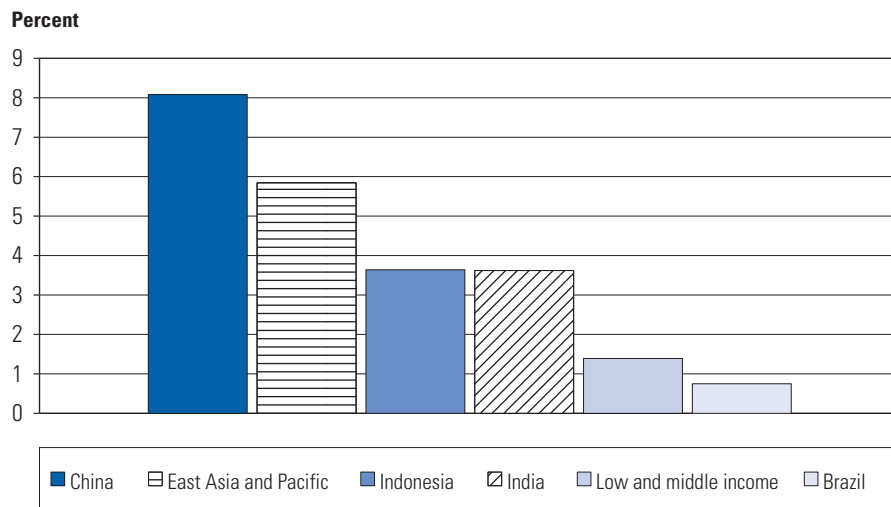
a. 1978.

b. 1996.

c. Data from World Bank China Program real-time database; new definition was introduced in 2001 data that includes better measurement of short-term debt.

d. World Development Indicators and *China Statistical Yearbook*.

Source: The World Bank Sima database, data as of July 15, 2003, unless noted otherwise.

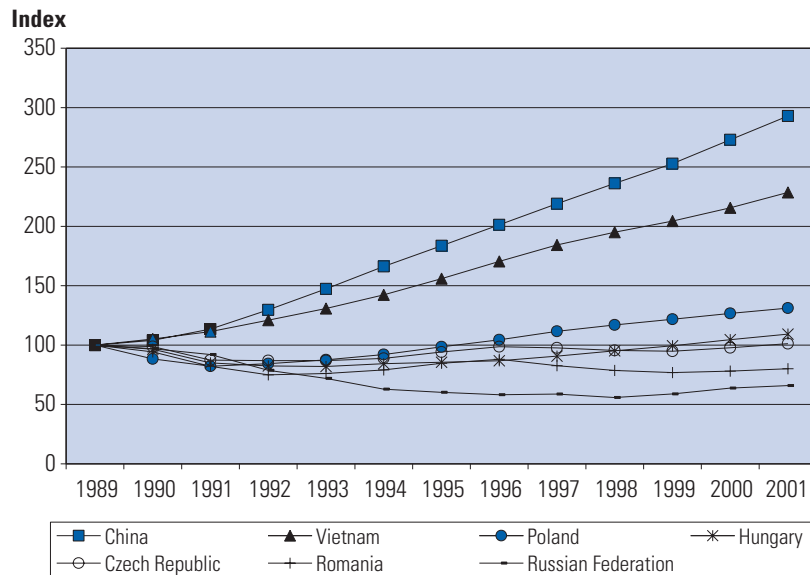
Figure 1.1 Average Annual Real GDP per Capita Growth, China and Comparisons, 1980-01

This partly reflects the fact that coastal provinces have benefited more from reforms and opening up than remote, resource-poor inland provinces; but decentralization has also favored coastal provinces and reduced the scope for

fiscal redistribution, and reforms have led to less equal access to health and education services. A 1998 survey by the Ministry of Health found that 22 percent of households below the poverty level were in that position because of

Figure 1.2

Real GDP Index of Selected Transition Countries, 1989-01



a family member's serious illness or injury (Zhu 2002). Gender inequality persisted in the 1990s, when there were both advances and setbacks.

- **Environmental degradation.** China's air and water are heavily polluted, accounting for tens of thousands of deaths annually. Seven of the 10 most polluted cities in the world in the late 1990s were in China.⁴ "Green" environmental problems are also serious. One-third of China's grasslands, which cover 40 percent of land area, are seriously degraded. A falling water table in northern China has seriously restricted the sustainable development of the region.
- **Risks from incomplete reform.** The strategy of gradual reform is hard to fault in terms of the growth and stability it has provided. "Growing out of the plan"—leaving state enterprises relatively unreformed while encouraging private sector competition and growth—can be seen as an ingenious way to compensate potential losers that purchases precious time and stability. But the incompleteness of enterprise reform poses risks that could undermine some of the achievements of the past 20 years. Most notably, it weakens the state-dominated banking system, which still has more than 20 percent nonperforming loans

(equivalent to about 30 percent of GDP), despite moving many such loans to asset management corporations since 2000. It also poses direct risks of unemployment and social instability and compounds fiscal problems by cutting into revenues needed for reforms of pensions, housing, and social services and for redistribution to poorer provinces. Finally, insufficient reform in regulatory and legal processes fosters corruption, which has become an additional source of discontent and potential instability.⁵ A World Bank China Client Survey (2002) found that corruption and social protection were most frequently considered the greatest challenges facing China (Annex K).

China was admitted to membership in the World Trade Organization (WTO) in 2001. This represents a significant commitment on all sides. For the rest of the world, it implies granting equal access to markets. For China, it is a commitment to continue market-oriented reforms and opening up to the outside world. It thus poses both opportunities (for exports and growth) and challenges (of adjustment to competition in agriculture, industry, and banking).



Evolution of World Bank Assistance Strategy

The People's Republic of China assumed its seat in the World Bank in 1980. China's membership was significant for both the World Bank and China. For the Bank, admission of the world's largest country offered the chance to be a truly *World* Bank and provided an opportunity to work with a country trying to introduce market socialism. For China, gaining membership in the Bank (and the IMF) was part of its opening up and reversal of isolation. The Bank was viewed by China as a source of technology and information—a window on the outside world. Deng Xiaoping summed up initial Chinese expectations of the relationship this way: “We can do it with or without the Bank, but with you we can do it faster.”

The early years of the relationship were marked by patient efforts on both sides to overcome cultural differences and mutual misunderstandings or suspicions. Chinese officials were disconcerted by the extensive data requests in preparation for the Bank's first economic report (World Bank 1982).¹ For its part, the Bank was surprised to be presented with fully prepared projects that were apparently expected to be financed with no modification. Chinese suspicions that the Bank had an ideological agenda were matched by Bank concerns that the Bank would be used to certify projects or policies on the basis of government assurances, rather than independent investigation and analysis. Finally, there were different expectations about International Development Association (IDA) allocations.

Some Chinese officials expected that China would reach immediate parity with India and might even be compensated for the years China had lost while not a member. Because of China's size and pressures for allocation to Africa, these expectations could not be met.

A compromise was reached in which China's IDA allocation gradually increased to a level comparable to India's, while China limited International Bank for Reconstruction and Development (IBRD) borrowing to maintain a 50–50 blend. This meant that overall lending to China rose less quickly than originally expected.

Establishment of trust and mutual respect was

Establishment of trust and mutual respect was a long and arduous process, but by the middle of the 1980s relations were excellent.

Chinese officials were impressed by the big picture painted by the Bank in the first report, and were surprised by the similarities of problems with other developing countries.

a long and arduous process, but by the middle of the 1980s relations were excellent and Bank prestige in China was high. The Bank's economic and sector work (ESW) was a big factor (Stern 1997). Chinese officials were impressed by the big picture painted by the

Bank in the first report, and were surprised by the similarities of problems with other developing countries (Jacobson and Oksenberg 1990). The Brookings history of the Bank noted that this report "became a primer for senior Chinese officials and went a long way in establishing the Bank's credibility in that country" (Kapur, Lewis, and Webb 1997, p. 24). The second major report (World Bank 1985) had an even more dramatic impact. After reading it, Premier Zhao Ziyang asked the System Reform Commission to prepare a new five-year plan incorporating some of the main proposals of the report (Lu 2002).

Lending also helped promote mutual trust. At first, the Bank largely accepted Chinese project proposals with little modification, but insisted on application of standard procurement and other procedures. The results of international competitive bidding (ICB) lowered project cost so much that China adopted competitive bidding for many of its own projects. By the mid-1980s, project preparation and appraisal involved much more give and take, and in 1987 the Bank approved the first (and only) adjustment loan to China—a Rural Sector Adjustment Loan (RSAL) in

The Bank thus emerged from the 1980s with considerable prestige and as a trusted adviser to those Chinese policymakers and researchers who favored economic reform.

support of ongoing rural reforms.

The first real test of the relationship arose in the aftermath of the events in Tiananmen Square in June 1989. The Board of Executive Directors was deeply divided over the implications for Bank

strategy. At the behest of the G-7, the Bank imposed a hiatus on lending to China.² Bank management was concerned to avoid political conditionality and to help maintain the gains of economic reform that had taken place in China. The director of the Bank's China Department traveled to China to take stock of the situation and report back to the Board, and in 1990, World Bank President Conable pushed the Board to resume lending over the opposition of some shareholders (Gwin 1997). In 1991, Bank lending resumed and quickly built up to higher levels than before (see figure 2.1).

The Bank thus emerged from the 1980s with considerable prestige and as a trusted adviser to those Chinese policymakers and researchers who favored economic reform. Earlier evaluations gave the Bank high marks for its assistance to China in the 1980s. The Brookings history (commissioned by the Bank) of the Bank's first 50 years called the relationship "one of the most successful interactions of the World Bank with a borrower" and "one of the Bank's prouder achievements of the 1980s."³

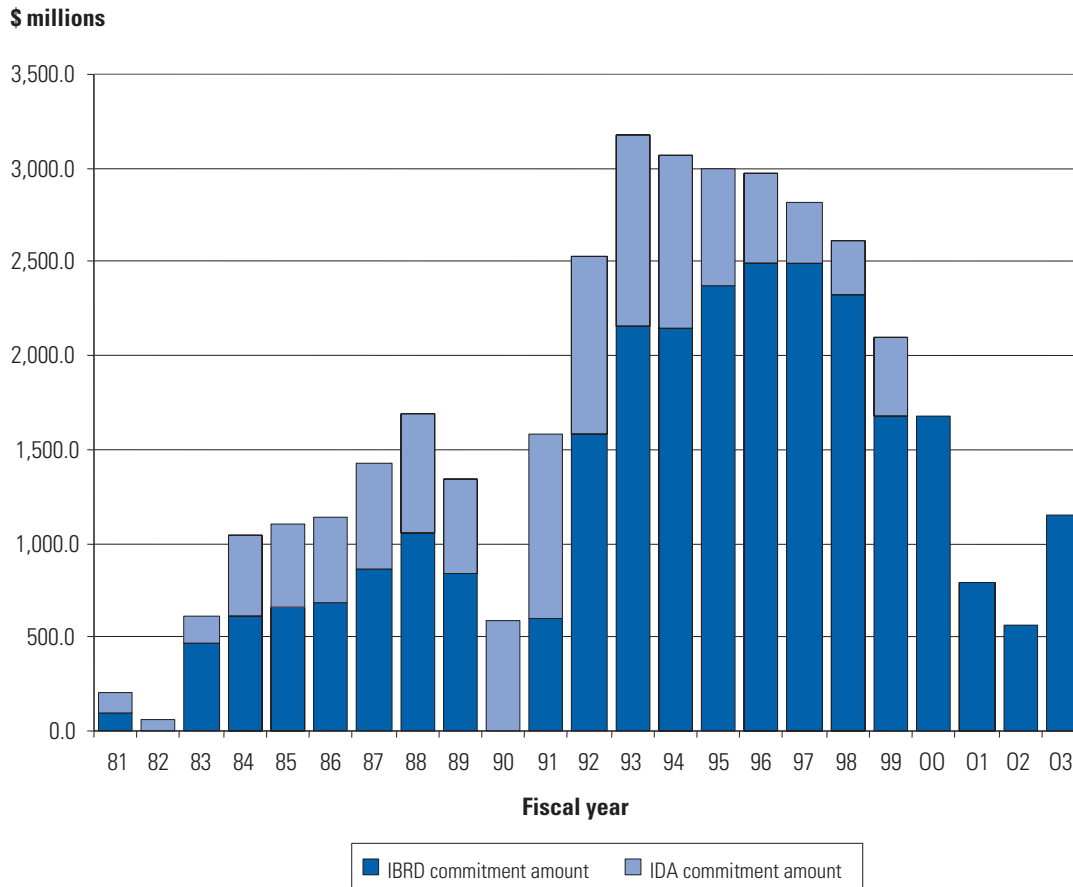
Lessons from the 1980s are limited, and comparisons between the 1980s and the past decade are fraught with difficulty. By the 1990s, China was a completely different country than it had been in the previous decade. The Bank's role in the 1980s as a source of knowledge for a long-isolated country was clear. But China in the 1990s had far greater capacity, international experience, and access to other sources of knowledge and capital. In this more sophisticated and competitive environment, therefore, the Bank was bound to have a lower profile and play a different role.

Evolution of the Relationship and Bank Strategy after 1991

The overarching objective of the Bank's assistance strategy during most of the 1980s and early 1990s was to promote economic system reform.⁴ In focusing on reform, the Bank was following a long tradition of outsiders who have sought "to change China" for one reason or another (Spence 1969).⁵ System reform was seen by the Bank and Chinese reformers alike as the key to long-

Figure 2.1

IBRD-IDA Commitments to China by Fiscal Year, 1981-03



term growth, modernization, and poverty reduction.

System reform and macromanagement—and continued reform *for* better macro management—have remained prominent themes of Bank Country Assistance Strategy (CAS) statements. Over the course of the 1990s, increasing emphasis was placed on other objectives that were already noted as secondary objectives in 1991. The first stand-alone assistance strategy in 1995, for example, had four areas of focus: macroeconomic and structural reforms; infrastructure bottlenecks; poverty reduction; and environmental protection. The 1997 strategy was similar, but grouped around five themes: macroeconomic growth and stability; infrastructure; human development and poverty reduction; agricul-

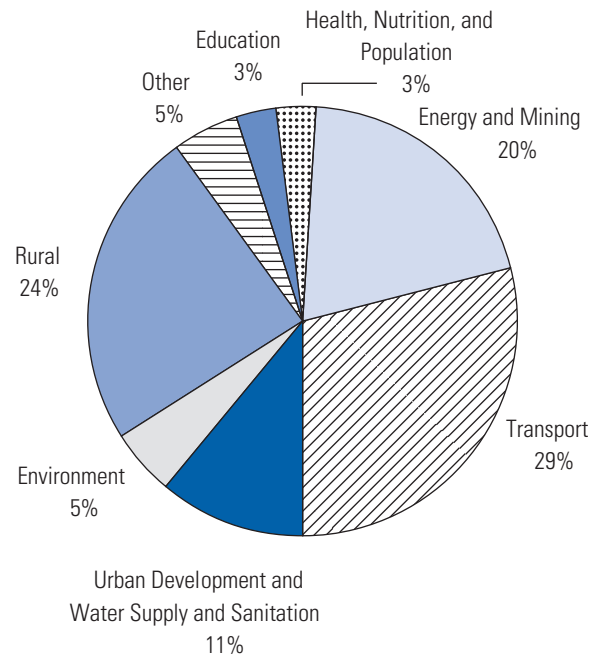
ture and rural development; and environmental protection. The Bank's strategy on poverty reduction and the environment evolved in line with the approach in most of the Bank. The strategy for poverty reduction, for example, was to be pursued by helping China maintain high overall growth and by supporting agricultural and human resource development. Lending for agriculture, the social sectors, and (increasingly) inland areas was an important part of the Bank's stated strategy.

The Bank's strategy for China differed from that for other countries, in degree if not in kind, in two areas. First, the Bank consistently emphasized lending for infrastructure

The Bank consistently emphasized lending for infrastructure and stressed policy reform within each sector.

Figure 2.2

World Bank Investment Lending for China by Sector (% of total investment)



in China at a time when such lending was falling Bank-wide⁶ (see figure 2.2 for sector allocation to China and chapter 4 for a comparison with other countries). Infrastructure bottlenecks were identified as a major impediment to growth and macrostability, as well as to market integration. Second, more than in other countries, the Bank's strategy in China stressed policy reform within each sector.

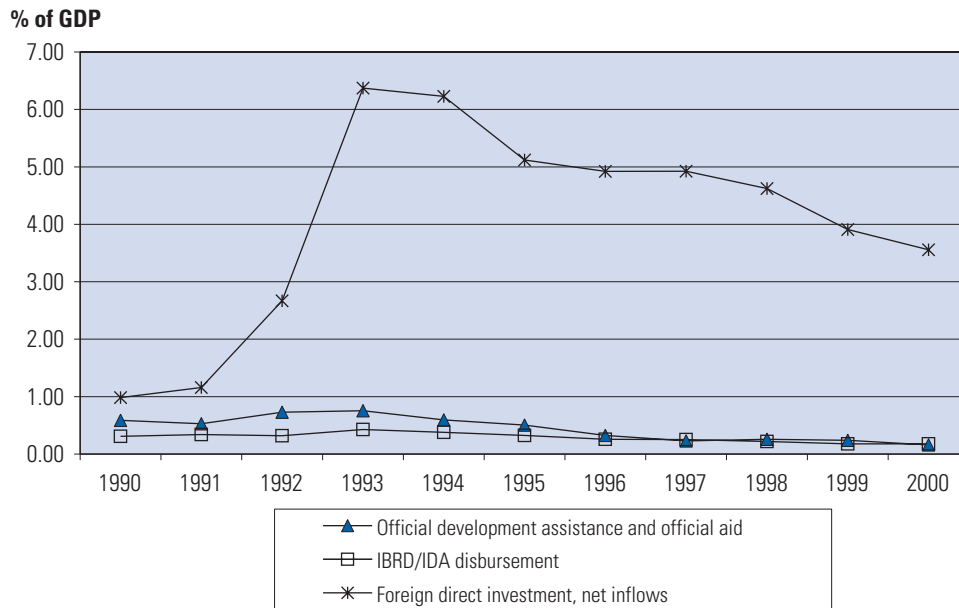
How did the Bank aim to effect its ambitious objectives? Not through the direct impact of its lending. The Bank's lending was modest⁷ for a country the size of China—\$3.3 billion (0.6 percent of GDP) at its height in 1994. Direct foreign investment at that time was already 10 times as high (see figure 2.3). Bank lending was, however, 4.2 percent of government expenditure (and a higher but unknown proportion of discretionary expenditure) at a time of great fiscal stringency, so that for a brief period in the mid-1990s the Bank made a noticeable incremental contribution to budget resources. Nevertheless, resource transfer was never seen as the main instrument of Bank strategy or a major objective in its own right.⁸

Nor was conditionality an important instru-

ment. Like other large countries for which the Bank is a relatively modest source of capital, China was reluctant to accept strong conditionality. China was particularly sensitive to conditionality because of its associations in the minds of some with unequal treaties and extraterritorial concessions. China also had no need for balance-of-payments support, and the one adjustment loan (the RSAL of 1988) was an untranching operation based on already completed actions and disbursed against expenditures. There was project-specific conditionality, of course, but sectorwide conditions were rare.

The methods the Bank employed to pursue its strategic objectives were mostly variants of persuasion and example.

- *Persuasion* through ESW, workshops, and other analytical and advisory activities (AAA) was a key method. The target audience was mainly senior officials and their policy advisers, and the objective was to persuade them to implement top-down reforms.
- *Dual-track approach* of building trust through lending while carrying the policy dialogue through sector work. Each project was in-

Figure 2.3 Ratios of Aid and DFI to GDP, 1990-00

tended to push the frontier of policy or institutional change, but the approach was gradualist and depended less on conditionality than persuasion.

- *Working with willing partners.* The Bank worked with the power sector, which wanted access to the technology that Bank lending could provide and which was receptive to policy suggestions, but the Bank withdrew from working in the coal sector because the Ministry was not interested in policy dialogue. In housing reform, the Bank worked with municipalities that were willing to introduce economic rents and excluded areas such as Shanghai that were not. The Bank continued to work with Shanghai in other sectors, however, and Shanghai later introduced housing reforms on its own.
- *Demonstration effect.* The Bank relied on the demonstration effect of successful project experience in introducing new technologies, management methods, or policy reforms to leverage the impact of project outcomes. This was largely a bottom-up process of diffusion by example, though China also uses pilots to test changes before they are rolled out nationwide through changes in national policy.

The approach just outlined fits well with China's preference for gradual and pragmatic reform. It clearly left the government "in the driver's seat," with all that implies for country ownership and performance. One drawback is that important issues may be omitted if key actors on the government side are unwilling to be partners with the Bank, or with other Chinese agencies in cases such as the environment, where coordination is vital.⁹ The dual-track approach can also lead to overly modest project objectives or complacency, and accountability for the Bank's performance can be difficult to assess when policy issues are left to the uncertain timing and outcome of the second track (policy dialogue).

After the 1997 reorganization, the Bank decentralized the China department, moving the country director to Beijing and expanding the size and functions of the resident mission. This positive development for Bank-China relations was offset by three negative developments from China's point of view.

First, IBRD lending to China was increasingly constrained by the

The methods the Bank employed to pursue its strategic objectives were mostly variants of persuasion and example.

Bank's limits on the share of its portfolio in a single country. As a result of this, IBRD lending, which had built up rapidly in the early 1990s to a peak of \$3.3 billion in FY93, declined to below \$1 billion by FY01.

Second, the Bank stopped lending IDA funds to China after FY99. Although plans to switch from blend to all-IBRD lending had been considered earlier and postponed for three years, the loss of IDA was a disappointment to the government and placed strains on the Bank's relationship with China. IDA donors decided that China was sufficiently creditworthy to dispense with IDA funding. The government thought this unfair because per capita GDP was still below the cutoff line at that time and because there were still some 200 million people in China with consumption below a dollar per day. The government also felt that Bank senior management could have fought harder to retain China's access to IDA. Apart from the strain this placed on the relationship, it greatly complicated Bank strategy. Beneficiaries right down to the village or individual farmer level have always been responsible for loan repayment. With the loss of IDA, the government has decided that the Bank will be largely excluded from lending to poor provinces or the social sectors because IBRD terms would be too onerous.

The third significant negative development was an Inspection Panel report on the Qinghai component of the Western Poverty Project. The Panel's report, issued on April 28, 2000, concluded that the Bank had failed to follow its own safeguard procedures for the environment, indigenous peoples, and involuntary resettlement.

The loss of IDA was a disappointment to the government and placed strains on the Bank's relationship with China.

Following a Board decision that the project be resubmitted for approval after additional studies, China withdrew its request for Bank funding and decided to

complete the project using its own funds.

These three developments affected the Bank's assistance strategy. After the 1998 update of the 1997 strategy, the Board asked that no further CAS be sent until there was a strategy to deal with the constraints posed by exposure limits. An agreement reached in July 2002 provided, among other things, for prepayment of some Bank loans and for offset purchases of IBRD bonds so that the Bank can increase its annual lending to a projected \$1.2–\$1.3 billion.

The latest CAS, presented in December 2002, is consistent with previous ones. The main objectives are to support China in making two transitions, from a rural/agricultural to an urban/industrial society and from a planned to a market economy. The CAS is organized around three themes—improving the business environment to help accelerate the transition to a market economy, addressing the needs of poor people and regions, and facilitating environmental sustainability. The main differences with previous strategies are imposed more by the shift to all-IBRD terms than the overall reduction in lending. The Bank is constrained from shifting its lending to lagging regions and from maintaining the level, or even the share, of lending to agriculture, the social sectors, and poverty projects because of the difficulties these regions and sectors would have in repaying IBRD. An innovative arrangement, in which the U.K. Department for International Development (DFID) blends grants with IBRD loans to simulate IDA terms, offers an opportunity for the Bank (jointly with DFID) to remain engaged in social sectors and poverty projects. By also maintaining a relatively high level of lending for infrastructure, the Bank aims to increase the share of lending to poorer, inland provinces. The effect of the Inspection Panel Report on safeguards policy is discussed in chapter 4.



Progress on Development Objectives

The Bank's assistance strategy had four main objectives during the past decade: (1) promoting market-oriented system reform and better macroeconomic management, (2) poverty reduction, (3) supporting infrastructure development for growth and market integration, and (4) environmental protection. This chapter reviews progress on these objectives over the past decade and the impact of the Bank's assistance on each objective.

Macroeconomic Management and System Reform

System reform has been the most prominent objective of the Bank's assistance strategy, particularly in the early years of the period under review. Macroeconomic management and system reform have always been seen by the Bank as complementary. Growth and stability (low inflation) create a favorable climate for reform, and system reform (notably, creation of a "hard budget constraint" for enterprises and banks) creates the micro foundation (responsiveness to price signals) for indirect macro management.¹ China's macro management could hardly have been better in the areas of growth, inflation, and foreign trade and exchange rate management. Fiscal management has been more of a problem. While progress has been made on enterprise and related reforms, the unfinished agenda of system reform poses risks for financial, fiscal, and social stability.

Macroeconomic Management

China faced two critical tests to the maintenance of growth and stability in the past decade. The first came in the early 1990s following the resumption of reform in 1992. By mid-1993, inflation had again risen to about 20 percent per annum (as it had during 1988–89), provoking a fierce debate in China on whether reform was compatible with macro stability. The Bank was able to make an important contribution to the debate through a conference on "Macroeconomic Management in China," held in Dalian in June 1993. This was one of a series of annual conferences, co-sponsored by the Bank and the System Reform Commission, that brought together Chinese officials and scholars with Bank staff and foreign experts to discuss some aspect of reform. The Bank's argument that macro

China faced two critical tests to the maintenance of growth and stability in the past decade.

instability was the result of incomplete reform, rather than inherent in reform itself, helped influence subsequent efforts to reform the central bank and monetary management and to undertake fiscal reform to restore and partially re-centralize revenue collection.² This influence seems to have carried over into trade and exchange rate reform as Chinese reforms in these areas were influenced by and largely consistent with the recommendations of a major Bank trade report (World Bank 1994b).

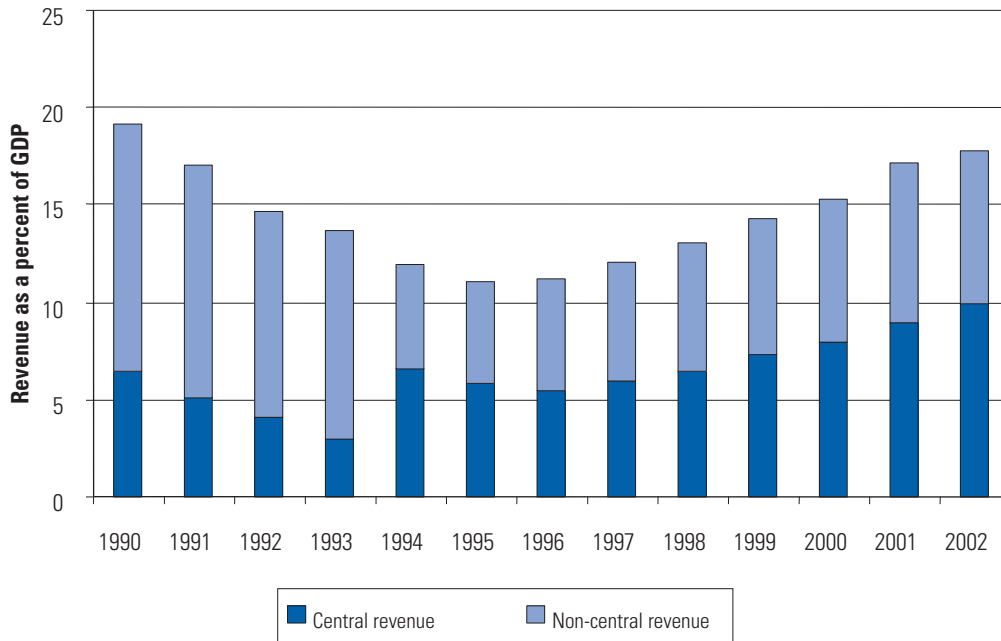
The second test was the Asian financial crisis of 1997. China's decision to forgo competitive devaluation in the wake of the 1997 crisis helped limit the crisis. China also countered that shock with an expansionary fiscal policy. This maintained China's growth rate and helped neighboring countries recover more quickly, but it also led to growing fiscal deficits and postponement of financial sector reform in order to sustain growth. Bank advice may have influenced China's response to the crisis. The Bank's chief economist met with the premier and other officials and advised China to prevent deflation and competitive devaluation. Those views were circulated within the government.³ The ambitious *China 2020* study (World Bank 1997) coincided with the Asian crisis, which distracted policymakers from the long-term issues addressed in the report and the impending loss of IDA, which strained relations. Chinese officials and researchers interviewed for this Country Assistance Evaluation (CAE) also

Although China experienced the same relative decline in revenue as many other transition economies, it avoided fiscal collapse and inflation because of its high savings rate and implicit taxation of the financial system, and because it undertook timely fiscal reforms.

criticized *China 2020* because it had too little Chinese input and focused on problems and long-term goals, rather than on concrete steps to achieve them. Other donors, however, reported that they found this report valuable for helping formulate their own assistance strategies, and sector ministries found the background papers very useful.

Fiscal policy is the most difficult long-term challenge of macro management. Although government revenue never declined in absolute terms, it decreased sharply as a percentage of GDP from 34.4 percent in 1978 to 19.1 percent in 1990, reaching a low of 11.1 percent in 1995 (figure 3.1). In part, this was an intended consequence of the declining financial intermediation role of the government, but it was mainly due to the erosion of state-owned enterprise (SOE) profits because of competition from township and village enterprises (TVEs). Central government finances were particularly hard hit because of a series of adverse (to the center) fiscal contracts negotiated with individual provinces in the mid- to late 1980s. The declining share of government revenue, attempts to maintain funding of SOE investment (through banks, as well as the budget), and pressures to cushion the effects of reforms through subsidies led to growing inflation in the late 1980s. Fiscal reforms in 1994 regularized intergovernmental fiscal relations and set the stage for a gradual recovery of the share of government revenue to 17.2 percent in 2001 (Ahmad and others 2002).⁴ Although China experienced the same relative decline in revenue as many other transition economies, it avoided fiscal collapse and inflation because of its high savings rate and implicit taxation of the financial system, and because it undertook timely fiscal reforms. The Bank argued strongly for these reforms in order to improve the instruments of macro management. The Bank also gave advice on a value added tax in 1993 and provided a fiscal technical assistance credit in 1995 to support budget administrative and fiscal policy improvements, including tax policy and intergovernmental grants. The momentum for fiscal reform slowed in the late 1990s, and implementation of the project was delayed, but interest in fiscal issues has recently increased.

Despite these achievements, China faces two other difficult fiscal issues. First, continuing budget deficits and large contingent liabilities for pensions and the banking system create a debt management problem. Informal work on the implications of contingent liabilities for

Figure 3.1 Revenue Trend

debt management (see Krumm and Wong 2002 for a published version) has reportedly sensitized officials to the seriousness of this issue. Second, the intergovernmental fiscal system remains deeply flawed. The Bank's Provincial Public Expenditure Review (PER) provides a good analysis of the issues (World Bank 2002a). There is a mismatch between tax and expenditure assignments at different levels of government, and the overall incidence of the fiscal system is regressive. Per capita government expenditures in the richest five provinces were 3.3 times those in the poorest five provinces in 1998 (up from a differential of 2.1 times in 1990).⁵ This imbalance accentuates regional inequality. Moreover, provincial and local authorities impose a number of ad hoc fees that are a particular burden in poorer areas.⁶ The level and arbitrary nature of these fees have been a major source of discontent, leading to "tax revolts" in some poorer rural areas. A pilot program introduced by Anhui Province to substitute taxes for fees and limit the level of rural taxes is now being rolled out in other provinces, but it does not address the overall regressiveness of the fiscal system.⁷

System Reform

China's strategy of gradual economic reform has successfully sustained growth, stability, and political support, but the unfinished reform agenda poses significant risks.⁸ To some extent, these have been calculated risks—the calculation being that it was more important to sustain growth after the Asian crisis than to press ahead with enterprise and banking reform—but the risks are significant nonetheless. Although sometimes impatient with the pace of reform, the Bank has broadly supported China's incremental approach.

State-owned enterprise reform is central to reform of the entire economic system for several reasons.

The unfinished reform agenda poses significant risks.

- In the pre-reform system, SOE profits were the main source of savings and government revenue. Prices bore little relationship to costs or scarcity and were used by the central authorities as implicit taxes and subsidies. Thus enterprise reform was closely linked to price reform and had enormous macroeconomic implications—15 of the 23 percentage point

drop in the share of government revenue to GDP between 1978 and 1995 was attributable to lower revenues from industrial SOEs.

- SOEs have traditionally had enormous social responsibilities, providing lifetime employment and housing, pensions, health care, and education for workers and their families. Without unemployment insurance and housing and pension reform, enterprise reforms resulting in dismissal of workers would create hardship and social unrest.
- Reforms that shift responsibility for social services and insurance from the enterprise to the state (the socialization of welfare) have budgetary implications. They require additional public funding and/or individual fees at the same time that revenues are tight.
- Much SOE investment previously financed through budget grants is now funded through loans from state-owned commercial banks. Banks, however, are subject to political and social pressures and often lend to SOEs that might not qualify on strictly commercial criteria.

It is not surprising that enterprise reform has been gradual. The social responsibilities of SOEs and the links between enterprise reform, social services and insurance, the budget, and the financial sector mean that all aspects of reform have to go forward together, or be carefully sequenced, to avoid adverse macro or social consequences.

Considerable progress has been made on system reform. Price reform took place gradually during the 1980s and early 1990s, and most prices in China are now market-determined.⁹ SOEs themselves steadily declined in importance during the 1990s. Their share of industrial output

It is not surprising that enterprise reform has been gradual. All aspects of reform have to go forward together, or be carefully sequenced, to avoid adverse macro or social consequences.

declined from 78 percent in 1978 to 54.6 percent in 1990 and 23.5 percent in 2000, although the share of industrial output of “state-owned and state-holding enterprises” was still 47.3 percent in 2000.¹⁰ This relative decline reflects the rapid

growth of the non-state sector, rather than an absolute decline of SOE output, but in recent years SOE reform has accelerated. Under a 1997 guideline of “focusing on the big and letting go the small,” reform strategy has been to corporatize large enterprises while putting small enterprises under private management or ownership. By the end of 2000, 81 percent of the 635,000 small SOEs had been transformed to non-state ownership.¹¹ The introduction of bankruptcy legislation, unemployment insurance, housing reform, and limited pension reform has enabled the closure of many loss-making SOEs and a reduction in SOE employment of some 30 million jobs between 1998 and 2002.

Enterprise and related reforms are far from complete, however, and this poses significant challenges and risks. Although reforms boosted SOE productivity, the proportion of SOEs incurring losses increased from 26 percent of the total in 1992 to 50 percent in 1998, as competing non-SOEs did even better.¹² Despite housing and other reforms, many SOEs still have social obligations that may partly account for their poor financial performance. Privatization of small SOEs has lacked transparency, frequently leading to asset-stripping and other forms of corruption. Large SOEs have been delinked from ministries and organized as corporations, but corporate governance and regulation are weak.¹³ Coverage of unemployment insurance and social security is limited to urban areas, and programs are underfunded because responsibility for funding remains mainly at the municipal level. Finally, commercial banks have become seriously exposed to risk of non-repayment by SOEs. Nonperforming loans (NPLs), mainly from SOEs, are officially estimated at around 25 percent of total loans despite an earlier shift of part of the portfolio to asset management corporations. Ultimately, since the banks are also state-owned, NPLs create contingent liabilities for the budget.

The Bank’s role in enterprise and related reforms has been mixed. One of the most frequently cited areas of successful Bank

assistance by Chinese sources is pension reform. Bank support included ESW, research papers and participation in an international workshop, a policy note at the request of the premier, and a project to help support implementation of a pilot reform scheme in Liaoning Province (Lu 2002).¹⁴ The Bank has also contributed to housing reform through projects as well as ESW. AAA on enterprise reform has been influential in promoting concepts such as corporatization; the Bank has given a great deal of advice in reports, seminars, and technical assistance on corporate governance and bankruptcy, but it has also been criticized for being too generic (“operating at a level of 30,000 feet,” as one staff member put it) and too timid in discussing privatization (Lu 2002).¹⁵ Bank projects in the industrial sector were the least successful in the lending program; five of eight industrial projects completed after 1992 had unsatisfactory outcomes. Technology upgrading was the dominant objective in most projects, but some also sought to pilot some type of reform. Overall, they failed on both counts. The Bank is ill-suited to providing the kind of quick, flexible assistance needed in industry, and partial reforms at the enterprise level do not succeed without a wider change in policies and incentives. More recent experience has also been less than satisfactory. A technical assistance project for enterprise reform attracted little interest from the local governments that were meant to be its beneficiaries, and the Shenyang Industrial Reform Project had little impact on reform.¹⁶ The Bank has incorporated the lessons learned into its current strategy and there have been no new industrial projects in recent years.¹⁷

The biggest risk to China’s continued growth and the biggest failure of the Bank’s assistance strategy thus far is the financial sector. The banking system has been extremely successful in mobilizing household savings to replace SOE savings, but it does not allocate resources efficiently (a majority of loans from the dominant state-owned banks go to SOEs) and its alarming rate of NPLs poses a huge risk to the budget. While it is true that

the potential budget costs are mitigated by the fact that the state is both creditor (as owner of the banks) and debtor (as owner of the SOEs), the systemic risk is still enormous because different levels of government have different net positions, the value of enterprise assets may be only a fraction of outstanding loan value, the government has an implicit contingent liability to household depositors, and entry into WTO will increase competitive pressure on banks as well as enterprises. Financial sector reform cannot be separated from enterprise reform, because to reform one quickly risks forcing collapse of the other. The government has made progress in recent years (see Annex E), but the stakes and risks are still high.

The Bank’s financial sector review (World Bank 1990) was the basis for assistance strategy in the 1990s, which sought to create independent banks that, while still state-owned, would operate on commercial principles, subject to an improved regulatory and supervision system. The Bank recognized the need to find ways to limit political interference, especially from local authorities who had influence over local bank branches, as well as control over SOEs. Bank advice to create regional branches of the People’s Bank of China (PBC), along the lines of the U.S. Federal Reserve, represented an early (successful) attempt to limit local political interference and reassert central authority over monetary aggregates. Although little subsequent progress was made on the objectives set out in the 1990 review, the Bank did not recast its strategy.¹⁸

A Financial Sector Technical Assistance Project (FSTAP) completed in 1994 supported development of financial sector “infrastructure” in areas such as the payments system, prudential supervision and regulation, and PBC’s debt management, and provided an opportunity for discussion of policy issues. Other Bank lending to the financial sector did little to build up

The biggest risk to China’s continued growth and the biggest failure of the Bank’s assistance strategy thus far is the financial sector.

institutional capacity for independent financial intermediation, however. Although three of the six line-of-credit (LOC) projects completed after 1991 were rated satisfactory and three were marginally satisfactory shortly after completion, they appear less successful now than at the time. Subprojects had good rates of return, but the Bank's loans neither improved the overall quality of loan portfolios nor had much impact on systemic financial sector issues. To the extent that project evaluation improved, it may have been used to select the best projects for Bank funding, rather than to reject projects that showed a low rate of return. The last LOC operation closed in 1996. The Bank had tried to develop a Financial Sector Development Project and then a project to support the Construction Bank, but these efforts came to nothing. The Bank was reluctant to include a large LOC component, and China disliked the disclosure requirements and felt the Bank was not nimble enough in preparing the project. The Bank's analytical work suffered from lack of staff with sufficient expertise or familiarity with China, and there was frequent turnover. China also looked to investment banks and consultants rather than the Bank for the increasingly specialized policy and institutional advice being sought. Financial sector work on China continued to dwindle after 1997. During the 1997 Asian crisis, China's top leadership was interested in lessons of the crisis for China's own banking and financial sector. However, there was little interest or confidence in Bank advice or support at lower levels, and the Bank accommodated this lack of interest, undertaking almost no Bank work in the sector until 2001.

In 2001, the Bank agreed with the government to renew Bank support for financial sector reform and development through a program of AAA. The Bank produced a series of confidential policy notes on specific issues of interest.¹⁹ The notes provide a good survey of the issues, but are based mainly on international experience. If this promising renewal of collaboration is to be effective, the Bank will need to ground its recommendations in analysis of Chinese experience.²⁰

Summary: Macro Management and System Reform

China's achievements in growth and stabilization over the past decade have been outstanding. Steady progress has also been made in key areas of system reform, but intermittent and incomplete reform of the intergovernment fiscal system, SOEs, and the financial sector pose risks for continued growth and stability. The Bank made a significant contribution to China's macroeconomic management following the resumption of reform in the early 1990s, helping to persuade the top leadership that continued reform was not only consistent with, but essential for, high growth with low inflation. With respect to system reform more generally, the Bank helped identify the critical nexus of enterprise/financial sector/fiscal reforms needed to underpin high growth with stability, but it was less successful in promoting implementation of some of the components. In the banking sector, the Bank largely failed to engage with the relevant authorities throughout the mid- and late 1990s, though it helped improve basic banking infrastructure such as payment systems. The Bank has now reengaged in the financial sector, but the effectiveness of its advice remains to be seen. In state enterprise reform, the Bank provided useful support on bankruptcy legislation and in associated housing and social security reform, but attempts to introduce reforms through industrial projects were largely unsuccessful, and overall reform advice remained too generic to have much practical impact. In the fiscal area, the Bank's advice was influential in helping reverse the decline in government revenues and the central share of revenues in the early to mid-1990s, and more recently, the Bank has stimulated government awareness of the large fiscal contingencies arising from non-performing loans and unfounded enterprise pension obligations. Finally, Bank analysis and advice helped stiffen China's resolve to complete its successful negotiations on WTO entry. Overall, the Bank met with only mixed success in helping move reform forward. Incomplete financial sector and enterprise reform, and the associated heavy fiscal contingencies, pose significant risks to China's accomplishments.²¹

Poverty Reduction

No country has been more successful than China in reducing poverty in the past 20 to 25 years. Some 220–290 million people have moved out of poverty, depending on the definition used. The biggest reductions in poverty came in the early period, mainly due to rural reforms.²² In the latter part of the 1990s, the number of poor remained roughly constant despite high growth rates, and China's poverty rate, using the purchasing power parity dollar-per-day measure was relatively high compared with other countries at a similar PPP income level (see box 3.1). In contrast to the early 1980s, the benefits of growth in the 1990s have accrued disproportionately to the better-off, and inequality has increased steadily. The ratio of urban-rural incomes, which had fallen from 2.9 in 1978 to 1.9 in 1985, rose to 2.2 in 1990 and 2.7 in 1999 (see Annex R, table R.8).²³ Vulnerability has also increased markedly. Particularly in rural areas, access to health care has deteriorated. In urban areas, insecurity has increased as enterprise reform has led to redundancies and uncertainty about funding for pensions and unemployment benefits. And while migration restrictions have been relaxed somewhat, under the urban registration (*bukou*) system, most migrants are not entitled to resident benefits such as housing and education. China is making good progress on meeting most national Millennium Development Goals (see Annex R, table R.9 and China CAS 2002), but progress has been highly uneven geographically. On current trends, some poorer regions will not meet all the goals by 2015.

Growth was the most important factor in China's success in poverty reduction. But the recent slowing of poverty reduction and increasing inequality and vulnerability show that growth—even very rapid growth—is not enough. Several structural factors offset the poverty-reducing effects of growth: remote, resource-poor areas have lower growth potential than coastal areas; the scope for raising rural incomes by improving cropping patterns and the terms of trade for agriculture had largely been exhausted by the mid-1980s; and with accelerating enterprise reform, employment

growth naturally lags behind output growth because of the huge reserve army of hidden unemployed in state and collective enterprises.²⁴

No country has been more successful than China in reducing poverty in the past 20 to 25 years.

But policy factors also inhibited poverty reduction. Special privileges designed to attract foreign investment (such as special economic zones) were long limited to the coastal region; the tax-sharing system has redistributed revenues in favor of rich localities; and migration from rural areas has been limited. This last policy has special significance because one of the main ways in which growth trickles down from leading sectors and regions is through the movement of labor.

The Chinese government recognized early on that growth is not enough to reduce poverty. In 1986, at about the same time that China's development strategy shifted from agricultural growth to export-led development in coastal regions, the government set up the Leading Group for Poverty Reduction (LGPR) under the State Council and started to identify poor counties that would qualify for targeted assistance. Studies have estimated that targeted programs may have raised the rate of growth in poor counties by 1 to 2 percent per year.²⁵ Unfortunately, regional targeting may be a "blunt instrument" for reaching the poor (Lipton and Ravallion 1995). About half of China's rural poor do not live in poor counties, and a majority of people living in targeted counties are not poor. Thus coverage (of the poor) was weak and leakage (to the non-poor) substantial.

The government introduced several new elements into its poverty strategy during the period 1999–01. The most significant new element was the adoption of a 10-year plan in 2001. The plan introduced an explicit multi-sector approach, emphasizing agriculture and rural development, provision of education and training to the poor, and facilitation of voluntary migration and

Growth was the most important factor in China's success in poverty reduction. But growth—even very rapid growth—is not enough.

Box 3.1**China's Poverty in International Perspective**

While there is broad agreement on the tremendous progress China has made in reducing poverty, estimates of the remaining problem depend critically on how poverty is defined. Using China's official poverty line (an income level equivalent to 66 cents per day), the number of poor people has declined from 250 million (26 percent) of the population in 1978 to fewer than 30 million (2.3 percent) in 2001. Using World Bank figures based on a dollar-per-day consumption level in PPP terms, the number of poor has declined from an estimated 490 million (51 percent) in 1978 to about 205 million (16.1 percent) in 2000.

China has a relatively high proportion of poor people compared with other countries at similar income level. Based on the most widely used poverty line of a dollar per day consumption in PPP terms, China ranked fourth among countries with annual per capita PPP income between US\$2,500 and

US\$4,500 in 1999 (see table below). Comparisons of poverty among countries are sensitive to definitions, however—especially to the poverty line used to divide, somewhat arbitrarily, the poor from the non-poor. The China household saving rate is high even in low-income households, making the comparison based on levels of consumption less meaningful. Using income rather than consumption, only 9.8 percent of the population would have been below the dollar-per-day poverty line in 1999. Moreover, the PPP comparison is based on average consumption, whereas to compare poverty levels across countries, it ought to be based on the consumption basket of low-income households. The main conclusion to be drawn is not that poverty is relatively high or low, but that a large proportion of the population is close to the poverty line, however defined.

Comparison of Poverty among Selected Countries

Country	Per capita PPP income (US\$)	Percentage in poverty (measured by \$1 per day consumption)
El Salvador	4,260	26.9
Turkmenistan	3,340	20.9
Paraguay	4,380	19.5
China	3,550	18.5
Peru	4,480	15.5
Guatemala	3,630	10.0
Indonesia	2,660	7.7
Sri Lanka	3,230	6.6
Jamaica	3,390	3.2
Egypt	3,460	3.1
Ukraine	3,360	2.9
Jordan	3,880	<2.0
Morocco	3,320	<2.0

Source: World Development Indicators 2002.

resettlement of people from ecologically disadvantaged areas. Another new element in its poverty reduction strategy involved the introduction of programs for protection of the urban poor, including unemployment insurance and subsistence allowances. Although meant to provide a comprehensive urban safety net, resources are inadequate to achieve this objective (ADB 2002), and programs are funded at too low a level (usually municipal) to spread risk and provide a sustainable funding base.

Finally, the Great Western Development Strategy adopted by the State Council in 2000 extended the regional development approach to all of western China. The program has multiple objectives that may dilute, or be at odds with, poverty reduction. In particular, emphasis on capital-intensive resource extraction projects will do little for the poor in western provinces unless the traditionally low transfer prices for raw materials are raised and appropriate fiscal sharing arrangements are made.

Until the late 1990s, China's poverty strategy was to push for the fastest possible growth, combined with targeted regional development interventions. Could China have done more to reduce poverty faster? Or would such attempts have simply reduced growth without affecting poverty? The recent changes in strategy suggest that the government thinks it could have done better. It is now recognized that poverty is not just a rural phenomenon and that rural poverty is not just concentrated in remote areas. Vulnerability is also recognized as a serious problem, though many required reforms (housing, pensions, social assistance for the poor and unemployed) need further development and more secure funding, and others (such as health finance reform) have scarcely begun. Similarly, the importance of migration in spreading the benefits of growth and helping to create a more sustainable balance between population and resources in fragile areas is now recognized, but migrants still face restrictions and discrimination. What is perhaps still not sufficiently recognized is that the regressive fiscal system offsets many of the benefits of targeted interventions.²⁶

The Bank has made a substantial contribution to China's evolving poverty reduction strategy through its AAA, poverty monitoring, and projects. The main strength of the Bank program has been the close integration of these three instruments.

AAA and Poverty Monitoring

The Bank's ESW and research on poverty have been influential both inside and outside China. Two studies of rural poverty (World Bank 1992 and World Bank 2000) provided an overview of poverty issues and sensible strategy proposals on targeting and the need for a multi-sector approach to rural development. Combined with an international conference cosponsored by the Bank in 2000,²⁷ these reports helped influence the reorientation of government strategy in the 10-year plan for poverty reduction adopted in 2001. Research by the Bank's Development Economics Research Group (DECRG) on the determinants and measurement of poverty has also influenced

both scholarly and policy views.²⁸ Both the sector reports and research papers are widely cited in the literature. DECRG has also worked closely with China's Bureau of Statistics, providing training and advice on defining and measuring poverty and on the design of the household survey and other monitoring activities. One gap in the Bank's poverty work has been the neglect of studies on urban poverty (although the Bank has been involved in analyzing pension reform and other vulnerability issues, as discussed in the previous section). But a report by the Asian Development Bank (ADB 2002) has filled this gap admirably, and it makes sense to build on this division of labor, rather than to duplicate efforts. One high-priority area would be a study of labor market issues, including the informal sector and links between rural and urban areas.

Poverty Lending

Lending for poverty-related projects, as measured by "poverty-targeted intervention" (PTI) lending, has been relatively low—under 15 percent of total lending in China, compared with 56 percent in India.²⁹ However, the share of PTI lending may be a misleading measure of support for poverty reduction for several reasons: non-PTI projects (such as highways that integrate remote markets) may be more beneficial to the poor than direct interventions; projects may have poverty components, but still not qualify for PTI classification; and finally, the Bank's impact will largely depend on providing replicable examples of best practices, given the small share of Bank lending in total investment. In fact, the Bank's direct poverty lending through integrated rural development projects has provided a replicable model for targeted intervention. The Southwest Poverty Project, in particular, has introduced new concepts and practices that have benefited not only project participants but also the government's own targeted interventions and practices (see box 3.2). Nevertheless, the share of poverty-related projects in the lending program has probably been less than optimal for demonstration purposes, and PTI lending has virtually disappeared following the loss of IDA.

This growing disparity between the share of agricultural employment and the share of agricultural GDP reflects the growing importance of non-farm income.

Agricultural Sector

Agriculture is still the most important source of livelihood for rural residents, though it is declining in relative importance. Half the population was still employed in agriculture in 2000, down from 60 percent in 1990, but agriculture's share of GDP was only 16 percent in 2000 (down from 27 percent in 1990), despite continued annual growth of 3.5 to 4.0 percent. This growing disparity between the share of agricultural employment and the share of agricultural GDP

reflects the growing importance of non-farm income, which grew from 26 percent of farmers' household income in 1990 to 47 percent in 1999.

The structural changes also show the importance of looking at agricultural production as only one element in rural development and poverty reduction. The Bank's assistance strategy for agriculture in China has increasingly done that, gradually shifting its emphasis from increasing agricultural production to improving rural incomes in poorer areas and improving natural resource management for a more sustainable rural economy in ecologically fragile areas. Most agriculture sector projects have emphasized diversification of production, including non-farm

Box 3.2

A Best Practice Poverty Project

An internal assessment review in 1995 identified the Southwest Poverty Project as best practice soon after the project began being implemented. Subsequent project performance has confirmed this assessment. The project implements many of the recommendations of the 1992 rural poverty report (World Bank 1992b) and involved DECRG and Chinese poverty-monitoring organizations in M&E. The design of the project went against long-standing conventional wisdom that integrated rural development projects were too complex to implement. Because of involvement of the Leading Group for Poverty Reduction (LGPR) and the support of the highest levels of the national government, it was able to overcome bureaucratic resistance to coordination.

The outcome of the project has been highly satisfactory overall. Preliminary results of a review by DEC (Chen and Ravallion 2003) estimate a rate of return on investment in the project of nearly 10 percent. Since the comparator villages were part of the government's own program in poor counties, this is a measure of the Bank's value added. Poorest households benefited most. This was achieved by targeting the poorest townships and villages, rather than attempting to identify poor households within "poor counties." The latter approach has not worked well in very poor areas because it undermines political support and leads to favoritism in allocation, with attendant leakage and corruption.

Not all components worked. Investments in TVEs, as in other projects, were largely unsuccessful, but this component was reduced sharply during implementation. The health component, involving an attempt to provide collective insurance, was not

very successful. Preventive care was often preempted by expenditure on curative measures. The project was also more successful in some provinces than in others. Success depended on the capacity and commitment of provincial and local governments and on ability to monitor and enforce repayment of credit in the project.

Several lessons have emerged from the project. Two lessons that the government is applying to its own projects are, first, the *importance of project supervision*—for ensuring that implementation takes place and benefits reach intended beneficiaries and for making adjustments to take account of problems, successes, and unexpected events—and second, the need to *improve targeting* to reach the poorest areas. Two additional lessons have yet to be assimilated. First, the project confirms the value of a multisector approach to poverty interventions. Whether this coordination should be done through national projects under the LGPR or through provincial authorities, and whether all sectors (such as health and education) should be integrated under a single project umbrella are still matters of intense debate within the government and the Bank. Second, the project highlights the primacy of national or sector policies in some areas. Labor mobility can be facilitated through a regional development project, but national policies to remove obstacles to movement and to protect migrants from exploitation are necessary and more cost-effective. Improved education and (especially) health outcomes in poor regions will also require systemic changes and outside resources, as well as local efforts.

production, rather than just increasing production or yields of traditional crops.

The impact of the Bank's program in agriculture has been mixed. The Bank's sector work and policy advice on grain policy and other broad aspects of agricultural strategy have been sound,³⁰ but failed to overcome resistance in some areas. By 1999, 83 percent of all agricultural products were sold at market prices, but grain marketing has been liberalized at a slow rate since the late 1980s. Quotas still exist, and policies on marketing arrangements were reversed in 1998. This mainly reflects strategic concerns about dependence on grain imports; the economic case for liberalization is well understood by Chinese policymakers.³¹ The national market has become increasingly integrated, and domestic prices for most agricultural products are close enough to world prices that WTO accession should have a relatively modest impact on agricultural output and incomes, though there will be some adverse distributional effects that will need remedial action (such as increased mobility of labor).³²

OED ratings of Bank lending in agriculture have been high—94 percent for outcomes during 1993–2002. Sustainability was rated as likely for 79 percent of lending—higher than

most comparator countries and the Bank average—but institutional development was rated favorably only 63 percent of the time (see Annex R, table R.5b). Borrower feedback credited the Bank with substantial impact on project management (procurement and project appraisal) and with introducing and popularizing many innovations and new plant varieties, which raised incomes and productivity. But there were shortcomings as well. Selection of project components has been distorted by incentives for local governments to include income-generating activities to repay project loans. Such incentives led to inclusion of many unsuccessful TVE investments; although TVEs contributed enormously to rural development in the 1980s and early 1990s, Bank-supported investments often failed because Bank procedures are too cumbersome to support timely investment in commercial activities. TVE components also tended to crowd out the private sector. (This lesson has been absorbed and the Bank has cut down on such components.) More generally, Bank projects have focused too much on specific production results and on ad hoc arrangements for channeling credit, rather than on helping to build a viable rural credit system. The blame for this is

Box 3.3

WBI/China Network for Training and Research in Health Economics and Finance

The WBI/China Network for Training and Research in Health Economics and Finance was established in 1991 at the request of the Ministry of Health to create capability in health financing and related policy issues among senior-level decision-makers in the ministries of health, finance, and planning and among provincial and local government officials. Senior policy seminars (SPSs) organized by the Network have brought together ministerial, director-general, and vice-gubernatorial levels of governments from health and non-health sectors to debate health financing policy issues, some of which were supported by policy research carried out by the Network's research centers at six medical universities. Earlier seminars helped to demystify market mechanisms in the health sector, while later ones have facilitated decisions by individual provinces on allocations to rural health. Increasingly, provincial governments

are asking for the Network's policy and operational research inputs in formulating local health initiatives and activities. Perhaps the greatest role the Network can play is influencing the State Planning and Development Commission (SPDC), Ministry of Finance, and State Council decisions, which would facilitate changes at the wider country level and bring about larger central and provincial allocations for basic health services and preventive care. SPSs have reached only officials within these entities with oversight for health. It is important to reach the decisionmakers within these institutions who wield greater influence on broader fiscal and economic policies and to demonstrate to them the critical contributions of health to China's long-term productivity and growth. Thus far there has not been good follow-up on the results/outcome of policy issues debated at the SPSs.

Although physical construction targets and outputs were achieved in several cases, crucial institutional issues did not receive the attention they need.

shared between the Bank, which has been too eager for production results at the expense of institutional development and sustainability, and the borrower (especially local governments), which has resisted surrendering control to independent financial institutions.³³ Finally, recent project assessments show that, although physical construction targets and outputs were achieved in several cases, crucial institutional issues did not receive the attention they need. One such issue is the operation and maintenance (O&M) of irrigation infrastructure. Gains in productivity and incomes from greater water availability achieved with support from a Bank project may well be short-lived if O&M issues are not given the attention they need. And while it is commendable that physical implementation often exceeds project targets in China, this has sometimes had unintended consequences; for example, in the Hebei Agricultural Development Project, overexpansion of tube wells may have contributed to lowering the water table.

Health Sector

China's health and nutrition indicators have always been good compared with countries at a similar income level, and they continued to improve on average in the 1990s.³⁴ But average indicators mask rising regional and urban-rural differences and a near crisis in poorer rural areas, where infant mortality and other indicators have deteriorated.³⁵ The World Health

Average indicators mask rising regional and urban-rural differences and a near crisis in poorer rural areas, where infant mortality and other indicators have deteriorated.

Organization (WHO 2000) ranked China 61st out of 191 countries on overall quality of health, but 188th in terms of fairness of financial contribution to health. While the WHO methodology is controversial among health economists, the Bank's

own reports confirm the deterioration in health access. In 1975, 85 percent of the rural population had access to cost-effective preventive and curative health services and shared at least to some extent the risks of medically caused financial misfortunes. In 1995, this coverage had dropped to about 10 percent (World Bank 1996b). Decentralization of responsibility for health finance has widened disparities in health resources, and the fee for service system has distorted incentives, leading to neglect of preventive care and to the prescribing of inappropriate drugs and services. Serious illness or injury is a major cause of poverty.

The Bank's ESW has thoroughly analyzed health finance issues (see especially World Bank 1996b and the chapter on health finance in World Bank 2002b), and the World Bank Institute (WBI)-China Network has helped expose senior officials to health sector problems (see box 3.3). However, this seems to have had little impact at the highest level of decisionmaking responsible for intersector allocations or intergovernmental fiscal relations. The lending program is small (3.2 percent of total lending during 1993-02) compared with other large comparator countries, including IBRD countries such as Brazil (see Annex R, table R.5a). Project ratings have been variable, but include a high proportion of highly satisfactory outcomes.³⁶ The lending portfolio has rightly focused on rural health issues. Most projects have been disease-oriented, with fewer projects dedicated to addressing health systems performance and reforms. An important exception was the Integrated Regional Health Development project of 1990-98, which introduced a systematic approach to health planning and influenced the 1997 State Council strategy on health sector reform. Within the constraints of the policy framework, the lending program has been innovative, had substantial to high institutional development impact, introduced state-of-the-art concepts and technology, and contributed to building technical capacity. But overall the Bank assistance program has not managed to change the health financing

system, which continues to create perverse incentives and widening disparities in health outcomes.

Summary: Poverty Reduction

China made substantial gains in poverty reduction over the past decade, but progress has slowed significantly since the mid-1990s, despite continued high growth rates. Inequality in incomes and access to social services has grown. Vulnerability has also increased with a rise in unemployment combined with slow development of social protection. The Bank made several significant contributions to poverty reduction in the 1990s. Its analytical work helped clarify the nature of rural poverty and shape China's poverty reduction strategy. The Bank has also helped improve capacity for poverty measurement, as well as monitoring and evaluation. Perhaps most important, the Bank has helped establish successful models of targeted interventions through integrated rural development projects. In addition, many projects in agriculture, health, and transport have contributed directly or indirectly to poverty reduction. Where the Bank has been less successful is in persuading the government of the implications of broader development policies for poverty and for growing inequality and vulnerability. The mismatch between intergovernmental fiscal resources and responsibilities exacerbated regional inequality; the health finance system in particular has created adverse incentives for provision of preventive care and led to grossly unequal access to health services; grain policy has penalized farmers in some of the poorer areas; and migration restrictions have limited economic integration, helped perpetuate the urban-rural income gap, and denied those who did manage to migrate equal access to services. The Bank has produced some excellent ESW analyzing these problems, but has failed to persuade the government of the importance or urgency of policy change. The situation may be changing, however, as the government has recognized the risks that growing inequality and vulnerability pose for social stability and economic progress.

Infrastructure

Infrastructure development has been a central element in the Bank's assistance strategy for China. In the early and mid-1990s, helping to break infrastructure bottlenecks was seen as critical to the strategy of sustaining high growth without inflation and thus preserving a conducive climate for reform; in more recent years, infrastructure development was considered to be one of the most effective ways of promoting market integration, poverty reduction, and development of inland China. Sector reform and institutional development were important objectives as well, to be pursued mainly through parallel AAA and by piloting individual reform elements in a series of projects. China also placed high priority on Bank support for infrastructure—to provide new technology and management methods, as well as finance.

It is not surprising then that infrastructure (narrowly defined as transport and energy) dominated the Bank's lending program. During the period 1993–02, energy and transport commitments were \$11.1 billion, nearly half of all lending.³⁷ Highway projects alone were 20.9 percent of all lending, and power projects accounted for 17.2 percent. Other infrastructure lending was distributed across railways (4.3 percent of total Bank lending), urban transport (3.1 percent), ports and inland waterways, and natural gas. The energy sector received \$90 million in Global Environment Facility (GEF) grants through the Bank as well. The Bank also carried out a substantial amount of AAA, including support for national sector and subsector strategies.

Overall, Bank support for infrastructure was highly successful. Portfolio performance was

The Bank has helped establish successful models of targeted interventions through integrated rural development projects.

Infrastructure development was considered to be one of the most effective ways of promoting market integration, poverty reduction, and development of inland China.

without equal in the Bank. All 28 transport projects that closed during the period 1993–02 were rated at least fully satisfactory (and 2 were rated highly satisfactory). None of the 12 completed energy projects was rated unsatisfactory, although 3 were marginally satisfactory (balanced by 3 highly satisfactory). Sustainability was rated likely or highly likely for all transport projects and all but one energy project, and institutional development was rated substantial for 20 of 28 transport and 10 of 12 energy sector projects. OED sector reviews broadly confirmed that China’s performance in the infrastructure sector was the best in the Bank. The energy sector review (OED 2001) concluded that the Bank’s assistance strategy was highly relevant and fully satisfactory, and that Bank performance was highly satisfactory. The transport sector review (OED 1999), while more mixed in its assessment, still rated outcomes satisfactory. Client satisfaction has also been high. Interview feedback was largely favorable,³⁸ and respondents in the 2002 Client Survey ranked “helping to strengthen infrastructure development” as the most effective area of Bank activity (Annex K).

Many of the sector and macro objectives of the Bank’s assistance strategy were also met. China’s road network grew by 40 percent during the decade of the 1990s, and power generation capacity now exceeds 300 gigawatts, making China the second-largest producer in the world (World Bank 2003).³⁹ China’s growth in power and transportation networks certainly helped sustain growth, dampen inflation, and integrate market networks. Transport costs fell, and many previously local or regional markets, such as grain, moved toward national integration.⁴⁰ The Bank’s role in expanding supply is debatable

China’s road network grew by 40 percent during the 1990s, and power generation capacity now exceeds 300 gigawatts, making China the second-largest producer in the world.

since Bank finance accounted for less than 5 percent of road investment and about 3.5 percent of power investment, but Bank projects contributed to 40 percent (3,500 kilometers) of the expressways built since 1985 (World Bank 2003); in the

power sector, the Bank helped build 20 percent of the transmission lines and 20 gigawatts of generating capacity, including the first 300-megawatt, 600-megawatt, and 900-megawatt generating plants in China.

Apart from its direct contribution to supply expansion, the Bank leveraged its influence in two ways. First, Bank AAA contributed significantly to sector policy reform and institutional development, especially in the power sector. Over the course of the decade, and especially in the past five years, China introduced extensive policy and institutional changes that were first outlined in a Bank report on power sector reform (World Bank 1994c) and further developed in other AAA and through pilot projects. These changes include price reform, separation of management and regulation, corporatization of government energy production units, introduction of competitive power markets, and improvements in the policy framework for private participation in infrastructure. The energy sector is perhaps the most successful example of the Bank’s dual-track approach to lending and policy reform. Transport reforms have been slower in coming, but the Bank introduced the concept of toll roads and worked with the government (which came up with the proposal) to promote securitization of revenue-producing highways, thus opening the way for private participation and faster expansion of the sector.⁴¹

Second, the Bank introduced the discipline of the project process to civil works. Competitive procurement brought large efficiency gains and new technology. Improving the project process laid the foundations for more general reforms in the economic and administrative framework. The financial management systems required by the Bank have revealed weaknesses and lack of accountability in the existing framework, and the introduction of modern management tools and technology opened up the possibility of change in most of the infrastructure sector. In the railways, for example, new information and cost accounting systems have made possible the consideration of separating infrastructure costs from operating costs and thus could

bring about eventual changes in ownership and administration.

Despite these achievements, Bank assistance strategy has been less successful in other areas. First, the Bank has been little involved in primary fuel subsectors such as coal and gas, where it might have brought new technology and useful international experience.⁴² Second, institutional and policy components of projects were less successful than physical implementation. It is not clear whether many of the proposed management techniques and policy changes have been internalized, nor how widely they have been disseminated. In the power sector, for example, a multiple pricing arrangement was a source of dispute in the Ertan Hydroelectric Project; elsewhere in the sector, multiple pricing still creates incentives favoring the use of thermal over hydro and the use of older, less efficient plants.⁴³

Reforms and institutional changes have also been less successful in transport than in energy for a number of reasons. First, policy and institutional change have been less successful whenever coordination was required among ministries or levels of government, as is generally the case in transport.⁴⁴ For example, in highways, agreement has been reached in principle to introduce a fuel tax, but implementation has been stymied by disagreements between the center and provinces over allocation of charges and revenues. Second, China's infrastructure finance and loan repayment system has distorted the allocation of investment, especially in highways, which have a higher public goods element than power or even railways. In particular, China has relied too much on toll road financing. While economically justifiable under conditions of congestion, toll roads otherwise distort the provision of public goods and constrain the ability of the Bank to assist the government in stimulating economic growth, for example, to finance roads in poorer regions with limited capacity to repay. Finally, and most importantly, the benefits of transport investment have been diminished by the government's broader development policies. Migration controls and local protectionism limit demand for transport services.

Market integration is constrained by low density of transport infrastructure, to be sure, but it is equally limited by policies.

Summary: Infrastructure Development

China successfully broke infrastructure bottlenecks that imperiled growth and stability in the early 1990s. A growing transport network also promoted market integration and development of lagging regions. China had a lot to gain from international experience in infrastructure development in the early 1990s, and the Bank had a lot to offer. Bank support was highly successful in promoting better project management, competitive bidding, and technical improvements. Even resource transfer from the Bank was of some importance for breaking infrastructure bottlenecks during this period. In addition, the Bank's dual-track strategy of promoting sector policy and institutional reform was successful, particularly in power, less so in transport and water. The main question looking forward is whether the Bank can still contribute significant value added in the infrastructure sector, or whether the Bank finance that the government still desires is a substitute for reforms that could open up other modes of finance.

Environment

China faces serious environmental problems, and because of its size, some of the effects, such as greenhouse gas emissions, are also worldwide. During the 1990s, government gave increased attention to the environment. Awareness was heightened by widely publicized international reports⁴⁵ and by events in China. Widespread illness among users of the Huai River in China's industrial Northern Plain in 1994 was a turning point for government, resulting in the eventual closure of 75,000 small, high-

The energy sector is perhaps the most successful example of the Bank's dual-track approach to lending and policy reform.

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As a result of policy shifts, China has had some successes in reversing or containing some forms of environmental degradation.

polluting TVEs nationwide. Floods in 1997 and 1998 prompted the introduction of a logging ban in sensitive areas. The government has also used less drastic measures, including more open environmental reporting, price incentives, and new laws and regulations. Leaders regularly address environmental issues in major speeches, and China has adopted “sustainable development” as a guiding principle for the tenth five-year plan (2001–05).

As a result of these policy shifts, China has had some successes in reversing or containing some forms of environmental degradation, though serious problems remain and future trends are uncertain:

- Although China remains one of the most inefficient major economies in terms of primary energy use per unit of GDP (3.3 times higher than the United States in 2001 and 40 percent higher than India), unit energy use improved by 30 percent between 1995 and 2001. In a period of increasing industrial production, industrial pollution loads have fallen drastically since the late 1990s.
- China increased forest area during the 1990s, albeit with some loss of species diversity.
- Erosion on the extended Loess Plateau area has been contained, with benefits not only to the people living there but also in the quality of the Yellow River and the amelioration of dust storms as far away as Beijing.
- China made a major contribution to the global environment through a sharp reduction in ozone-depleting substances (ODS) in recent years.

AAA

Bank environmental ESW has generally been of high quality and has helped raise environmental consciousness and influenced policy. The *China Environmental Strategy Paper* (World Bank 1992a) outlined the Bank’s environmental assistance strategy and marked the beginning of a major partnership with the State

Environmental Protection Agency (SEPA).⁴⁶ Many of the recommendations found their way into China’s own environment strategy of 1994. The most recent major report *Air, Land, and Water* (World Bank 2001) updates the 1992 strategy; it was produced collaboratively with SEPA and has had a significant impact on official thinking;⁴⁷ some of its recommendations were incorporated into the tenth five-year plan.

ESW on individual environmentally important sectors has been variable. A major agricultural sector report, *Accelerating China’s Rural Transformation* (World Bank 1999), provided a good basis for public discussion of environmental issues. In the water sector, a jointly produced comprehensive quantitative plan built around a “dynamic optimizing model”⁴⁸ gave highly valued assistance to the Ministry of Water Resources. An internal study of planning for the Yellow River Basin highlighted the importance of integrated river basin management and contained some prescient remarks about the opportunity cost of abstracting water.⁴⁹ Most water sector AAA has been based on informal reports and workshops and seminars with project or individual ministry counterparts. More recently, however, the Bank published a water resources assistance strategy (World Bank 2002b), which should provide a broader basis for dialogue with the many agencies involved in water resource management. The only formal report on the forestry sector is OED’s own sector review (OED 2000). The lack of sector work in forestry has limited the Bank’s ability to judge whether it is working in the right areas, to conduct policy dialogue, and to reach an important wider audience of social scientists concerned with forestry issues and their broader environmental implications. However, in 2002, the World Bank helped form a task force on Forestry and Grasslands through the Chinese Council for International Cooperation on Environment and Development (CCICED). The task force has produced reports and promoted discussion on policy issues among Chinese officials and scholars and international efforts.

Lending

World Bank lending has two environmental dimensions: (a) to avoid or mitigate any adverse impact of projects in any sector—the “do no harm” principle; and (b) to “do good” through projects that are intended, in whole or part, to have environmentally beneficial effects. The Bank’s activity to prevent harm, mainly through safeguards and environmental impact assessments (EIAs), is discussed in chapter 4.⁵⁰ This section focuses on lending intended to have a positive impact. Projects intended to have a positive environmental impact are found in many sectors, and the definition of an environmental project is sometimes arbitrary. Many power projects, for example, are not classified as environmental even though they may have substantial environmental implications. Of the 11 completed projects from various sectors classified as “environmental,” 3 were rated as having *highly satisfactory* outcomes—an unusually high proportion. But projects with an environmental theme attracted a large number of relatively weak ratings as well—one *unsatisfactory* outcome and four *marginally satisfactory*. The remaining three projects were rated *satisfactory*.

Because of the crosscutting nature of environmental concerns and the arbitrary classification of projects, it makes more sense to review the extent to which environmental concerns are mainstreamed in individual sectors. In general, the Bank has done a commendable job of mainstreaming the environment in energy, forestry, agriculture, and transport. Performance in the water sector has been mixed, while little has been done in the area of environmental health. Some of these assessments are elaborated in the sections below on air, land, and water.

Air. Air quality improvements have been strongly influenced by technological changes in the energy sector, where the Bank has been heavily involved. The environmental performance of Bank-funded coal-fired power plants has been very good when compared with non-Bank plants. Not only are emissions much lower, but also China’s power authorities themselves have taken responsibility for

environmental management and supervision. The Bank has financed several large hydro and multipurpose dams that substitute for thermal coal-powered plants. While dams have their own environmental problems, the Bank has adequately addressed these in Bank projects. The multipurpose Xiaolangdi Dam, supported by the Bank, has been credited with drastically reducing silt and enabling continuous flow in the lower reaches of the Yellow River, something which has not been achieved in the previous 10 years. The OED review of China energy operations concluded that the Bank had made substantial environmental contributions in power generation, district heating, and many other areas, though it has not been successful in promoting the introduction of gas on a large scale to substitute for coal (OED 2001).

China is the world’s biggest producer of ozone-depleting substances and the second-largest producer of carbon dioxide (CO₂), and both are being reduced through international agreements and provision of grant funds through the Multilateral Fund for the Montreal Protocol (MFMP) and the GEF. Energy conservation and fuel diversification policies have made significant contributions to reducing global CO₂ levels. Current Bank support includes lending projects for renewable energy scale-up, heating reform, and urban transport programs to address emerging vehicular pollution trends.

Land. Past neglect of land and watershed management has caused severe and widespread erosion, land degradation, and desertification. Bank-supported projects made major contributions to increased efficiency of water use by demonstrating that profitable orchard and mixed farming models are compatible with watershed rehabilitation and soil preservation. Terracing and erosion control projects in the

China’s power authorities themselves have taken responsibility for environmental management and supervision.

China is the world’s biggest producer of ozone-depleting substances and the second-largest producer of carbon dioxide.

Box 3.4**Rural Water Supply in China**

The Bank has supported four rural water supply and sanitation (RWSS) projects, mainly in poor counties. Designs have evolved by combining the strengths of existing village administrations and community financial participation with international best practices. Design concepts include appropriate technology, financial cost recovery, decentralization of regulation, and financial autonomy. This contrasts with the more popular approach of justifying non-cost-recovery tariffs in poor communities by claiming the “beneficiaries are willing but not able to pay.”

In the latest generation of RWSS projects, the investment cost for water supply is 75 percent, paid for by cost recovery, and 95 percent of villages abide by the tariff covenant. The average cost of two yuan per cubic meter (about 25 cents) provides startlingly clear evidence that even the poor can and are willing to pay tariffs that raise eyebrows when proposed for urban con-

sumers. Rural consumers supplied by Bank-supported RWSS consume an average of 28 liters per capita per day (lcd). While lower than U.N. standards of minimum daily need, this level of consumption and the implied tariff captures most of the consumer surplus generated by supplying RWSS services. The high cost-recovery and sustainability, good quality, continuous service, and a cost-recovering tariff have increased welfare. Consumers, averaging five per household, are willing to pay a higher price for a better-quality product and to adjust their consumption downward to fit the household budget.

The oft-quoted “affordability index” for this project was that water charges were 3 percent of disposable income. If the U.N. definition of supply or need had been used for planning purposes (implying 112 lcd consumption), then the affordability index would have been 12 percent and the project would presumably have been rejected as “unaffordable.”

Source: Varley (2002).

larger basins also have significant downstream benefits, reducing silt loads and increasing incomes. Building, among other things, on the Bank-supported central Loess Plateau and Red Soils projects in southeast China, these technologies have been replicated.

Land degradation is closely correlated with rural poverty. Erosion arising from deforestation increases the silt load in rivers, increasing flood frequency and severity. In 1998, the government introduced a blanket ban over much of the country on logging of natural forests and on opening new lands at the expense of forest. This reduced incomes in these often-poor areas while increasing timber import requirements.⁵¹ Reforestation has been implemented on a vast scale, with plantations representing 40 percent of forest area; while this has arrested the decline in forest area, it has not reversed the loss of biodiversity. Bank forestry projects have contributed 3.3 million hectares of new high-quality forestry land (one-sixth of the increase in forest areas) since the early 1980s. Despite some evidence that China’s forestry regulations and policies have negatively affected forests, OED’s forestry

sector review (2000) concluded that the Bank’s forestry work in China has been remarkably successful—“a high point in one of the highest-quality portfolios.”

Water. The Bank has been involved in many aspects of water resource management (WRM) with varying degrees of success.⁵² Hydro-power, watershed management, and forestry have been discussed in previous sections. The other areas of WRM with substantial environmental implications are water resources/flood control, irrigation, and urban water supply and waste management. Rural water supply projects, while more important for poverty reduction than the environment, have been highly successful and provide useful lessons for China and other countries on the importance of pricing and cost recovery (see box 3.4).

A noted Bank success story was the Taihu Flood Control Project, praised by the vice minister of WRM for reducing losses during the 1998 floods. Several Bank-supported projects in the 1990s have been in the vanguard of Bank-China cooperation on integrated WRM. The Yangtze Basin Water Resources Project (1995) incorporated both autonomous, locally run Self-

Financing Irrigation Development Districts (SIDDs) to improve O&M and an integrated river-basin development component. The first and second Tarim Basin projects (1992/1998) in the western Xinjiang Uygur Autonomous Region have the best-developed framework for integrated water management—both the financial components of SIDD and a comprehensive set of procedures/regulations for integrated WRM. Even with these successful models, only limited progress has been made in introducing integrated river-basin approaches to WRM in China. China has been reluctant to borrow for management components in Bank projects, devoting only about 5 percent of project funds to this purpose, compared with 25 percent in Brazil and Mexico (World Bank 2002b).

The scale of Bank involvement in irrigation has been very limited, but has had a positive effect on Chinese practices for procurement, project management, and (more recently) irrigation management, especially at the provincial level. Irrigation has usually been a component of an integrated area development project. Poor and underfunded irrigation O&M is still a problem, but the organization of farmers within SIDDs on both Bank- and non-Bank-supported projects has improved management and accountability, empowering farmers, through legal contracts, to pay for and receive water services, both from local government agencies and publicly owned bulk-water companies. Water user associations (WUAs) are part of SIDDs, playing a key role in many aspects of improved water resources management that can increase productivity. The Bank has supported water conservation through technical innovations (for example, drip irrigation, drought-resistant crop varieties), conservation pricing, and agricultural engineering support services, but these have not been replicated on a large scale.

In two important areas, the Bank's initial approach to irrigation diminished its contribution

- Failing to allow for a very high opportunity cost of water in the economic analysis of upstream irrigation projects largely undermined the claimed high rates of economic return and ef-

iciency. For instance, the appraisal of run-of-the-river pumping schemes on the upper reaches of the Yellow River should have subtracted the opportunity costs (to high-value municipal and industrial users in the lower reaches) of water supplied during the dry season.

- A seeming disregard of an obvious and serious water resource constraint contributed to the mining of groundwater resources on the North China Plain. A recent Bank audit notes that in addition to the impact of the demand on groundwater, the Hebei Project put in many more new wells than planned at appraisal (OED 2002a). Conservation aspects do not appear to have been high on the agenda. Even the economic benefits were overstated, as the anticipated supply of irrigation water cannot be sustained.

One of the largest and fastest-growing programs of Bank support has been in water supply (WS) and wastewater treatment plants (WWTPs).⁵³ An OED sector review (OED 2002) judged the outcomes of China WS/WWTP projects to be *moderately satisfactory* with respect to overall development objectives, which are themselves described as *modest*. OED rated project outcomes *satisfactory* in terms of efficacy and standards of construction, but efficiency only marginally so, and the institutional impact, *modest* or *negligible*. The Bank approach has supported capacity building, with relatively little control over the quality of institutional reform. Projects still live in both a nonmarket and an under-regulated environment. There has been no significant difference between Bank- and non-Bank-supported water utilities, raising questions about whether the Bank offers any real value added. Bank-supported projects may have been better implemented than others, but overall water quality targets are not being met. Statistics for China show that, despite an 8

Rural water supply projects have been highly successful and provide useful lessons for China and other countries on the importance of pricing and cost recovery.

percent increase in water consumption and a 19 percent increase in wastewater treatment capacity, the proportion of waterways meeting minimum standards has decreased. There are two broad reasons for the disappointing sector performance and World Bank impact.

- Institutional arrangements do not match the source of the problem. Municipalities are responsible for WWTP, but much of the pollution comes from “non-point” agricultural runoff and periurban TVEs. Overall responsibility for management is fragmented among several agencies, many of whose environmental mandates may conflict with financial interests, public and private.
- Low prices for urban water supply and wastewater treatment perpetuate unsustainable pollution levels for two reasons: they fail to restrain demand for water, and they provide insufficient financial resources for expansion of reticulation (network collection facilities). The maximum water supply tariff level achieved is in the range of one to two yuan per cubic meter, compared with an average of two yuan per cubic meter for rural water supply. Bank WS/WWTP projects have introduced higher tariffs and other policies, but the Bank has little influence over the degree of institutional reform required to address environmental management needs.⁵⁴ Bank operations are tied to particular municipal governments that cannot themselves resolve the institutional problems. Bank projects, if successful, are at best demonstrations of what can be achieved within the existing framework. Project designs have to go beyond existing agency partnerships and reach out to a broader array of public and private partnerships.⁵⁵

Strengths and Weaknesses of the Bank’s Environment Assistance

The Bank has influenced environment policy and legislation, has helped introduce environmental concerns into the mainstream of several sectors, and has directly contributed to improving natural resource management (NRM), flood control, and other areas. The Bank also introduced policy and institutional changes

such as water tariffs and integrated river basin management into its projects. Yet the impact of the Bank on changing critical approaches to water resource management and other environmental policies has been less than hoped. Continued shortcomings in China’s environmental strategy include:

- Strategy still favors expanding supply rather than reducing demand, and technical and engineering rather than economic approaches. For example, the proposed South-North Transfer Project (in which the Bank is not involved) would require a water tariff of 6 to 10 yuan per cubic meter to cover costs, while the maximum tariff level achieved, even in the most seriously affected cities, is still in the range of 1 to 2 yuan.⁵⁶ The proposed project may be justified as it ameliorates social conflicts over competition for water in rural areas, but the transfer might not even be necessary if tariffs were raised sufficiently to restrain urban demand.
- Coordination among overlapping agencies and levels of government remains a major problem. Coordination of both water and environmental responsibilities and decisions will not be resolved without a supra-ministerial body to push through reforms.
- Neither the Bank nor the government has faced up to the reality of tradeoffs between equity and efficiency or between short-term growth and poverty reduction on the one hand and long-term growth and environmental sustainability on the other. Although there are important complementarities between poverty reduction and environmental protection in some areas (such as NRM in the Loess Plateau), there may be difficult tradeoffs between upstream irrigation and downstream urban use of the Yellow River or between the effects of higher urban water tariffs on poverty and the environment. Recognition that it is not always a “win-win” situation would permit exploration of ways (such as tradable property rights in water) to mitigate some of these tradeoffs.
- More than in most sectors, the fiscal transfer system leads to inaction, conflict of interest, and misallocation or underinvestment in environmentally sound projects. Environmental pro-

tection is a quintessential public good, and requirements that investment costs be recovered at the source can literally lead to underinvestment upstream because of inability to capture the benefits downstream. The recently completed Loess Plateau project, for example, was exemplary in every respect but one: there was underinvestment in dams that provided benefits mainly outside the project area.

Summary: Environment

China's air, land, and water resources have been put under tremendous strain by high growth and a legacy of poor environmental policies. Over the past decade, progress in the environment has been mixed, with some successes in reversing adverse trends. The Bank has made some visible contributions to improving environmental protection, but there have been shortcomings as well. The Bank's collaborative AAA with SEPA has influenced environmental legislation, but it has had less influence on integrated water resource management and, until recently, has generated little dialogue on forestry sector policy. Bank-supported projects in natural resource management, forestry, power (both thermal and hydro), and multipurpose dams have had a direct and favorable impact and may have influenced design and implementation of non-Bank projects as well. The Bank has helped improve irrigation practices, especially

through water user associations, but it may also have contributed to unsustainable expansion of irrigation in some parts of the North China Plain.

In water supply and wastewater treatment plants, Bank projects have been well-implemented and have introduced useful policy and institutional innovations, but because these are implemented at the municipal level, diffusion seems to have been limited. The Bank has also helped mainstream environmental concerns in a number of sectors, notably energy—China has made significant progress in improving energy efficiency. Environmental safeguard policy (discussed in chapter 4) has been highly variable. Most EIAs are now done collaboratively with Chinese research institutes. Exposure to international practice through Bank support has strengthened China's EIA system, which predates the Bank's. However, increased technical competence has not been matched by institutional independence from political interference, and environmental safeguards still tend to be applied too late in the project cycle to have sufficient impact on project design. Overall, the Bank has had a positive impact on the environment, but improving coordination of environmental policy, especially WRM, remains a considerable challenge.

Coordination among overlapping agencies and levels of government remains a major problem.



Program Administration and Crosscutting Issues

Chapter 3 reviewed progress in, and the Bank's impact on, the four main development assistance objectives. This chapter reviews the use of lending and other instruments in achieving assistance objectives, compares outcomes in China with other countries, and examines some important crosscutting issues.

Lending

By most measures, China's portfolio is the largest in the Bank Group. As of June 30, 2002, China had the largest total of IBRD loans (\$18.4 billion vs. \$13.8 billion for number two Mexico), second largest total of IDA credits (\$9.6 billion, well behind India's \$24.3 billion), and an active portfolio of 101 projects, by far the largest in the Bank Group.

The regional allocation of Bank lending to China has gradually shifted from eastern to central and western China,¹ with the share of the central and western provinces shifting from 37 percent during FY81–92 to 43 percent in FY93–97 to 56 percent in FY98–02. Despite the shift from the better-off coastal region to poorer inland areas, the Bank's overall regional lending allocation was regressive during most of the past decade. Per capita Bank lending was positively and significantly correlated with provincial income per capita during 1993–97 and still positively, though not significantly, correlated during 1997–02.²

This allocation is consistent with the overwhelming emphasis given to reform in the early 1990s and to a belief that the trickle-down effects of growth were the dominant mechanism for poverty reduction. The most willing and reform-minded partners were often in the coastal areas; in Shanghai (the richest province), the Bank had a special reform support program in the early 1990s. The Bank was following the lead of the government, which also favored coastal development throughout most of the early period. Moreover, the Bank found it difficult to shift lending toward poor provinces (or to poorer regions within provinces) because of China's requirement that all loans be repaid by beneficiaries. Here, too, Bank lending patterns were shaped by the same factors that limited the government's ability to develop a system of fiscal transfers to benefit poorer provinces. Finally, political sensitivities have also influenced Bank lending allocations. Poorer provinces generally have a higher proportion of minorities, which entails more safeguards for

China has the best-performing portfolio of any large country in the Bank Group.

projects and attracts widespread outside attention. The Bank has never been asked, for example, to finance a project in Tibet, one of China's poorest provinces.³

The sector allocation of Bank lending in China has always differed from that in the rest of the world and has diverged even more in recent years (figure 4.1). The most important difference is that, with the exception of the Rural Sector Adjustment Loan in 1988, there has been no adjustment lending in China. The allocation of investment lending has been distinctive on several dimensions:

- *Emphasis on infrastructure.* Lending for infrastructure (transport, energy and mining, telecommunications) has always been unusually high in China, and the share of infrastructure has been increasing in China (representing 52 percent of the Bank's loans during FY98–02) while declining elsewhere (32 percent Bankwide average during FY98–02). Transport alone accounted for 25 percent of the Bank's commitments to China during FY98–02.⁴
- *Declining share for human resource development.* Bank lending to China for human resources development has declined. In the rest of the Bank, it has increased.
- *Increasing share for environment, urban, and water (EUW).* Environment lending only started after 1990, but reached nearly 8 percent of total lending in China in the most recent five-year period. Overall EUW lending rose from 6 percent during FY81–92 to 20 percent in FY98–02. Lending for infrastructure, broadly defined to include EUW increased from 57 percent during FY81–92 to 72 percent during FY98–02.
- *Sustained rural lending.* Lending for agriculture and the rural sector ranged from 22 to 25 percent in China between FY81 and FY02, compared with a declining Bankwide trend (from 23 percent to 14 percent).

Project Performance

China has the best-performing portfolio of any large country in the Bank Group. Of the 138

projects closed and evaluated through FY02, less than 9 percent were rated unsatisfactory (compared with a Bank average of 31 percent unsatisfactory for FY80–02). In the past decade, China's percentage of satisfactory outcomes has remained above those of the Bank, the East Asia and Pacific (EAP) Region, and (with the exception of Brazil during 1998–02) other large comparator countries (table 4.1). China's performance is even more striking with respect to sustainability and institutional development ratings. During the period FY98-02, sustainability was judged likely for 96 percent of China's projects (weighted by commitments), compared with 75 percent Bankwide; institutional development was rated substantial for 80 percent of evaluated projects (50 percent Bankwide).

Of the 12 projects rated unsatisfactory in the past decade, 6 were industrial sector projects, and 3 were in agriculture and rural development; environment, health, and water supply and sanitation each had one project rated unsatisfactory (annex table R.5b shows comparative country performance by sector).

What accounts for China's exemplary project performance? The most frequently cited factor is the high degree of country "ownership" of projects. Projects are identified and largely prepared by the government, and there is a strong commitment to implement projects quickly and thoroughly, along with a generally strong determination to abide by project agreements and conditions. Ownership is reinforced by the Chinese system of repayment obligations. The requirement to repay project loans concentrates the minds of local governments and project beneficiaries on the costs and benefits of individual project components and lends a sense of urgency to project implementation.⁵

At the same time, the success of World Bank projects in China may have been overstated for two reasons. First, there is a possible "halo effect," whereby projects are seen as successful, or given the benefit of a doubt, because of the strong performance of the Chinese economy.⁶ Second, project performance criteria give less emphasis to policy change in China than elsewhere. An OED review of

Table 4.1

Overall Project Rating: China and Comparisons

Exit fiscal year	Number of projects	Total net commitments (\$ million)	Net commitments		
			Outcome (% satisfactory)	Sustainability (% likely)	Institutional development impact (% substantial)
1993–97					
China	54	6,760	89	83	46
Brazil	41	4,679	72	65	41
India	70	10,858	71	55	29
Indonesia	49	5,432	86	68	40
Other East Asia and Pacific Region	146	11,153	82	68	40
Bankwide	1,195	90,962	74	56	36
1998–02					
China	53	8,546	93	96	80
Brazil	41	7,314	94	95	62
India	58	8,260	77	77	49
Indonesia	53	6,043	78	24	40
Other East Asia and Pacific Region	142	19,752	89	72	46
Bankwide	1,314	102,095	82	75	50

lending to China's water and sanitation sector rated overall sector performance as only marginally satisfactory, despite satisfactory outcomes in 20 of 22 projects, on the grounds that project objectives were insufficiently ambitious. Project objectives often give a lot of weight to physical implementation, which is nearly always excellent in China, while the dual-track strategy means that indicators such as improving sector policy are outside the project framework. Effectiveness in improving policies and in diffusing best practice need to be evaluated in a top-down approach (see chapter 3).

Portfolio Management

The evaluation of completed projects gives a picture mainly of the project portfolio approved in the late 1980s and early 1990s.⁷ Evidence from internal assessments can be used to illuminate the status of the current portfolio.

- Internal quality-at-entry (QAE) reviews from FY97–02 rated 20 of 21 projects (95 percent)

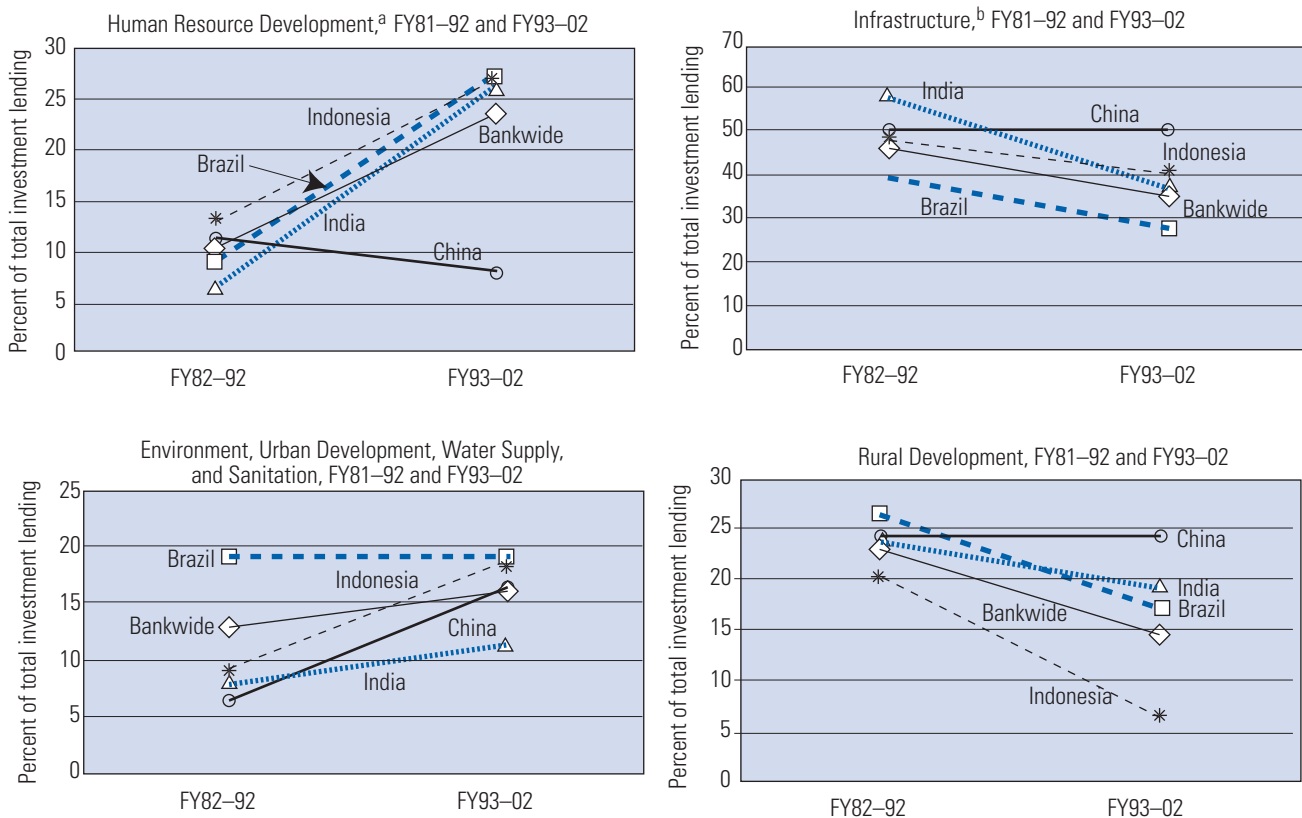
satisfactory or better.

As before, this is higher than both the Bankwide and the EAP Regional average (88 percent and 92 percent, respectively).

- Reviews of quality of supervision assessments (QSAs) from FY97–02 gave China similar ratings (81 percent of 54 projects were satisfactory or better) to the region (82 percent) and the Bank as a whole (79 percent). China's ratings started below average and rose to above average during the latter part of this period.
- Only 5 percent of the projects in the active portfolio were considered at risk at the end of FY02 (compared to 16.5 percent for the Bank as a whole), and disbursements at risk were only 2.6 percent (14.5 percent Bank average). As of January 2003, there were only three problem projects (3 percent) in the portfolio, compared to 12 percent for the Bank as a whole.

There is a strong commitment to implement projects quickly and thoroughly, along with a generally strong determination to abide by project agreements and conditions.

Figure 4.1 Comparison of Bank Sector Investment Lending Activities



a. Includes education, health, nutrition, population, social development, and social protection.

b. Includes energy and mining, transport, global information-communication technology.

Source: World Bank data as of 12/16/02.

Although overall portfolio risks are low in China, there are a number of recurring problems. Internal portfolio risk assessments show that 10 percent of projects were flagged for effectiveness delays in FY02, 14 percent for slow disbursement, and 14.3 percent for the new indicator for financial performance. Counterpart fund problems had affected 13 percent of projects in 2001, but this was reduced to only 1 percent in 2002. In addition, the disbursement ratio improved significantly in FY02 to 24.1 percent, which was above the Bank average (20.7 percent) for the first time in several years.⁸

Several problems in portfolio management became apparent around 1997. Through the mid-1990s, the Bank conducted periodic country performance portfolio reviews (CPPRs)

involving the full Bank management team and government officials from the finance, planning, and line ministries, as well as from provincial and municipal governments. The last CPPR in 1996 highlighted three broad problem areas:

- **Systemic issues:** Counterpart funding, procurement, and project management weaknesses—all of which pointed to the need to strengthen field-office capability.
- **Supervision:** Need for more management attention, more cross-fertilization across sectors, increasing government capacity for supervision and project monitoring, and more attention to resettlement and other safeguard issues.
- **Lengthy procedures:** Both the project approval process in China and processing in the Bank were slowing project implementation.

The Bank reorganization of 1997, which put sector directors in charge of large units dealing with the entire region, and the Asian crisis, which occurred about the same time, reduced attention to portfolio management. The CPPR process was interrupted, and the position of project adviser for China was eliminated. An internal assessment in 1998 found the QSA in China (at 57 percent satisfactory) to be below the Bank's average of 75 percent. Most important, the adequacy of supervision inputs and realism of ratings were rated very low (at 43 percent and 50 percent satisfactory, respectively). Thus inadequate management attention led very quickly to a drop in Bank performance.

Spurred by these findings, the EAP Region initiated its own review of supervision in 1999, shortly before the Inspection Panel investigation of the Western Poverty Project. The intensified scrutiny, both internal and external, of Bank-China relations after the Inspection Panel report led to a huge increase in management attention to the portfolio.⁹ The Region introduced a new portfolio and risk-management process; decentralized a number of functions (selected task management, procurement, financial management, and disbursements) to the resident mission; and introduced thematic supervision for groups of projects. These measures seem to have had a positive impact and may be responsible for the improved QSA ratings (100 percent satisfactory in FY01). Both staff and government officials particularly praised decentralization for improving procurement and other services. But the higher attention to safeguard and other portfolio issues may also account for renewed complaints by China about the "cost of doing business" with the Bank.

AAA/ESW

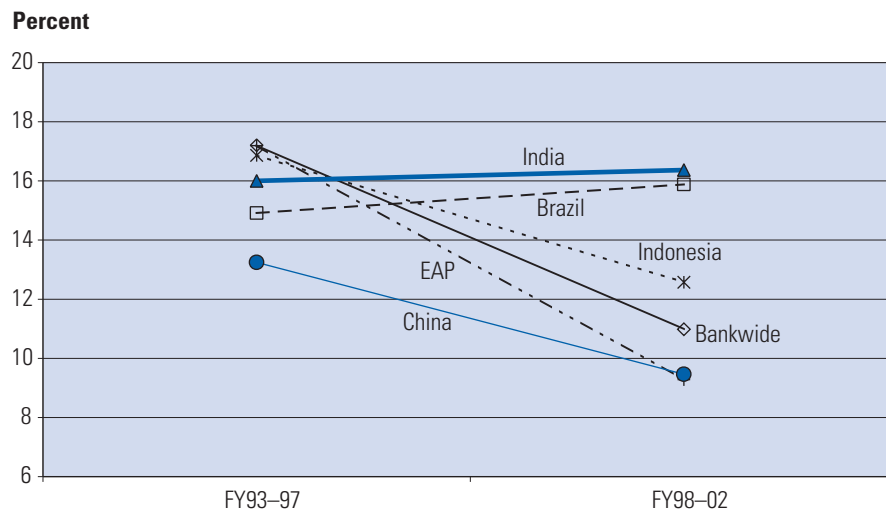
Analytical and advisory activities (AAA), especially economic and sector work, have always featured prominently in the Bank's statements of its assistance strategy for China.¹⁰ In part this reflected the relatively low weight of project lending in investment for a very large country and the limited scope for nonproject conditionality. But it also stemmed from the Bank's ambitious

objectives to promote system reform and to act as a source of knowledge on international experience. Chinese expectations of the "knowledge Bank" were also high, and in China, prime ministers have been regular readers of World Bank reports or have asked specifically for World Bank advice on policy issues. The relevance of ESW was enhanced by institutionalized arrangements for its programming. Beginning in the mid-1980s, the Bank and the government agreed on a rolling three-year program of studies.

Beginning in the mid-1980s, the Bank and the government agreed on a rolling three-year program of studies, subject to approval by the State Council. Programming extended beyond formal reports. For example, the Bank and the System Reform Commission¹¹ cosponsored an annual conference that brought together Chinese officials and scholars with Bank staff and foreign experts to discuss some aspect of reform. This arrangement allowed the Bank to respond to changing concerns and to facilitate access to foreign expertise. This facilitative role was as important as the Bank's own ESW in the early days of the relationship, but became less important as Chinese officials became increasingly capable of attracting and screening outside advice on their own.

The prominence of AAA/ESW in country strategy prompts several questions. Were the high ambitions and expectations realized? Were they realistic? How could AAA have been more effective? Is stand-alone ESW effective (a particularly important question because of the declining lending program)? Some of these issues are addressed here and some in the final chapter on lessons and recommendations.

There is a gap between the Bank's rhetoric on the importance of ESW in country assistance strategy and ESW budget allocations. ESW as a proportion of the total administrative budget was lower for China than for other large comparator countries and for the Bank as a whole throughout the past decade, and spending on ESW declined both absolutely and relatively during FY98-02¹² (see figure 4.2). The effect is most apparent on sector work. In several sectors, new work is needed to take

Figure 4.2 Ratio of ESW to Total Direct Cost

stock of progress and problems and to lay the foundation for better policy dialogue and new directions in lending.

Within China, there is a widespread view that the Bank's AAA, which was so valued in the 1980s, declined in relevance and quality during the 1990s.¹³ There were exceptions, and there has been an improvement in Chinese perceptions of the relevance and quality of the Bank's AAA in the last few years. The Bank's macroeconomic advice in the early to mid-1990s and the more recent work on pension reform were repeatedly cited in interviews as examples of highly relevant and effective work (box 4.1). These examples were particularly well known because of press coverage and public acknowledgment of the Bank's contribution by Premier Zhu Rongji. Other areas in which respondents cited important Bank contributions to debate and policy change in the past decade included value added tax (VAT) reform, WTO entry, public utility reform, environmental policy, and preparation of the most recent five-year plan. Still,

Within China, there is a widespread view that the Bank's AAA declined in relevance and quality during the 1990s.

despite these examples, Chinese officials and researchers often expressed disappointment with the overall relevance and quality of the Bank's ESW. They felt

the Bank was slow to adjust to the growing knowledge and sophistication of Chinese counterparts and continued to provide generic advice based on international experience, rather than discussing relevant policy options.¹⁴ As one researcher put it, the Bank's glossy reports were thorough and competent, but "Where is the value added?" There was also a feeling that the Bank did too many reports on its own, making too little use of Chinese collaborators.¹⁵

Internal ratings for a sample of twelve ESW reports on China from FY98-02 were similar to the Bank average. Nine reports (75 percent) were rated satisfactory or above and two of those were highly satisfactory. All reports were rated relevant, but some reports fell short on criteria of internal quality, presentation/dialogue, and likely impact. One surprising result was that half the reports were rated less than satisfactory for Bank processes. Specific shortcomings included failure to provide concept papers or peer reviews at a critical stage, but a more general theme was that there was inadequate management attention. This may partly reflect organizational changes in 1997 that broadened sector managerial responsibility from the country to the region.

OED's assessments of the Bank's AAA in its sector background studies was also mixed. The general quality of AAA was good, and the

Box 4.1**A Chinese View of the Bank's AAA**

A specially commissioned review of analytical and advisory activities and system reform (Lu 2002) concluded that the Bank's AAA had been largely successful because the Bank consistently advocated reform even when the political climate was unfavorable; relied on cooperation and persuasion, rather than trying to impose its views; used a variety of outputs; and developed a sound knowledge base and extensive contacts. The paper, which was based on extensive interviews with leading scholars and officials familiar with the Bank, as well as a document review, also found that Bank influence declined somewhat in the 1990s because of a reduction in the knowledge gap between the Bank and China, increasing political difficulty in taking reform measures, and the Bank's failure to recognize and exploit the strengths that contributed to past success.

To be more effective, the paper suggested the Bank should:

- Pay more attention to dissemination of results through more innovative formats.
- Be more forward-looking in choice of topics. Devote more attention to emerging sector and structural issues such as urbanization, education, and urban transport, rather than to state-owned enterprises and other reform topics.
- Extend its range of cooperation and revitalize its contacts. The Bank should, of course, be responsive to requests for work from the top leadership, but it should also expand its network to replace its dwindling contacts from an earlier period and renew its collaborative approach to analytical work.

impact was significant in a number of areas. At the macro level, special mention should be made of the recent outstanding provincial public expenditure review (PER) (World Bank 2002a), as well as the Dalian conference and related macro and fiscal advice in the early and mid-1990s. ESW on poverty (both within the Region and in DEC) has made a significant contribution, as has the Bank's work on environment and the energy sector. In some sectors, however, AAA has been less effective or absent altogether. In forestry, for example, the Bank made loans of about \$1 billion without any sector work (OED 2000).¹⁶

The Bank has also had mixed results in exploiting its comparative advantage in doing cross-sector work. A very good internal report on rail-coal-power coordination had seemingly little impact on China's investment planning or Bank lending, largely because China did not have a government agency prepared to coordinate across sectors. Because the State Environmental Protection Agency (SEPA) is a cross-sector agency, the Bank has been more successful in influencing environmental thinking and policy. In the water sector, where China's own coordination is weak, the Bank has failed to gain a cross-sector audience. In the case of enterprise reform and financial sector reform, the Bank's work has been too compart-

mentalized to take advantage of the inherently close links between the two areas.

Donor Cooperation

The Bank has been the second largest donor in China, after Japan. During 1991–00, IBRD and IDA together accounted for 17.7 percent of China's net receipts from donors; Japan accounted for 24.9 percent; and the Asian Development Bank (ADB), 5.9 percent (Annex R, table R.3). Considering only concessional assistance (ODA), IDA accounted for 23.3 percent of total net disbursements during 1993–01 (25.9 percent during 1993–97 and 18.7 percent during 1998–00), Japan accounted for 41.7 percent, and Germany 13.5 percent.

China fits the Comprehensive Development Framework model of donor coordination more closely than most countries.¹⁷ Donors, including the World Bank, play a negligible role in aid coordination. China sets its own priorities and tries to match these with individual donor interests through agreements on sectors and location of projects. The government's own aid management is fragmented, however, between the Ministry of Finance, which coordi-

China fits the Comprehensive Development Framework model of donor coordination more closely than most countries.

nates loans, and the Ministry of Foreign Trade and Economic Cooperation, which coordinates grants. Generally the government allocates donor activities to areas or sectors that complement each other; in the highway sector, for example, the World Bank and ADB work on different sections of the national highway system.

Weak coordination within the government puts a premium on information sharing and coordination between the Bank and other donors. The Bank and the Fund, which have collaborated effectively on fiscal policy advice, recently discovered that they had received separate requests for advice on debt management. The requests were from different government agencies and overlapped in part; because they shared information, the Bank and Fund were able to provide more effective support.

The most notable coordination effort involving the Bank is the agreement to blend DFID grants and IBRD loans to mimic IDA terms. The first blend project was the Tuberculosis Control Project approved in FY02. Given the constraints of China's fiscal transfer and repayment system, this partnership makes sense. It enables the Bank to work on poverty reduction projects otherwise unavailable to it. In DFID's view, the Bank (and China) have also benefited from DFID's contribution to ideas and policy innovations (such as provision of provincial counterpart funding for poor counties and the introduction of social assessments at the design stage) that would have been unlikely from the Bank working alone. Nevertheless, the Bank/DFID arrangement is an inferior solution to the serious problem of a weak fiscal transfer system.

Other donors, active in many of the same sectors as the Bank, are highly complimentary about the Bank's ESW and use it in formulating their own strategies. A major objective of their assistance is to provide a demonstration effect

All levels of government complain that the Bank's safeguard policies impose high transactions costs.

from their projects, but the mechanisms of dissemination of good practice in China are not well developed, notwithstanding China's reputa-

tion for rolling out successful pilots nationwide. The Bank could provide a valuable service by helping to organize collaborative sector work to compare donor experiences in project design and implementation in key sectors.

Safeguards

World Bank experience with safeguards in China is highly variable. China has been held up as a model of how safeguards should be applied. An OED multicountry study of involuntary resettlement cited China's approach in the Shuikou and Yantan dam projects as best practice because of its participatory approach and its emphasis on jobs and incomes, rather than mere relocation and shelter (Picciotto, Rice, and Van Wicklin 2000). At the other extreme, an Inspection Panel Report found that the Bank had violated several of its own safeguard policies in the Western Poverty Reduction Project (see box 4.2).

China recognizes the need for safeguard policies and applies them to its own projects. China was among the first developing countries with environmental safeguards, and environmental impact assessments for Bank projects are now conducted by Chinese research institutes. But all levels of government complain that the Bank's safeguard policies impose high transactions costs and that the Bank has more stringent standards than other donors. China's view is that Bank procedures are intrusive, do not mesh with its own, lead to long delays in project implementation, increase costs, and are unnecessary because China has its own safeguards (some incorporating Bank practices). China argues that its "3-simultaneous policy," requiring environmental supervision at design, construction, and operational phases, is more comprehensive than the Bank's safeguard policies (box 4.3).

In 2000, an independent internal review was undertaken of Bank supervision of safeguards for six of the largest projects in China. Some of the principal findings were:

- Policy design, implementation, and Bank oversight of safeguards were generally satisfactory, but variable. Two projects each were *highly*

Box 4.2

Inspection Panel Investigation

The 15-month Inspection Panel (IP) investigation (from April 1999 to July 2000) of the Qinghai Component of the Western Poverty Reduction Project had a significant impact on Bank-China relations and on the Bank's approach to risk management and safeguard policies. A request for inspection had been lodged by the International Campaign for Tibet claiming that the project might irreversibly harm the livelihoods of Tibetan and Mongolian ethnic peoples in the Qinghai area. The Board authorized a review—the first full review since the creation of the IP in 1994. The Panel found that the Bank had violated a number of its own policies, including environmental assessment, indigenous peoples, and involuntary resettlement (Operational Directives 4.01, 4.20, and 4.30, respectively). When the Board asked for resubmission of the project for approval following additional studies, China withdrew its request for financing of the Qinghai component and has since implemented the project on its own on an accelerated schedule.

The Bank was naïve in thinking this was a routine project of little interest to the outside world, and it was lax in its assessment of risks and acceptance of government reassurances. Outside critics charged that the Bank was being used to legitimate a politically motivated project designed to dilute Tibetan influence, and the government felt that criticisms of the project were politically motivated and that the Bank's management and Board did too little to uphold the Bank's political neutrality. The government was as surprised as the Bank at outside reaction.

The fact is that any resettlement project in areas of traditional Tibetan settlement would be politically controversial.

The investigation revealed the need to correct a number of weaknesses in safeguard procedures: to distinguish advisory from mandatory procedures; to strengthen managerial oversight of risk assessment; and to ensure that staff treat safeguards as an integral part of project design, rather than an impediment to project implementation. The Bank responded by accelerating revisions of some operational guidelines (for environment but not indigenous peoples), overhauling risk assessment, and improving managerial assessment. This was a mostly welcome swing of the pendulum (“rebalancing the matrix”), which had gone too far in the direction of decentralization. But some feel that the reaction has gone too far, leading to lengthy and costly safeguard procedures and to risk aversion. These concerns are captured in phrases such as the increasing “cost of doing business” and charges that Bank safeguards are no longer designed to make sure projects “do no harm,” but to “avoid any criticism.” The Bank has since avoided some politically sensitive components; for example, Xinjiang Province (with a majority Muslim population) was removed from an education project shortly after September 11, 2001. Whether this shows undue risk aversion or mere prudence will be controversial, but such issues must be confronted and debated openly as the Bank shifts its emphasis toward western China with its large concentration of minorities.

satisfactory, satisfactory, and marginally satisfactory. Rated by safeguard, involuntary resettlement was *highly satisfactory*, dam safety and indigenous peoples (minorities) were *satisfactory*, and environmental mitigation was *marginally satisfactory*.

- Risk avoidance is creating a “safeguard dilemma”—the minimum standard is gravitating toward “best practice” regardless of cost.
- External monitoring by local institutes typically suffered from insufficient candor and lack of explicit recommendations for action.
- Despite some excellent work on social assessment and mitigation planning, the Bank is also at times reluctant to risk offending the Borrower by directly raising issues relating to minorities. Social assessment is the weak point in project design and delivery.
- Management input to safeguard design and supervision was inadequate. At the time the report was prepared (in August 2000) sector managers had no responsibility for oversight, and line managers had rarely visited the six projects reviewed by the Panel, despite their size and importance (\$1.7 billion loan amount).¹⁸

The principal recommendation of the review was that the Bank should be more strategic in its approach to safeguards. In particular, sector and policy work is needed to provide a context for project development, and early involvement is critical. Safeguards should be seen as an integral part of development and project design and not as an

The Bank should be more strategic in its approach to safeguards.

Box 4.3**The Views of the Borrower**

Chinese officials, researchers, and representatives of civil society all agree that the World Bank has made an important contribution to China's development. The consistent theme in all comments, ranging from researchers and policymakers concerned with structural reform and macro policy issues to project officials at the local level, was that the Bank's main contribution has been in the realm of ideas—introducing new concepts, methods, and technologies to China. Innovations attributed to the Bank by the Chinese included economywide concepts such as the economic value of services and corporate governance reform; international development best practices such as feasibility studies, project appraisal, and international competitive bidding; and numerous specific technologies, new organizational methods, and training at the project level. In a Client Survey commissioned by the Bank in late 2002, more than half of all respondents said that transfer of new project concepts was either the greatest value or second greatest value of the Bank, and nearly half said that the Bank's knowledge was either the first or second greatest value. Financial resources and other contributions were seen as less important.

There are also a number of criticisms of Bank assistance:

- **Cost of doing business.** Projects take longer than they used to, and the World Bank is said to be slower and more demanding than the Asian Development Bank and bilateral

donors, for a number of reasons: overly stringent application of safeguard procedures; ambitious project objectives (for example, sector reform in railways) that slow preparation; project complexity due to unwelcome components (such as rural road components in highway projects); and limited Bank administrative budget, which leads to delays as the Bank seeks trust funds to carry out many of its core activities.

- **Loss of IDA** is seen as a severe constraint. Because of China's repayment system, poor provinces and social sector projects may be excluded from Bank projects if only IBRD terms are available. The initiative to blend DFID grants and IBRD is appreciated, but should be applied on a larger scale.
- **Inflexibility in adapting to China's unique circumstances.** A consistent theme in Chinese comments was that China is different from other borrowers and the Bank needs to adapt its advice and procedures accordingly. The Bank was slow to recognize China's growing sophistication and need for detailed and specialized AAA in the 1990s, though the relevance and effectiveness of AAA have improved significantly in the past three or four years. The Bank should show more respect for local capacity by using local consultants. China's standards on procurement and safeguards are high and often based on World Bank advice on international norms. The Bank should harmonize with local standards in these areas.

Source: Annex J.

add-on or a "cost of doing business" to be minimized. As noted previously, the Bank has since responded to concerns about safeguard issues by strengthening risk management and by providing a separate budget for thematic supervisions. These steps have improved quality-of-supervision assessment ratings, but more needs to be done to move safeguard planning upstream and enhance strategic focus through sector work and social assessments at the design stage.

There is a strong case for moving toward greater harmonization of safeguard procedures between the World Bank and China, rather than simply ring-fencing World Bank projects with the Bank's own procedures. Harmonization has already taken place in a number of areas.

China has more often adopted Bank standards than the reverse, but the Bank has accepted China's standards and definitions on resettlement and on indigenous peoples, where Chinese "minorities" are treated as equivalent to the Bank's "indigenous peoples" (see OED 2003a). Differences still exist in a number of areas—for example, applicability of resettlement provisions to illegal squatters, but further harmonization should be possible.

There have also been suggestions for devolution of responsibility for safeguard policies to China, but this would be premature. Experience with local preparation of environmental impact assessments shows some significant weaknesses in China's safeguard design and implementation: perspectives are too narrowly focused on compli-

ance rather than problem solving and on the project rather than the sector or region, including downstream areas; technical capacity is variable, though the general standard is good and improving; and technical evaluations are too often distorted or preempted by anticipation of adverse political consequences. Some provinces are closer to meeting implementation standards than others, and it should be possible to move gradually toward further devolution, but for the time being the Bank will need to retain ultimate responsibility for safeguards for reasons of competence, independence, and reputational risk.

Crosscutting Issues

How Should the Bank Deal with Politically Sensitive Projects and Issues?

Controversies such as application of safeguards under the Western Poverty Project pose difficult issues for the Bank. How can the Bank fulfill its obligations to borrowers and preserve its institutional integrity as a nonpolitical development institution? There are no universal rules that will avoid the need for case-by-case decisions in which a balance must be struck, but there are guidelines and lessons from experience.

- The Bank has a mandate to promote development in member states “with due attention to considerations of economy and efficiency

and without regard to political or other non-economic influences or considerations” (Article III, Section 5(b) of Articles of Agreement).

- As an international organization with development expertise, the Bank may be well placed to play a certification role on sensitive projects if the borrower and the board agree. The Three Gorges Project is a good example of the possibilities and limitations for the Bank in this role (see box 4.4).
- The Bank should not shy away from projects just because they are controversial, but neither should it place itself in a situation that risks its reputation as a nonpolitical development institution. In deciding whether to participate in controversial projects, the Bank must weigh its potential contribution against its reputational risk.
- Safeguards are a particularly important tool for risk management of controversial projects, but the Bank has to have the courage and independence both to call for studies and remedies it considers necessary and to resist ramping up standards and requirements unnecessarily.

Similar considerations apply to other politically sensitive issues, such as labor standards or insider privatization, where safeguards may not be applicable, but which have important social and economic implications and pose reputational risks. For example, the CAE mission was told in a visit to a factory where the Bank had supported severance payments for redundant

Box 4.4

Bank Involvement in the Three Gorges Project

The massive Three Gorges Project was controversial both inside and outside China, especially because it involved involuntary resettlement of 1.3 million people. At the request of the government, the Canadian International Development Agency financed, and the Bank supervised, a detailed appraisal of the proposed project. The appraisal report concluded that the first two stages of the proposed project would have a high economic rate of return, but that taking the project to stage three (to allow navigation from the sea to Chongqing) would have only a neg-

ligible effect on the rate of return while entailing resettlement of an additional 600,000 people. Based on these findings, the Bank stated that variants that only marginally raised the economic benefits while greatly raising the numbers of people to be resettled would be economically suboptimal and would require further studies if the Bank were to participate in the project. However, the government decided to go ahead with the full three-stage project. The Bank did not participate in financing the project.

Source: OED (2001).

workers that a group of remaining workers had been working 84-hour weeks for a lengthy period to complete export contracts. China's Labor Law limits monthly overtime to 36 hours. A Bank supervision mission followed up but was told that the CAE mission had misunderstood.¹⁹ When the Bank supports a project it should make special provision to monitor such issues both to protect its reputation and to provide a good-practice model. The Southwest Poverty Project provides a good example of what should be done. The project supported seasonal migration of young women to coastal factory jobs, but also arranged for preinspection of firms and monitoring of labor conditions. The Bank should go beyond best practice at the project level, however. It should use project experience as an entry point for ESW and policy dialogue on important issues of social protection.

What is the value added of the Bank's participation in infrastructure projects?

Responsibility for improvements in transparency, the rule of law, corruption, and other aspects of governance lies squarely with China, but the Bank can help by supporting institutional and policy changes that have proven effective in other countries. The Bank has long promoted changes in corporate governance, regulatory reform, and improvements in procurement practices to help reduce incentives for corruption. Notable activities in recent years include an economic law reform project, fiscal and financial sector technical assistance projects, training in procurement practices, and co-sponsorship of an international conference on "Economic Reform and Good Governance: Fighting Corruption in Transition Economies" (see World Bank 2003, Annex G). It is noteworthy that respondents to the Client Survey (Annex K in this document) gave high ratings for the importance and effectiveness of Bank support on the issue of corruption, but low ratings for the Bank's importance and effectiveness on judicial reform.²⁰

Has the Bank Overinvested in Infrastructure?

The share of infrastructure in the lending

program is slated to rise even further in the coming CAS period, though this will be a larger share of a smaller lending program.²¹ A number of arguments have been made in favor of concentration on infrastructure. The rate of return on infrastructure investments remains high. Infrastructure investment has a high payoff in growth and, when directed toward the poorer parts of China, in reduction of regional disparities as well. Infrastructure projects are generally low risk and, with the exception of hydro projects, relatively noncontroversial. Last but not least, it is a country priority.

The question is not simply whether infrastructure investment has a high return. It does. The critical question is, what is the value added of the Bank's participation in infrastructure projects? Through the early to mid-1990s the Bank contributed a measurable amount of incremental funding and a great deal to technical upgrading and improved efficiency. In recent years the dual-track approach of sustained lending involvement plus policy dialogue through AAA has also yielded important policy reforms in energy. In the future, there are likely to be diminishing returns from direct Bank involvement in projects because competitive procurement and other project management methods have diffused across China. Where these methods have not spread, the problems of the sector cannot be solved through retailing of Bank repeater projects, suggesting the need for broader institutional and policy reforms.²²

Selectivity and sector allocation gains added significance in the face of exposure constraints on the size of the lending program. When lending peaked at about \$3 billion in the early 1990s (two to three times projected lending in current dollars for the coming CAS period), the Bank decided, and China reluctantly agreed, to "graduate" the port subsector, recognizing that the Bank's value added would diminish in the future and that China could access technology directly from the private sector. More recently, the Bank has phased out of power generation projects. Because infrastructure projects can absorb an enormous amount of funds, a hard look is

needed at the value added of conventional highway and wastewater projects.

But what if these are what the client wants? China should, of course, have the ultimate say in what projects it borrows for. But if the choice is driven mainly by a self-imposed repayment system, it would be a pity. So far, the compromise has been to agree on projects that push the envelope through marginal policy or technical innovation in each project; but China will do itself a disservice, both in the value added it will receive from the Bank and in the effectiveness of its own projects, if it fails to make the necessary changes to enable it to finance its own low-risk projects and to diffuse already-tested techniques.

Should the Bank Rely More on Stand-Alone AAA?

The Bank's dual-track approach—lending to gain trust and detailed sector knowledge plus ESW to persuade the government on policy issues—has been broadly effective in many sectors. In agriculture, for example, ESW had stressed the importance of land contract reform, but projects were essential to work out some of the practical details of implementation and to demonstrate the effectiveness of contract reforms in practice. In the power sector, sector work introduced the importance of cost

recovery, corporatization, and unbundling generation and delivery, but projects (and project conditionality) were the means of “pushing the envelope” of policy change. But given the need for greater selectivity in lending, should the Bank rely only on AAA in some sectors? This is a high-risk strategy. It might work in energy, where Bank advice seems to be valued for its own sake, but would probably not do so in transport. Unfortunately, free advice is seldom valued, and governments are not always able to implement advice because of competing interests (as in the case of the fuel tax). Moreover, the Bank is unlikely to be able to sustain a program of stand-alone nonlending services. Even with the large infrastructure lending program in China, the resources devoted to sector work have been relatively limited. The Bank's comparative advantage in the advisory business is that it is not free; Bank support is tied to a lending program. It is in the Bank's interest, if it wants to be repaid, to ensure that the borrower is in a position to generate the necessary resources. Given that the money has to be repaid, however, countries are reluctant to commit to activities they do not perceive to be in their best interests. In any case, development is about both what to do and how to do it. The “how to” is the great strength of the Bank's project lending.



Evaluation of the Bank's Assistance

The performance of China's economy with respect to growth and poverty reduction over the past decade is without equal in the world. What has the Bank contributed to this performance? And to what extent is the Bank responsible for shortcomings in performance, such as growing inequality and continued environmental problems? These are difficult questions to answer because the Bank's program is small (and has been declining) in relation to China's overall economy. It would be presumptuous to think the Bank could take credit for the successes, or be held responsible for the failures, of such a large and dynamic economy.¹ Nevertheless, by focusing on the *value added* of Bank assistance and by addressing a series of smaller questions, it should be possible to reach some conclusions about the overall impact of the Bank's assistance.

Outcome of the Bank's Assistance

Overall impact can be assessed by considering the outcomes of the four main objectives of the Bank's assistance strategy and the relevance, efficacy, and efficiency of the program as a whole.

Relevance of Bank assistance. The Bank's assistance strategy and activities have been relevant in the large, if not always in the small, context—at the broadest level of strategic focus and allocation of resources, the Bank has done the right things. The four main Bank objectives—promoting system reform and better macro management, poverty reduction, infrastructure development, and environmen-

tal protection—have helped address China's most pressing development issues. The gradual shift of emphasis toward poverty reduction and environmental protection has also been in the right direction, though the Bank was sometimes slow to recognize the importance of issues such as growing inequality and vulnerability, intergovernmental fiscal problems, and the need for better coordination of environmental policy and WRM. Within some activities, such as the financial sector and enterprise reform, the relevance of Bank advice waned during the mid- to late 1990s, though in the financial sector the Bank has embarked on a promising reengagement. Relevance at the

level of sector or regional allocation or the choice of project components has always been constrained by the project repayment system. Projects were often skewed toward components that generated revenue, sometimes at the expense of higher-return public goods components. With the loss of IDA, Bank lending for social sectors and poor regions has become increasingly constrained. Blending IBRD loans with bilateral grants can ease these constraints, but not eliminate them.

Efficacy of Bank assistance. The Bank's record on efficacy—doing things right—has been mixed. Project implementation has been excellent in most sectors, but efficacy also depends on achieving policy and institutional change within sectors and on achieving coordination across sectors and levels of government for crosscutting objectives such as poverty reduction and environmental protection. Bank strategy has been to rely on a dual-track approach, in which policy and institutional change depend mainly on persuasion through AAA combined with piloting incremental changes through projects. This has been successful in some areas (power sector and social security reform), but less so in others, particularly in areas that primarily depend on the demonstration effect of projects at the local level. Similarly, the Bank has been more effective on coordination where there is a high-level government coordination body (such as the LGPR, SEPA, and the erstwhile SCORES).

Efficiency of Bank assistance. OED normally measures efficiency by the cost of lending, supervision, and ESW per approved project, per \$1,000 of net commitment, and (more refined yet) by cost per dollar commitment of satisfactory projects. By all these measures, the China program scores well (see Annex R, table R.6). Two qualifications are in order, however. First, the government has complained about the high cost of doing business with the Bank, both in comparison with other donors and compared with earlier periods for the Bank itself. The Bank clearly needs to balance the costs and benefits of safeguard studies at the project level and find more systemic ways of addressing safeguard

issues (such as thematic supervision, which is under way). One measure of efficiency, elapsed time for various stages of lending, shows no trend, but this is an issue that needs further investigation. The second qualification is that the low cost of the China program may actually represent inadequate allocation of resources. The budget allocation for AAA, particularly sector work, declined during the late 1990s and certainly seems to have been inadequate to carry out the dual-track strategy. The recent budget increase for ESW may change this. More generally, the China program seems to have become increasingly reliant on trust funds to finance many of its activities. The Bank sees the use of trust funds as a way to leverage its scarce administrative budget, but the borrower sees this as a source of delay and uncertainty.

Overall outcome is based on the outcomes of particular objectives and on the relevance, efficacy, and efficiency of the Bank's assistance. *Outcome of Bank assistance to China is rated satisfactory.*

Sustainability of Positive Outcomes

Reform and institutional change in China have been gradual, but once changes have been made, they are rarely reversed. Sustainability of completed projects in China was rated likely or highly likely for 84 percent of net commitments during 1993–97 and 94 percent during 1998–02. This is well above the Bankwide average (56 percent and 73 percent, respectively, for the two periods) and higher than large-country comparators. The main risks to sustainability are a financial crisis, external shock, or social instability leading to an economic slowdown. Even a slowing of the growth rate could put poverty reduction at risk, given that poverty reduction has slowed or stagnated with an 8 percent growth rate in recent years. In spite of these risks, *sustainability is rated likely.*

Institutional Development Impact

The institutional development impact (IDI) of Bank projects in China was rated substantial for 46 percent of net commitments on projects completed during 1993–97, rising to 84 percent

during 1998–02. Performance of the China portfolio was marginally higher than the Bankwide average (36 percent) during the earlier period and substantially higher than the Bank average (50 percent) and comparator countries during the latter period. The review of institutional development impact by sector and objectives showed a mixed performance. Bank impact on project management, procurement procedures, and capacity building has clearly been substantial at the project level, though there are questions about how widely these institutional developments have diffused, particularly across provincial and lower-level boundaries. Bank encouragement of citizen and community participation in decision-making (through water user associations, consultations on project designs, and the like) seems to have had some impact beyond the Bank's own projects. At the ministerial or individual organizational level, the impact has also been substantial (for example, for the separate transport ministries or for SEPA), but the impact of projects involving coordination (for example, water basin management or integrated rural development) seems to have had limited impact beyond the particular project. At the macro and sector level, IDI has ranged from modest to substantial. At the micro or project level, IDI has been improving and in recent years has been substantial. Overall, *institutional development impact is rated substantial*.

Bank Performance

To what extent can China's development outcomes be attributed to the Bank? It would be hard to argue that Bank assistance has made China worse off in any way, but apportioning attribution for successes is difficult. China's own efforts, along with advice and support from many sources, mean that most of China's successes are "overdetermined." The main strength of the Bank has been its sustained support of an activity

or program over a number of years. Because of the Bank's long-term involvement, it has been able to have a substantial cumulative impact in a number of areas, its views have gained a respectful hearing, and it has sometimes been well placed to take advantage of opportunities when China was looking for support for change. Bank performance has varied across sectors and over time, but the Bank has made a positive contribution in a large number of areas. In the Chinese context, the Bank is relatively small, but it has punched above its weight.

One case of poor Bank performance should be highlighted—the handling of the Western Poverty Project, which led to the Inspection Panel investigation. Unfortunately, the repercussions of the Inspection Panel continue. The Bank still sometimes fails to get the right balance between development objectives and protecting against reputational risk.

Could the Bank have accomplished more if it had been more ambitious or aggressive in pushing its own agenda? That seems unlikely. China clearly values the Bank more for its advice and knowledge of international experience than its money, and the Bank could not have expected to achieve more through conditionality than through persuasion and demonstration. Demonstration has generally worked well when the partner agency had the authority to diffuse good practice and less well where authority was fragmented. Persuasion could have been better in some cases. The Bank has sometimes toned down its advice in anticipation of what it believes to be politically acceptable.² China would, in fact, be better served by more candid expression of Bank views.

On balance, the Bank has performed well in China, and overall *Bank performance is rated satisfactory*.

Reform and institutional change in China have been gradual, but once changes have been made, they are rarely reversed.



Lessons and Recommendations

China's experience offers lessons for other countries, as well for future development efforts in China. This chapter first addresses lessons learned and then makes recommendations on the repayment system, improving ESW, and improving performance of Bank lending.

Lessons

Lessons from China's Experience for Other Countries

Too much has been made (by the Bank and others) of China's exceptionalism and the inapplicability of China's experience to other countries. The Bank should make a systematic effort to analyze and disseminate lessons for other countries from China's experience. The 2004 Shanghai conference on lessons of poverty reduction was a commendable step in this direction. Some of the important lessons from China are:

- *China's reform experience is relevant for many countries.* China's gradualist reform strategy has often been portrayed as irrelevant to other countries because of its unique characteristics, such as a large agricultural sector. If the economic system has broken down, the only option may be to pursue radical reform, as China did with the dysfunctional commune system, but the main lesson of Chinese

experience is the importance of pursuing reform before systemic collapse.

- *Reform will be more sustainable if sequenced to protect potential losers during the early stages.* Mechanisms such as China's strategy of growing out of the plan or using transitional dual pricing may not be applicable in other countries, but the principle of using gradual changes to reduce opposition and build a constituency for further reform is important.
- *China's policy of beneficiary repayment has been an important factor in promoting strong project implementation and ownership.* Yet overly strict application of the principle creates problems of its own (see discussion below). China and other countries have much to learn from each other on this issue.

China has always been receptive to lessons from other countries, especially newly industrializing countries and other success cases. In its aspiring role as a "knowledge bank," the Bank should increase its effort to learn and disseminate lessons from China, as well as for China.

Broadening the Dialogue

The Bank's dual-track approach of building trust and supporting new techniques through lending while promoting policy reform through AAA has been broadly effective. But there are a number of important areas—poverty, water, health, agriculture, and rural development—that have issues that need to be discussed at a higher or more inclusive level than the ministerial or regional project counterpart. Progress in reducing poverty and inequality, for example, depends on addressing weaknesses in the intergovernmental fiscal system. Finding an appropriate counterpart, especially for complex issues that require sustained effort rather than stroke-of-the-pen decisions, is a major challenge for Bank assistance strategy.

Implications of a Smaller Lending Program

With a smaller lending program, the Bank's impact in China will depend more than ever on effective persuasion and demonstration. This implies that the Bank should:

- Be more innovative in project selection and design.
- Pay more attention to monitoring and evaluation and to dissemination of project lessons.
- Rely more on systemic or policy changes than on replication of projects.
- Systematically evaluate projects in terms of the Bank's value added.
- Review personnel policy to ensure that teams have the right balance of China knowledge and relevant up-to-date experience from other countries.

One option that should be used sparingly is stand-alone sector work. In general, there are important synergies between ESW and lending.

Importance of Candor and Openness

The relationship between China and the Bank has generally been based on working on an equal footing, mutual respect, and persuasion, rather than conditionality. This has served both China and the Bank well and could provide an example for the Bank's relations with other

countries. In particular, working on an equal footing has promoted gradual but sustainable reform and mutual learning. But much greater candor and openness are needed on both sides. For example, more collaborative ESW could have a high payoff, but China needs to provide access to data and knowledgeable sources, and the Bank needs to be more willing to speak frankly and openly about problems and policy options. In the banking sector, for example, China has been reluctant to share data on nonperforming loans, which have emerged as a major problem. But when the Bank was allowed to study four bank branches and found an emerging problem, it did not pursue the findings with relevant officials. In the *Air, Land, and Water* study (2001), the Bank was rightly criticized by the Quality Assurance Group (QAG) for not discussing organizational issues and options more forthrightly in the summary report. One Chinese researcher remarked that the Bank is "too polite" to be effective. The Bank should not strive to be impolite, of course, but speaking hard truths serves China better.

Recommendations

Repayment System

China's repayment system is the source of both the greatest strength and the greatest weakness of World Bank project performance in China. Its strength is that beneficiary repayment focuses attention on project detail and builds ownership. This is something other countries could learn from China. Its weakness is that the system biases the allocation of project funds against poor regions and public goods whose benefits are widely dispersed and generate no revenue. Blending bilateral grants and IBRD loans can overcome the constraint on a case-by-case basis, but this is cumbersome and has no effect on the overall concessionality of foreign assistance. China could get the best of both worlds by retaining the principle of beneficiary repayment, but differentiating repayment terms by ability to repay and by sector. The government operates a limited version of such a system for its domestic fiscal

transfers, but refining the system and applying it more widely to externally funded projects would improve the efficiency and equity of public investment allocation.

Improving ESW

There are several ways in which the Bank's ESW could be made more effective:

- *Focus more on China, less on international experience.* The Bank has given too much emphasis to lessons of international experience and too little to analysis of the Chinese economy. Lessons of international experience should remain an important part of the Bank's work (though perhaps more through WBI than ESW), but the relevance should be tested against China's problems and experience. Policy advice should also be grounded in analysis of the Chinese economy rather than being based solely on international experience. Finally, analysis of China's problems and accomplishments would help the Bank draw lessons from China's experience for other countries.
- *Broaden the audience.* In the early days of China's reform, the Bank sought especially to influence senior policymakers. As the agenda has moved from broad concepts to implementation and problem solving, the Bank should try to promote and participate in a much broader debate on policy and sector issues, not only among officials, but also among researchers and other stakeholders. Bank ESW can help ensure that this broader debate is grounded in analysis. The Bank still has a role as confidential policy adviser, but its long-term impact may be greater as a participant in policy analysis before a broader audience.
- *More collaborative work would enhance effectiveness.* The latest environment report (World Bank 2001), done in collaboration with SEPA, is a good example of the advantages to be gained in access to data, understanding of local conditions, and ownership of recommendations. More collaborative work would help broaden the policy dialogue among researchers and officials and facilitate Bank contacts with a new generation of scholars. The

Bank has been moving in this direction, but perhaps not fast enough.

- *Carry out more sector work.* ESW on China is under-resourced. The effect is most apparent on sector work. It is unusual for there to be no work on an important sector, but in several sectors new work is needed to take stock of progress and problems and to lay the foundation for better policy dialogue and new directions in lending.

Portfolio Management

There has been no CPPR since 1996. The China Department argues that CPPRs are too unwieldy and costly to use in a country with such a large portfolio and that instruments like thematic supervision are more effective. Nevertheless, we recommend revisiting the possibility of having another CPPR after more experience is gained with thematic supervision. We also recommend that a full-time portfolio manager be appointed to help follow up on systemic issues and facilitate cross-fertilization among project teams and sector units.

Safeguards and the Cost of Doing Business

While safeguards will remain a cost of doing business with the Bank, finding more efficient ways of implementing them and strengthening the systemic use of safeguards in China is possible within the constraints of existing policy. Much could be done to further harmonize procedures and perspectives, while developing China's capacity for technically competent and independent environmental safeguard management. More sector work, such as Sector Environment Assessments, would provide a broader context for project EIAs. Doing the work collaboratively would help develop China's own capacity. Continuation of thematic supervision will also broaden perspectives, lower costs, and build long-term capacity. Within China, use of a tiered system of evaluation, in which experienced Chinese research institutes from coastal areas collaborate with and monitor less experienced institutes in central and western China (analogous to the relationship between international and Chinese groups in conduct-

ing EIAs), could promote diffusion of methods and skills throughout China. Finally, introduction of more participatory and publicized safeguard methods could strengthen the independence of Chinese experts and broaden the debate on environment and other safeguard issues.

New Directions in Infrastructure

The Bank should not rely only on ESW in infrastructure, nor should it retreat into peripheral activities such as renewable energy. At the same time, it should not simply continue a large lending program devoted to expanding the supply of infrastructure into new regions of the country. Rather, it should try to move into relatively neglected, but mainstream, areas of lending and expand the sector work to provide the analytical base for lending and policy dialogue.¹ In energy, potential areas include gas, where the Bank could play a catalytic role in creating an environment for the private sector, and electric power distribution, where China could learn a lot from international experience. The time might also be right to try again to interest the government in Bank assistance for coal, where there are a number of important issues of technology upgrading, environmental protection, cross-sector coordination, and enterprise reform. In transport, one strategy for the Bank would be to support the needed highway investments by becoming a partner in a road fund or funds that would draw on a fuel tax for most of its revenues. This would allow the Bank to wholesale its practices in highway

construction and, more important, place the Bank in a position where it could influence the overall resource allocation decision on what is to be built, as well as where and when. The Bank's experience in highway design and network construction would be spread over a large program and contribute substantial value added to transportation in China. Other suggestions are given in the three background papers on infrastructure (Churchill 2002; Churchill and Thum 2002a, b; see also Annexes D and H).

Poverty Lending

The Bank's poverty-targeted lending has been effective and offers useful lessons (see box 3.2), but direct lending for poverty reduction is not necessarily the most expedient or effective approach in each sector. This is particularly true in the case of infrastructure, where investment is essential for growth and benefits widely distributed across all income classes. The Bank, for example, may contribute more to poverty reduction through the road sector by lending for highways than for feeder roads. It may make more sense for the Bank to confine feeder road lending to integrated rural poverty projects than as components of highway projects. However, in the case of electric power, improved distribution systems will have a major impact on lower-income groups, but if these groups become the exclusive target of this lending, the benefits will never reach them as they will be preempted by commercial and business interests, as well as higher-income groups.

ANNEX A: SUMMARY: ANALYTICAL AND ADVISORY SERVICES BACKGROUND PAPER

When the World Bank began its operations in China in 1982, Chinese policymaking was hindered by significant ideological debates. The government directly controlled the prices of almost all industrial inputs. It controlled distribution through planned allocations and a variety of quotas.

Since then, the Bank has contributed to China's policymaking, reform efforts, and development through research and advisory activities, as well as project investment and technical assistance. After exerting considerable influence throughout the 1980s, however, the Bank's role waned during the 1990s. Have China's economic advances and the growing skill of its own officials, economists, planners, and analysts made the Bank's advisory and analytical services less important? Or do the Bank's service modalities and methodologies need correction?

The Role of the World Bank in China's Reform and Development Processes

To ease China's transition to a modern market economy in the 1980s, the government practiced "incremental reform," retaining the planned allocation structure while allowing some activities to adopt the market system, with prices determined by the market and producers getting the lion's share of revenues. The government decentralized local finance, introduced two-tiered pricing, made rural households responsible for production, and entered into contracts with state-owned enterprises (SOEs) in urban areas. Together, these changes spurred the rapid

growth of markets and of the economy as a whole.

During this period, the World Bank's analysis of China's situation laid the foundation for comprehensive policy research. *China: Long-Term Development Issues and Options*, published in 1985, was a particularly important and influential country report. It forecast China's economic growth, affirmed the possibility of rapid growth, and provided policy analysis and recommendations on several key subjects:

- Structural adjustments, system reform, and social policies during economic growth
- Development of infrastructure and service sectors such as education, agriculture, energy, transportation, and urbanization
- Reform of SOEs
- Pricing reform
- Creation of accounting and legal systems meeting international standards
- Social policies, including social security, housing, social services, population, and rural poverty.

China adopted as government policy many of the report's recommendations on economic development. For instance, sectors such as agriculture, education, energy, and transportation became development priorities. But other recommendations, such as SOE reform and social security reform, failed to get the attention of the Chinese government until the need became pressing, whereupon the recommendations were added to the government's agenda one by one.

This is a summary of the CAE Background Paper, "Evaluation of the Effectiveness of the World Bank's Analytical and Advisory Services in China Since 1990," by Lu Mai, Secretary General, China Development Research Foundation.

The burgeoning market economy helped China double its GDP in the 1980s. The Chinese government pressed its advantage with dramatic economic reforms in the 1990s. Significant among these reforms were (a) reforming macro-economic management in order to integrate the two-tiered economy (particularly on fiscal, taxation, foreign exchange, and pricing issues), (b) reforming the inefficient state-owned economy, and (c) reforming the social security system.

The Bank's considerable impact on Chinese government policy during the period of incremental reforms can be attributed to several factors. The Bank worked cooperatively and respectfully with the Chinese government, building and maintaining effective channels of communication to key Chinese officials. In the 1980s, the chief representatives of the World Bank Beijing Office had friendly personal relations with the leaders of the Chinese State Council and many ministries and commissions. In the 1990s, some crucial researchers who had always had good working relationships with the Bank were promoted to ministers or department directors in the government.

Bank studies and recommendations were based on a sound knowledge base and ongoing experience and supported China's incremental reform model. The Bank was able to transform its research findings into concise policy recommendations in response to clearly defined policy needs from the Chinese leadership. This is important because, although China's reform process is gradual, the government maintains a long list of development topics; successive topics usually present themselves as urgent needs.

Issues of Concern

Despite these successes, the influence of the World Bank's policy research diminished in the 1990s as resources were devoted to research reports that failed to get leaders' attention. The reasons for the dwindling of influence are manifold.

- China developed substantial capacity to perform its own theoretical and policy research.
- The reform process in the 1990s became much more difficult because it directly affected strong vested interests. While the suggestions from

World Bank experts were correct in many cases, the Chinese government has found them very hard to adopt because of various political constraints.

- Because it has not been able to isolate the factors behind its earlier successes, the Bank in some cases has proved unable to deploy its strengths effectively.
- The Bank's research findings are not published in formats that are well suited to most Chinese audiences. Few Chinese read its lengthy research reports because Chinese translations appear after a long lag.
- Since the 1990s, the World Bank's research in China has been insufficiently forward-looking. The Bank has failed to focus on developmental issues with significant implications for China's development prospects, such as urbanization, education, and urban transport. In contrast, it has devoted disproportionate efforts and resources to the issue of SOE reform. A related problem concerns the gap between clearly identifying actual policy research needs and supporting what may be a totally different set of priorities articulated by the government.

Recommendations

World Bank project loans and policy research have been closely related in China—to good effect. But with the elimination of soft loans and the reduction in project loans, policy research has decreased in volume and significance. If the Bank wants to retain its influence on China's future reforms and development, it should adjust its research and analysis services. Among the recommended adjustments are the following:

- Expanding networks and channels for policy research so that when a current group of Chinese collaborators is promoted or retired, a new network is ready to take its place.
- Identifying current and future needs through proactive collaboration with Chinese researchers and specialists in various government agencies who could define needs and make suggestions in key research fields, as well as assess the Bank's reports from the perspective of Chinese experts.

- Formulating improved output and delivery formats for reports so that recommendations focus on the one or two most important findings. Proposals of no more than 3,000 words could be released separately and periodically (possibly 20 times per year) and circulated within the Chinese government. This approach could achieve a stable and loyal readership.
- Strengthening the studies of China's fundamental conditions in cooperation with Chinese experts, following the model of the World Bank surveys that shed so much light on the changing Chinese economy and society in the late 1980s and early 1990s.
- Upgrading the training of Chinese policy researchers in government, academia, and non-profit organizations. The World Bank should continue its efforts to provide support and assistance to the capacity building effort of Chinese research institutions by offering personnel training and short-term study tours.

Changes in the Agricultural and Rural Sectors

Like most of China, the agricultural sector changed significantly between 1970 and 2000, both demographically and economically. Agriculture slipped from 40 percent of China's economy to 16 percent, as industry and services advanced. The share of the population engaged in agriculture shrank from 81 percent to 50 percent; the population share living in rural areas declined from 83 percent to 64 percent. Even so, in 2000, the rural economy still employed 475 million people, with 347 million working in agriculture and 128 million in town and village enterprises. Historically tightly regulated, insulated, and protected, the agricultural sector is increasingly subject to market forces, the pressures of internationalism, shifting government policies, and changes in technology and consumer preferences. Rural enterprises now provide more diverse employment opportunities and an important source of income for rural and agricultural workers. A demand in urban areas for more diverse foods is widening opportunities for farmers to join China's dynamic domestic economy, although improved ways to market their products are needed.

But prosperity is not equally spread throughout China, nor has the agricultural sector shared in the wealth of industry and commerce. Incomes in urban areas are 2.7 times those in rural areas. Some provinces are remote, poor, and largely unconnected to the modern Chinese economy. In other provinces, high levels of prosperity coexist with equally high levels of rural poverty.

China has recognized this problem, and the Bank can provide new perspectives on how to solve it.

Challenges for Rural China

The focus of Chinese agriculture for decades was national self-sufficiency. To this end, the government regulated what was grown, with an emphasis on grains. A government monopoly still controls the grain market, but farmers are changing the rural output mix in favor of commodities not subject to price or market regulations, such as oilseeds, fruit, meat, and fish. Consequently the share of these products in agricultural output has risen rapidly, while the share of output sold at regulated prices has fallen—from 76 percent in 1980 to 56 percent in 2000. These shifts are driven by changes in demand, by policy, and by attempts to find loopholes in policy.

Shifts in the mix of agricultural output and in agriculture's share in national output and employment are typical of the structural changes that occur with growth in an economy at China's stage of development. However, challenging the process of change are conditions specific to China and China's policy choices to date. These conditions and policy choices are the basis of the challenges confronting rural China that will guide the priorities in the Bank's program of assistance to China. The most prominent issues that appear to concern policymakers include the following:

- A focus on product quality, rather than volume, to meet shifting consumer tastes, and an explicit shift in public discussion of food security to reflect this change

This is a summary of the CAE Background Paper, "World Bank's Assistance to China's Agriculture Sector," by Christopher Findlay, Professor, Asia Pacific School of Economics and Government, Australian National University.

- Less reliance on collectively owned township and village enterprises, which tend to be specially favored and inefficient, and more reliance on true private enterprises
- More interest in trade in food—not only food imports but also exports and access to markets for exports—again leading to a different perspective on food security, including an appreciation of product values and input costs and a reappraisal of China’s strategy with respect to the World Trade Organization’s Doha Round
- Continuing pressure for reform of domestic grain marketing systems to capture, through comparative advantage, more gains from the internal trade in grain and to facilitate adjustment to WTO commitments in the grain sector
- Removing impediments evident in markets for farm inputs and services that restrict farmers’ ability to respond to opportunities and to adjust production in the face of new competition
- Reform of rural finance markets to help farmers and rural entrepreneurs improve their operations
- Better infrastructure for agricultural product markets, especially logistics and multi-modal transport, to enhance trade and income growth, particularly in poor areas
- Redressing the growing imbalance in income distribution between rural and urban residents and the large gap between prosperity and poverty in rural areas
- Removing impediments to internal migration and relaxing other rural labor regulations, with implications for the management of markets in agricultural inputs, especially land; for the management of poverty programs; and for diversifying farmers’ income sources
- Greater focus on environmental constraints that limit the sustainability of Chinese agriculture and rural enterprises and threaten further degradation of water, soil, and other natural resources
- Correction of incentives in the national public finance systems that appear to be widening disparities rather than narrowing them
- Reform of financial and bureaucratic arrangements that prevent local and inter-regional funding and development strategies.

Policy change can be expected to respond to the pressures associated with the foregoing issues, as China’s experience with grain market regulation and the household registration system suggests. But a body of knowledge about policy options and their impacts is critical if policy-makers are to choose and implement policies that promote growth and reduce poverty.

Review of World Bank Assistance Strategy

World Bank lending is large in absolute terms but small relative to capital inflow into China. The World Bank has made the case for continuing to lend to China, observing that foreign direct investment (FDI) has tended to exaggerate regional disparities and has not met the need for public investment in essential sectors. Priorities in the Bank’s program—poverty alleviation, health, education, natural resource management, the environment, and urban development—have had a low priority in FDI flows, whereas Bank projects have piloted innovative approaches to areas of need, catalyzed repeater projects that demonstrated sound policy principles, and helped to build institutions necessary to complete structural reform.

The 2002 country assistance strategy (covering the period 2003–05) contains several goals relevant to agriculture and the rural population. It builds on a broad strategy that includes improving agricultural practices, upgrading marginal land, improving township and village enterprises, boosting employment and productivity, and paying more attention to lagging inland regions. Improvements to agricultural productivity growth are expected to come from changing the mix of output, strengthening land property rights, investing in irrigation, reforming water resource management, reforming systems of fees and taxes in agriculture, engaging more private sector participation, and improving transport and market infrastructure. Rural development programs will reflect key themes of the Bank’s program for transition to a market economy, assistance to disadvantaged people and regions, the rural-urban transition, and sustainable development.

Over the next two years, assistance priorities will shift further from direct interest in produc-

tion to poverty alleviation, natural resource management (with special attention to water), revitalizing agricultural research and extension programs, and environmental sustainability. The overall interest in moving toward a market economy remains. The changes in the portfolio of projects are consistent with the new priorities identified above. However, how project implementation proceeds will depend on whether China focuses on narrower or broader interpretations of economic development: Will efforts focus on rural areas in general or agriculture in particular? Should the goal be to bring prosperity to the countryside or to facilitate the migration of the rural poor into the cities?

Review and Further Questions

The biggest issue remains the system of subnational finance and the incentives it creates in project selection and design. The consequence of this system is that the Bank's contribution to public goods is being driven by its participation in the production of private goods. Ideally, the interaction should be in the other direction. The origins of the current circumstances are understandable, given China's public finance system, but this orientation leads to a bias in the portfolio and to problems in project design, implementation, and evaluation. It has also raised demands on Bank staff and crowded out the private sector.

In order to achieve the goal of participation in projects, the Bank tends to be drawn

into provincial-level activity. The sensible approach to poverty reduction, involving an integrated set of activities, then leads to large, complex projects requiring a high degree of micromanagement, thus exposing the Bank to significant risk.

The responses to this situation include continuing work to anticipate pressures for change in the three key areas of grain marketing, labor mobility, and public finance; to deliver a steady flow of ideas about policy innovation; and to ensure, through project design and evaluation, that public goods, including capacity and institution building, are not underrepresented in the portfolio.

The fundamental issue is the degree to which World Bank projects focusing on agricultural production boost the welfare of the poor in rural China and the economies of the regions in which they live. Although the Chinese government has recognized the need to address poverty in rural areas, it has traditionally used World Bank loans for projects that will quickly generate income to repay the loans. This has distracted attention from a focus on building institutions, economic capacity, health, education, and other social lending of the sort that benefits the rural population over the long term. Integrating such lending into the Chinese development strategy will require a shift in Chinese domestic economic policy and new ways of approaching and managing change.

ANNEX C: SUMMARY: DECENTRALIZATION BACKGROUND PAPER

Evaluations by Bank staff, borrower representatives, implementation agencies, and non-governmental organizations (NGOs) have shown that decentralization has had a positive impact on the Bank's effectiveness and efficiency since some functions were decentralized to the Resident Mission in China (RMC) after 1997. The presence of project staff in the RMC, many of whom speak Chinese, has helped (i) resolve project problems promptly, (ii) speed up transaction times, (iii) enhance the Bank's appreciation of the local situation, (iv) facilitate local capacity building through regular training and other support, and (v) build long-term relationships and trust by virtue of continuous presence in the community. Several improvements were made possible by the Bank's presence in Beijing, including the following:

Project Management. With portfolio tasks being managed in Beijing, increasingly by Chinese staff, RMC staff have spent more time within immediate reach of project staff, solving problems in real time and engaging in almost continuous supervision. Also, the persistence of Bank staff in the RMC has led to positive changes in project design, implementation, and procurement.

Public Procurement. The borrower consistently cited the Bank's role in public procurement as a major contribution to China's development. RMC staff helped prepare the National Public Procurement Law of 2000. It also played an important role in drafting standardized bidding documents for Bank projects in the early 1990s.

Disbursement and Financial Management. Financial management staff and disbursement staff are interchangeable in Beijing, streamlining their speed and effectiveness. Withdrawal applications are now all processed in Beijing; the requisite forms and supporting documentation are digitized and sent electronically; the service standard for processing applications is now 10 days; and financial management assessments for projects under appraisal and oversight of financial reporting and audits have increased. (About 220 project audits and 50 trust fund audits are reviewed every year.) The RMC is helping the Chinese National Audit Office adopt auditing standards in line with Bank and international norms.

Beneficiary Participation. The Bank has promoted the engagement of stakeholders in the design and implementation of development projects, notably in the creation of water user associations and in stakeholder consultation, through techniques such as rapid rural appraisal.

Safeguards. The Bank's safeguard policies have helped the Chinese improve the content and application of their own environmental and social safeguard policies. The Bank and RMC staff are supervising the implementation of Environmental Action Plans and Resettlement Action Plans, unlike many Chinese agencies (and even other donors). With two notable exceptions—resettlement of illegal squatters and the definition of indigenous peoples—there has been an increasing acceptance of the Bank's policy standards and practices. Environmental policies are

Annex C summarizes the CAE Background Paper, "Impact of Decentralization," by Daniel Ritchie, Consultant.

now more or less synchronized with the Bank, even though the definition of what constitutes a significant impact continues to vary. Possibly the most significant contribution by the Bank is in the application of the policies.

ANNEX D: SUMMARY: ENERGY BACKGROUND PAPER

China is now the second largest energy consumer in the world. The country's energy intensity is about 60,000 BTU (British thermal units) per dollar of GDP, three times the world average and twice that of all developing countries. It generates more than 300 gigawatts, making it both the world's second largest producer and second largest consumer of energy. Industry accounts for as much as 75 percent of total energy consumption, and although conservation efforts over the past two decades have resulted in more efficient consumption, household use (10 percent in 1999) is growing fast with recent improvements in the standard of living. Nationwide, although service is of uneven quality, rural access to electricity is high: about 96 percent of the nation's villages and about 80 percent of rural families now have access to electricity.

Three prominent issues in China's energy sector are the use of coal, management of electric power, and efforts at energy sustainability that include improving efficiency, conservation, and developing renewable energy.

Coal. China is the world's largest producer and consumer of coal. It is, in the foreseeable future, largely energy self-sufficient, although crude oil imports have increased steadily since 1993. Coal also presents problems concerning infrastructure issues of transportation and distribution, air pollution and health, and the efficiency of the technology used to burn coal (in power plants, as well as households).

Electric Power. The sheer size and the level of growth in China's power sector have been very

impressive. However, its institutional structure is complex and inefficient. The tenth five-year plan (2001–05) continues a number of ongoing institutional and organizational reforms: completely separating the distribution network from generation; restructuring both generation and power network enterprises; establishing competitive and open regional markets; and developing efficient management throughout the electricity chain, including generation, transmission, distribution, retail tariffs, and environmental protection.

Sustainable Energy, including Conservation, Efficiency, and Renewables. China has one of the world's largest renewable energy programs, with 20 gigawatt small hydropower and large-scale installation of improved woodstoves and biogas plants. The tenth five-year plan emphasizes renewable energy as an important measure to reduce the power sector's use of coal in the medium to long term and to provide energy services to remote rural households.

The Bank's Energy Sector Assistance Strategy

Between 1983 and 2002, China has been the Bank's largest borrower in the energy sector, with about \$7 billion in loans, and energy is about 20 percent of the Bank's total lending to China. Electric power received the most (86 percent), followed by oil and gas (10 percent), energy efficiency and renewables (2 percent), and coal (2 percent), with substantial analytical and advisory services. The sector also received \$90 million in Global Environment Facility grants

Annex D summarizes "World Bank Assistance for China's Energy Sector," by Anthony Churchill and Cordula Thum, Consultants.

through the Bank. Nonetheless, given the sector's sheer size, the Bank is a relatively marginal financial player in China's energy sector (less than 5 percent). And the Bank has had only limited involvement in the subsectors most critical to China's energy strategy—coal and petroleum.

The Bank's activities have progressed from helping China integrate into the global economy and build an energy infrastructure that supports the country's accelerating economic growth to developing the institutions, practices, organizational and market reforms, and environmental and resettlement programs to make China's energy system equitable, efficient, and sustainable.

After a period of significant loans during 1983–98, there has been a dramatic decrease in overall energy lending. Only four energy loans were made in the period FY99–02. Three loans totaling US\$420 million were made during FY99–00, but only one loan since then, for US\$10.5 million, in FY04. This is a shift from financing major capital projects to organizational and market reform programs. In the past two years, the establishment of a competitive power market in Zhejiang Province is an example of effective AAA, and the Hubei Hydroelectric Project (2002) is a model for technical assistance, providing lessons on reforming electricity generation, distribution, trade, and management.

Efficacy of Bank Projects: Performance and Outcomes

Completion and Supervision Ratings. The record of completed energy and energy-related projects is comparable to the transport sector: 6 were rated highly satisfactory; 4 were rated marginally satisfactory; none of the 20 projects had an unsatisfactory outcome; and one project was not rated.¹ Sustainability was rated likely for all but one project (the Daguangba multipurpose hydroelectric project, which was rated uncertain). And institutional development impact was rated substantial or high for all but three projects (the Daguangba, Changcun Mining, and Fertilizer Rationalization projects, which all had a modest rating).

An assessment of the Bank's impact in a country like China needs to go beyond the immedi-

ate achievements of Bank projects, which ultimately account for only a minute portion of overall sector investments. In this respect, the Bank's strategy from 1985 to 1993 was highly relevant to the sector's needs and consistent with the Bank's support of China's gradualist approach to economic reform. Most projects had minimal policy content, but they all shared a strong emphasis on technology transfer and capacity building. Projects were targeted to maximize their demonstration value to the rest of the sector, with benefits to be gained from modern technology and management methods, international procurement, and good resettlement practices. These early physical and institutional achievements were fully sustainable and paved the way for the more ambitious policy reforms of the mid- and late 1990s.

The outcome of the Bank's energy assistance program since 1994 is rated satisfactory, its institutional development impact substantial, and its achievements sustainable. The Bank's power sector strategy continues to be highly relevant and is supported by the government's stated commitment to reform. However, the Bank needs to renew a dialogue on the critical coal and petroleum sectors, where reform has been lagging, and on promoting an integrated approach to energy planning. Bank performance during the period is rated highly satisfactory, while borrower performance is rated satisfactory, with excellence in such aspects as resettlement, sustained commitment to energy efficiency, and renewed promotion of renewables, offset by weaknesses such as lack of effective sectoral coordination at the central level, slow pace of power tariff reform, insufficient enforcement of environmental regulations, and insufficient progress in reforming the coal sector.

Sector Reform, Institutional Development Impact, and Sustainability. The fundamental restructuring of the power sector has been the most ambitious institutional objective pursued by the Bank in the energy sector since 1994. In 2000, a joint report of the State Power Corporation and the Bank laid out a plan to introduce competitive power markets into the Chinese power sector, starting on a provincial or regional scale. Pilot programs are

under way in Shanghai and Zhejiang. The electricity industry in China is shifting to a competitively based electricity market framework, particularly Shanghai and Zhejiang in the East China power grid. Zhejiang is piloting the implementation of competitive power markets with assistance of the World Bank. The Bank is in a unique position to bring international experience to bear in power market design.

Zhejiang's competitive electricity market began trial operations in January 2000. A 2001 World Bank review found that impressive achievements have already been made:

- Sound trading mechanisms, operating rules, and risk management have been established.
- Information systems to operate a competitive energy pool have been well conceived, developed, and put in operation.
- Reform has been widely accepted and supported by government authorities.
- Improvements have been widely accepted and supported by government authorities.
- Improvements have been made by generators in cost control, internal performance management, and contract trading analysis and risk management.
- And most important, average generation availability (92 percent in 2000) continued to improve as a result of competition.

There are, however, problems that have prevented the market from advancing further. The pilot project has revealed the constraints and problems that arise if the government persists in adopting a fragmented, piecemeal approach to power sector reform.

Relevance of Bank Assistance

An assessment of Bank involvement in China's energy sector needs to start with the recognition that Bank financial support represents a tiny portion of the sector's total investment needs: even in the power sector, where the Bank has been most active, total lending between 1984 and 1995 (US\$3.4 billion) accounted for a mere 3.4 percent of sector investments. Consequently, aside from any actual or potential direct benefits of Bank projects, the relevance

of Bank assistance has to be seen primarily in terms of whether it was geared, through targeting, type of instruments, or partnerships, to achieve maximum catalytic or demonstration effect and policy impact in areas emphasized by the Bank's corporate, sector, and country assistance strategies.

The Bank's investments in the electric power sector reflect the Bank's comparative advantage and were driven by the high priority in China given to increasing power production. Financing big hydro projects, and later large thermal plants, has historically been the Bank's comparative advantage. Lack of electric power to support economic growth, combined with an inefficient and obsolete supply system made power plant construction an obvious high-return activity for the Bank and high ownership value for the government. But there has been less ownership concerning solving difficulties associated with pricing, financial matters, and other needed reforms that accompanied these projects.

In the past few years, the Bank has encouraged China to seek private sources of financing to increase electric power supplies. In spite of Bank encouragement, China has been able to attract only relatively minor amounts of private financing, usually with substantial government support. Without an appropriate market structure, private capital is reluctant to enter this market. Getting the market structure "right" is the challenge for the future. In any case, given the size of the sector, most of the resources will have to come from domestic savings, with external capital playing only a limited role.

Given the large size (for the Bank) of the electric power supply program, it has been difficult for the Bank to find the resources and the will to move into other areas of energy investments. The supply problems associated with primary fuels, oil, gas, and coal are obvious, but taking action has been beyond the capacity of the Bank, particularly in the face of China's unwillingness to deal with the associated institutional issues. The few attempts to do so have not been successful and have discouraged further action. The fuel sector is the major unfinished business for the future.

Lessons

- An incremental approach to institutional development, initially emphasizing technology transfer and capacity building, can be extremely effective.
- Internal Bank factors are critical to building up and sustaining an effective long-term sector dialogue.
- In focusing on the ultimate introduction of market forces in the energy sector as part of its policy dialogue, Bank staff should not lose sight of the importance of fundamentals.
- A two-pronged approach that combines high-level policy dialogue with central authorities and a direct operational involvement with a representative set of provincial utilities is essential to success.
- The Bank should be particularly sensitive to possible misinterpretation by outsiders of its stance on private sector development issues.
- The Bank's emphases on ensuring compliance with environmental guidelines in the design of the projects it finances and on designing and enacting appropriate environmental regulations at the national level must be complemented by similar efforts at the monitoring and enhancing enforcement levels.

Future Bank Involvement in the Energy Sector

The Bank is at a crossroads in its energy sector dialogue with China. After the major policy breakthroughs of the mid-1990s in the power sector, progress on sector reform has slowed, and major policy issues in such critical subsectors as coal, oil, and gas have largely gone unattended. To address this, the Bank could choose to focus increasingly on "peripheral" subsectors such as renewables and energy efficiency where policy issues are less sensitive and government buy-in more likely. But this approach may lead to a marginalization of the Bank's role in a sector of central importance to the country's future development, at a time when IFC is not positioned to expand its involvement—precisely because major institutional and policy issues remain to be addressed. A more difficult path is for the Bank to continue its sizable financial support to the energy sector, but frame it

within a truly comprehensive dialogue on national energy policy issues. This evaluation clearly suggests that this is where the Bank's comparative advantage lies. In particular, the Bank can:

- **Help promote comprehensive energy planning in China.** The Bank should offer to help at two levels: regionally, preferably in Sichuan province, which has a varied resource supply and where the Bank has ongoing operations and institutional relationships; and nationally. The Bank could build on its recent working dialogue with the State Council, a recently completed study on liquid national gas financed by the Japan Policy and Human Resources Development Fund (PHRD), and an older Bank study of China's coal and electricity delivery services.
- **Continue to balance assistance in terms of subsectoral priorities, mix of instruments, and central versus local dialogue.** An appropriate mix of lending and nonlending instruments will continue to be needed for maximum impact, and sector interventions at central and provincial levels need to continue on parallel tracks.

While future energy policy dialogue will need to be comprehensive, calling for broad-ranging economic and sector work, the scope of individual project interventions need not be. Instead, individual projects may be geared to areas neglected in past Bank lending and areas in which IFC involvement is less likely:

- **In the power sector, the Bank should increase its attention to inefficiencies at the distribution level.** It should broaden the efforts initiated in Zhejiang province under the Tongbai project. This increased emphasis on local issues, together with the photovoltaic pilot financed by the Bank under the Renewable Energy Project, could pave the way for a more proactive and better-integrated Bank strategy on rural energy.
- **The Bank should provide direct assistance toward municipal-level natural gas distribution and demand,** for example, by replacing coal-fired furnaces with gas-fired furnaces, co-generation, and district

heating. Loans to municipalities could help expand municipal gas-distribution infrastructure and utilization of natural gas in urban district heating systems.

- ***The Bank should make a renewed and determined attempt to engage Chinese authorities in a full-fledged dialogue on the coal sector.*** The Bank must address coal in its assistance strategy; the coal sector is too important to China's future social, environmental, and economic development, and the issues the sector must resolve are too daunting.
- ***In its future lending to the power sector—and possibly the petroleum sector—the***

Bank should give higher priority to the early resolution of pending asset ownership issues, which continue to cloud the reliability of many sector agencies' financial statements. In this context, the Bank should consider revisiting its current auditing requirements (which only provide for certification by government audit bureaus) and, at a minimum, ask to be provided with audit reports from international auditors whenever these have been prepared (for example, for those power companies that have obtained, or are seeking, partial listing on foreign stock exchanges).

ANNEX E: SUMMARY: FINANCE BACKGROUND PAPER

China's economy grew spectacularly through the 1990s. The banking system grew even faster, but there is widespread concern that its mounting problems may mar what is otherwise a remarkable economic transformation.

After China's economic transition began in 1978, output and incomes grew quickly and deposits flooded into Chinese banks. The banks—government-owned investment arms of the Ministry of Finance (MOF)—had little experience in making sound loans. With depositors protected against losses from bad loans, deposits became contingent government liabilities, posing significant fiscal and macroeconomic risks. But with national income doubling every decade and domestic savings at 35–40 percent of GDP, the steady flow of new deposits has so far spared China a banking crisis and allowed a risky situation to continue largely unchecked.

The magnitudes are staggering: banking deposits were about 150 percent of GDP in 2003, up from less than 30 percent in 1978. Four state banks account for about two thirds of these deposits. Banks lend mostly to state-owned enterprises (SOEs), not the booming private sector, which relies on retained earnings and informal finance. If non-performing loans constitute one third of the portfolio and are worth 10 percent of their face value, the government's contingent liability is about 45 percent of GDP.

Before 1978, "the plan" covered almost every decision by SOEs. Prices, which bore little relation to costs or scarcity, were used by central authorities as implicit taxes and subsidies. Firms had no role in allocating resources, and most in-

vestments were funded through budget grants. Credit, too, was an integral part of planning. But then as now, Beijing set targets and flows at a high level of aggregation, and provincial or municipal governments effectively controlled most SOEs.

As budget-financed investment fell from 16 percent of GDP in 1978 to 3 percent in 1995, Bank lending took up much of the slack, and when some SOEs could not qualify on strictly commercial criteria, banks were pressed, or directed, to fund them. After 1980, economic reforms and increasing competition among firms exposed the financial weakness of many SOEs. Loss-making SOEs rose from 26 percent of the total in 1992 to 50 percent in 1998.

The Bank's Role

In the 1980s, the Bank offered China a window on the world of market economics, in banking as in other sectors. The Chinese authorities listened to the Bank's general advice and used the Bank to vet the legions of experts who came to offer guidance.

During this period, the Bank approved nine line-of-credit projects that benefited borrowers in light industry and agriculture but did not achieve their stated purpose: to improve the soundness of banks or the overall quality of their loan portfolios. The last of these projects was approved in 1990 and closed in 1996.

When Beijing lost control of its monetary aggregates in the late 1980s, the Bank worked closely with Chinese counterparts to take stock of the banking system. A Financial Sector Review, completed in mid-1989, described the con-

This is a summary of the CAE Background Paper, "China's Financial System and the World Bank's Role during the 1990s," by S. Ramachandran, Senior Evaluation Officer, Operations Evaluation Department, Country Evaluation and Regional Relations (OEDCR), World Bank.

flict between having banks operate autonomously and governments (at various levels) funding favored enterprises regardless of profitability.

The review's prescriptions were sensible, but generic: to have banks, although government-owned, operate commercially and be subject to the central bank's prudential regulation and supervision. The review also suggested removing interest rate controls and credit ceilings and introducing indirect instruments of monetary policy. But the effort to remake the Chinese system in the image of industrial countries ignored Chinese realities: "loans" were often understood by all parties to be equity stakes, and the central bank's power was very limited. Enterprises had unclear ownership, high debts, and unchecked access to bank loans. Banks' head offices had little oversight and virtually no control over their own branches, which often kept two sets of books, one for the head office and central authorities and another for the local authorities, which exerted *de facto* control over local branches.

Central authority was splintered among rival agencies—among them the Ministry of Finance, State Planning Commission, central bank, and the State Council's research arm. Each of the many groups had to agree on the scope and design of a Bank project, and their rivalries were not conducive to addressing difficult problems. The ambitious Financial Sector Development Project, first proposed in the mid-1980s and continually prepared and altered during the 1990s, was finally abandoned in 1997, because the Bank and its Chinese partners could not agree on its components.

A Financial Sector Technical Assistance Project (FSTAP), approved in August 1992, was designed to help the central bank better understand the inner workings of the banking system and so indirectly influence policies. At \$60 million, it was the largest technical assistance loan the Bank had ever made. But the project's approval did not end tensions among the various counterparts. Because each entity liked only specific features, project implementation was difficult.

As China's banking deposits increased in the 1990s and a new generation of policymakers returned from advanced study abroad, the technical abilities of Chinese officials rose dramatically.

The Bank, meanwhile, did not increase the analytical rigor of its reports, which then became less useful to the technocrats in the government, who nevertheless proceeded to use them in bureaucratic battles for influence.

No further financial sector projects and no major economic and sector work were conducted after 1997. The Bank's China Department, reorganized in 1994, was again shaken by the mid-1997 reorganization of the East Asia Region. Bank staff fought to resuscitate or replace canceled financial sector projects, but work dwindled. By 1999, most financial sector staff working on China had left.

Hopes for reviving the Bank's involvement in the financial sector rose in mid-2000 when the Bank's new Regional vice president designated a full-time program manager for financial sector work in China with a greatly augmented budget. Regional sector staff think that they have turned a new page, but it is too early to tell if the Bank's effectiveness has improved.

The Decade's Developments in Perspective

China has made significant improvements in the institutional setting of its financial sector. The central bank law and commercial bank law were revised in 1994–95. National financial accounting standards and standards for risk-based loan classification were introduced in 1998. The credit quota system has been replaced by a less rigid system of indicative quotas. Banks are trying to resolve their nonperforming loans (through asset management companies). A troubled regional commercial bank was closed. Several foreign banks were licensed, and further opening is set for 2004 under the World Trade Organization. For the capital markets, a long-delayed securities law, approved in late 1998, defines insider trading and permits criminal prosecution of offenders. Capital market oversight responsibilities have been clarified and consolidated, and a new agency has been established to oversee the insurance industry.

Despite these advances, the problems of China's huge banks are daunting. Deposit growth may continue to postpone a banking crisis, but nonperforming loans must fall as a proportion

of GDP if China is to grow out of the problem—and this requires drastic improvements in the quality of bank lending.

Poorly defined property rights and reports of corruption and misappropriation suggest that the central government may find it harder to realize the value of what it purportedly owns (as a shareholder) than what it is owed (as a creditor). If so, the banks' nonperforming loans could jeopardize central government finances. When added to Beijing's external debts and the unfunded pension liabilities promised to a rapidly aging population, the fiscal implications of the contingent liabilities from nonperforming loans of state banks are worrying.

An Evaluation

The Bank's work in the Chinese financial sector, especially during 1993–94, fell short in two ways.

First, project preparation documents contained no analytical work on banking. To some extent, this was because data were not easily available—or not forthcoming—but no great attempt was made to get them, and readily available data were never analyzed. Five years after the East Asian crisis, for example, the Bank has not analyzed such issues as the size distribution of deposits that would greatly help in the orderly handling of a banking crisis that many fear will follow if banking does not improve. And despite considerable Chinese interest in asset management companies, the Bank has not examined their efficacy. Academics and commercial bankers appear to know more about what is happening—and are therefore more influential—than the Bank.

After 1993–94, the Bank's technical work failed to keep pace with the technical abilities of Chinese officials. Written reports became inaccur-

rate or misleading to avoid annoying every official through which they were transmitted. But oblique criticism or sugar-coated reports are of little interest to technically able counterparts, and some reports have not been passed on to the decisionmakers, sometimes on technical grounds, but also in battles over turf.

Second, after the mid-1990s, the Bank's work on Chinese finance did not reflect what other Bank staff already knew about Chinese enterprises. The Bank would have been more persuasive had it showed, for example, that value-subtracting enterprises were being funded. Moreover, the Bank has framed the issue as making banks sound, while the authorities at the central and provincial levels have been more concerned about enterprise restructuring and its attendant social and political implications. Powerful factions in China favor state support for a stable of large, "strategically important" firms. Had the Bank integrated its banking work with its work on enterprises, its prescriptions may have been more appropriate and convincing to the authorities.

The Bank's regional Poverty Reduction and Economic Management (PREM) Network is now responsible for financial sector work in China. The program manager appointed in 2000 has an ample budget to draw on expertise within other parts of the Bank and outside. The work has shifted from capacity-building projects with individual banks to broader issues of overall financial sector reform and sequencing. Such strategic advice will be effective only if it is anchored on analytical work specific to China. Having Chinese scholars and academics do analytical work under the Bank's aegis could sharpen its relevance while augmenting the country's policy-oriented capabilities.

ANNEX F: SUMMARY: POVERTY BACKGROUND PAPER

However one chooses to measure the available data, poverty rates fell in China during the 1990s. The proportion of the population living on less than \$1 per day (in purchasing power parity) declined from 32.9 percent in 1990 to 17.8 percent in 1999. Yet most of that reduction took place in 1994–96. Using an income-poverty threshold for rural China, one gets a less extreme difference in the rates of poverty reduction during the three thirds of the decade. However, the broad pattern still holds: the rate of reduction in poverty was rapid during 1994–96 and far slower during the earlier and later years.

But even after two decades of rapid growth, the overall incidence of poverty in China was higher than in many countries in similar circumstances. During the first and last thirds of the decade, China experienced very high rates of GDP growth that coincided with a rapid increase in per capita real personal income in both rural and urban China. Yet both subperiods saw a slow or negative decline in poverty, indicating that China failed to realize the potential for poverty reduction created by rapid growth. That failure was due to a sharp increase in inequality. The increase in inequality is ascribable to five sets of circumstances:

Increase in Inter-regional Inequality. Since the 1980s, China's economic growth has been concentrated in the coastal and eastern provinces, which enjoyed natural advantages and public policy preferences in attracting export industries and foreign direct investment. In contrast, the central and western regions were excluded from those advantages and

have grown at a much slower rate. Other policies impeded progress in the “backward” regions, including an almost colonial approach to extraction of natural resources at extremely low ex-factory prices, price controls on agriculture, and low investment in infrastructure. Only after the mid-1990s did signs of a reversal of some of these policies become discernible.

Slow Growth in Rural Income. At the end of the decade, poverty in China was overwhelmingly concentrated in rural areas, which accounted for nearly 70 percent of the population in 1999. The ratio of urban to rural per capita household income increased from 2.20 in 1990 to 2.65 in 1999. This widening disparity was due to the slow growth of agriculture, discriminatory terms of trade, and reductions in public investment in agriculture.

Regressive Transfers to Households and Reduced Transfers from Rich to Poor Provinces. The system of taxation and transfers practiced by the state and collectives is highly regressive. An average household in rural areas paid a net tax amounting to 0.5 percent of income, whereas an average urban household received a net subsidy of 11 percent of income. China's budget system has undergone changes that restrict the ability of the poor regions to fund essential services, such as education and health, and to invest in economic development. The provinces, not the central government, must repay external lenders like the World Bank and bear foreign exchange risks for loans for many social-sector projects. As a con-

This is a summary of CAE Background Paper, “Poverty Reduction in the 1990s,” by A. R. Khan, Professor, University of California, Riverside.

sequence, the extremely poor counties are often not eligible to participate in externally funded poverty-reduction projects.

Low Employment Growth. During the 1990s, economic growth in China created very little employment, the primary conduit through which the poor benefit from growth. In the mid-1990s, state and collective enterprises began reducing a significant payroll of nonworkers employed in a form of “concealed unemployment insurance.” The reductions affected about 29 percent of their urban workforce—41.24 million people—and 6 percent of the workforce of township and village enterprises. No alternative system of social protection has been developed.

Discriminatory Treatment of Migrants. The incidence of poverty among urban migrants is about 50 percent higher than among the registered urban residents. Migrants have been denied access to health and education services and the opportunity to seek employment on an equal footing with registered urban residents. Restrictions on migration have also prevented laborers from leaving rural areas in response to market forces, thus contributing to the urban-rural inequality.

If these adverse factors were completely offset, China’s income distribution would probably have become more equal in the 1990s, directing more than the entire benefit of economic growth to poverty reduction. It is possible, however, that the steep fall in the incidence of poverty in the 1980s precluded similar reductions in the 1990s, as the remaining poverty became more intractable: heavily concentrated in poor areas with inadequate infrastructure and little contact with the rest of the economy.

The Chinese Government’s Response

The evolution of the problem of poverty and China’s public response to it may be divided into four distinct periods. From the late 1970s to the mid-1980s, poverty fell rapidly in response to a growth strategy based on agriculture. From the mid-1980s until 1994, China’s development strategy shifted to export-led growth as the nation rapidly joined the global economy. The five sets of unequalizing forces outlined above grad-

ually took hold during this period. Growth was expected to alleviate poverty in most of China, but the need for targeted assistance for the ecologically disadvantaged poor areas also came to be recognized.

The third period began with a well-articulated strategy to commit greater resources to poverty reduction. In January 1994, the State Council put into effect the national “8-7 Plan” to lift 80 million rural poor out of poverty in the remaining seven years of the century. Serious shortcomings compromised this plan.

The fourth period of China’s public response to poverty may be said to have started around the turn of the millennium. New programs now aim to improve agriculture and farm production, provide education and training for the poor, promote productivity through science and technology, facilitate out-migration, voluntarily resettle people from ecologically disadvantaged areas, and promote economic development in the western provinces, as well as in the relatively poor provinces of the central region. There are also social protection programs for the urban poor.

The World Bank’s Role

Through its economic and sector work on poverty assessment and analysis, IDA’s Poverty-Targeted Intervention (PTI) projects, and poverty-reduction components in non-PTI projects, the Bank has proven the importance and viability of poverty reduction as the principal goal of its assistance to China. During the 1990s, the Bank made important contributions to China by disseminating methods of poverty monitoring, serving as a friendly critic of China’s poverty-reduction strategy, and offering a set of best-practice projects for poverty reduction.

Projects have been less important an instrument for the Bank’s poverty-reduction strategy in China than in other comparable countries. Even so, the Bank’s project portfolio for China in the 1990s included outstanding examples of best-practice poverty-reduction projects. In the 1990s, examples were available for all major poverty-oriented sectors, although some sectors were unable for one reason or another to classify the poverty-oriented components of their projects as PTI lending.

Since China became ineligible for IDA funds in 2000, the Bank's lending has included only one PTI project, thus jeopardizing the role of the Bank as the provider of best-practice examples of poverty-reduction projects. The Bank should not completely abandon projects as an instrument for poverty reduction in China, a country with a higher absolute incidence of poverty than most countries with comparable real income. The Chinese government's aversion to borrowing for poverty-reduction projects, except on soft terms, is a very puzzling phenomenon in view of the high financial rates of return on such projects.

Future Priorities

The Bank's analytical and operational instruments can provide effective assistance for further poverty reduction in China.

Poverty Monitoring. Any analysis of poverty in China must contend with unreliable statistics. The inherent problems of the data include a poverty threshold that is too low and does not differentiate adequately between urban and rural differences, the exclusion of a significant urban population of migrant workers, the exclusion of rural poor who live outside county jurisdictions (estimated at 30–50 percent of the rural poor), records for lower-income groups that are either withheld from study or do not exist, and poor survey methodology.

The system of poverty monitoring in China needs to be improved, first by making household-level survey data available both to the Bank and to independent researchers in China so that estimates of poverty become more accurate and transparent. A plurality of estimates would promote healthy debate and open discussion.

Adjustment and Broadening of the Poverty-Reduction Strategy.

Two main directions for improving China's poverty-reduction strategy are emphasized in the Bank's recent poverty assessment: (a) targeting of the poor should be improved in designated rural counties and (b) the poor who reside outside the designated rural counties should be brought under the umbrella of the poverty-reduction programs. A third natural extension is the need to provide an official umbrella for the program of urban poverty reduction.

Economic and Sector Work. The Bank's ESW agenda should include an early and comprehensive analysis of household taxes and transfers, with a view to making these at least mildly progressive. Restructuring state finance to increase transfers from rich states to poor states is a necessary concomitant of the shift in the regional allocation of public expenditure that is contemplated under the poverty-reduction strategy.

Lending Program. The Bank's lending program in China helped reduce poverty in the 1990s by including in its portfolio a set of projects that provided a large benefit to the poor, projects that served as examples of best-practice methods of investment for poverty reduction. Since 2000, PTI projects have been almost absent from the Bank's lending operation. To maintain the Bank's role as a source of best-practice poverty-reduction project blueprints and to preserve the credibility of the Bank's anti-poverty strategy, Bank lending in China should include such projects in its portfolio, a challenge complicated by China's aversion to borrowing for poverty-reduction projects on IBRD terms. A combination of a "third window" and a serious effort at persuading China's decisionmakers of the rates of return on these projects might help overcome this problem.

ANNEX G: SUMMARY: WATER BACKGROUND PAPER

China has an ancient tradition of water management, but in the past half century exploitation of the country's water resources has intensified as a result of population and economic growth. Since 1949, China has increased the number of its large dams from 22 to 22,000, almost half the global total. It also has more than 80,000 reservoirs and 240,000 kilometers of dikes. Most rivers and streams are used for irrigation, power generation, transport, urban water supply, or waste disposal—some for all of these purposes.

With all these demands, China now faces an acute version of the global water crisis. Flooding and drought, always a problem in China, now occur with increasing frequency and greater impact. Associated water pollution imposes major costs that offset economic growth. Users consume manmade and natural reservoirs (such as groundwater and natural lakes) at rates well above recharge. Unsustainable depletion is exacerbated by watershed degradation and organic and chemical pollution. Siltation, a very serious problem for centuries, continues with increased erosion from development, deforestation, and poor farming practices that imperil flood control and storage/irrigation objectives. In key industrial areas, surface and groundwater pollution have caused widespread sickness, requiring central government intervention to compensate for poor enforcement of environmental regulations.

China's most serious water problems are experienced in four river systems that dominate life in the eastern third of the country. The available water, surface and ground, has been allocated by

implicit values that are far removed from economic realities. (The value to users of untreated but usable water for municipal and industrial (M&I) and household demand, for example, is a multiple of 10 to 40 times that in agriculture.) The adjustment to available supplies over time is mediated by often arbitrary institutional responses from fragmented agencies, unrelated to economic or social priorities in a systematic way. And tariff reforms have been slow in coming as a means of addressing water resource constraints because, until recently, setting rates was seen purely as a financial matter.

The central government's successful leadership in large projects involving multiple provinces has not been repeated with water resources management (WRM). The existing water management framework is insufficiently comprehensive or unified to optimize uses or resolve conflicts in a socially optimal manner. Negotiations have not settled differences among sector interests (such as industry and agriculture), the ministries responsible for different aspects of WRM, or competing political jurisdictions. While the river basin is clearly the most appropriate locus for negotiation, effective institutions corresponding to basins, rather than provinces, have proved very difficult to establish, despite much central government commitment and awareness. The devolution of political and economic power to separate riparian provinces along the great rivers has made central government control over allocation of water resources even more difficult.

This is a summary of the CAE Background Paper, "World Bank Assistance for Water Resources Management," by Robert C.G. Varley, Consultant.

The Scope of Bank Operations in China

From 1982 to 1993, before the Bank formally adopted the Water Resource Management Policy in 1993, operations responded almost entirely to the borrower's investment priorities, financing projects that had already been identified and the basic concepts designed. Projects were not derived from an overarching policy or strategy. There is no evidence of a comprehensive lending strategy for individual sectors such as irrigation and water supply, let alone for "integrated water resources management." The approach was pragmatic and ad hoc, but significant incremental reforms were introduced and included in projects where possible.

In return for substantial transfer of some kinds of knowledge, access to high-caliber specialist expertise, and financing, the Chinese tolerated what they feel to be intrusive Bank covenants and burdensome procedures. China and the Bank have developed over time a partnership that in the early years cast the Bank in a more humble role than it is accustomed to. However, the relationship has produced significant results.

Overall and particularly more recently, the Bank can claim credit for articulating a water conservation and financial sustainability policy and for championing river basins as the basis of integrated water resources management. The Yangzi Basin Water Project was the Bank's first truly integrated water resources project. China has supported and provided the majority of the funds for Bank projects that piggybacked innovative institutional components on what were largely conventional water supply, wastewater treatment, irrigation, drainage, and flood control projects. These new components were seen to be effective and have been replicated.

The Bank's considerable influence has also been conveyed through professional interactions at the project-management level, a high quality of technical advice, continuity of high-quality staff, and a discerning client, very eager and able to learn. The Bank also performed a useful function during changing relationships between central and provincial governments, playing the roles of intermediary, honest broker, and convener. Several significant reports emerged from the close partnership between

the Bank and China. The Bank-China relationship achieved a truly productive interaction, for example, with the cross-sectoral "China Water Resources Assistance Strategy/EAP 2002" (CWRAS), a strategic vision for future cooperation on water resources management (WRM). But China's need for ESW and AAA exceeds the Bank's level of support.

The 1997 assistance strategy for China did not discuss water specifically—particularly surprising since the government of China has long acknowledged water to be a key problem area.

The following Bank sector categories all have high relevance for water resources management in China.

Land and Watershed Management, Forestry. Bank-supported projects made major contributions to increased efficiency of water use by demonstrating that profitable orchard and mixed farming models are compatible with watershed rehabilitation and soil preservation. Terracing, upstream forestation, and erosion-control projects in the larger basins also have provided downstream benefits, reducing silt loads and increasing incomes. Building on the successful central Loess Plateau and Red Soils projects in the southeast, these practices and technologies have been replicated. But for these to be truly effective, basin-level management is needed.

Water Resources and Flood Control. The Bank supports several projects in integrated WRM. These include the Tarim Basin I and II Projects (1992/1998) in the western Xinjiang Uygur Autonomous Region, which feature a well-developed framework for integrated water management through self-financing irrigation development districts and a comprehensive set of procedures/regulations. Another, the Hai River Basin Project, focuses on China's most complex and intensively developed basin. The Bank will help finance the components for river basin management. Beijing, the site of the 2008 Olympics, lies in the basin.

China has been reticent to borrow for technical assistance to support river basin institutional development, but the Bank and other donors have coordinated assistance in a very cost-effective

manner. Chinese and Bank staff, supported by leading international consultants, have developed a comprehensive plan for the North China Plain, built on a “dynamic optimizing model” that represents the state of the art in analytic and technical engineering for WRM planning.

Agriculture, Irrigation, and Drainage. Before opening to the world in 1978, China had an extensive, but troubled, irrigation program. Though limited, Bank involvement in irrigation has had a positive effect on Chinese practices in procurement, project management, and, more recently, irrigation management, especially at the provincial level. Geographical poverty targeting has been refined to a county and township level, accompanied by some concessionary IDA funding and full loan recovery from the beneficiaries. Although the distributional effects and provincial bearing of foreign exchange risk on the Bank loan have been criticized, the emphasis on sound finance has been central to motivating project participants, from governors on down. It has created a cascade of accountability and responsibility for results, from project managers who have to collect levies down to beneficiaries who have to pay them.

The organization of farmers into self-managing irrigation development districts (SIDDs) has improved management and accountability, empowering farmers to pay for and receive water services. Water user associations (WUAs) within the development districts play a key role in many aspects of improved WRM, including water provided by both local government agencies and publicly owned bulk-water companies. These innovations have been incorporated in Bank-supported projects, but have not been replicated on a wide scale.

Multipurpose and Hydroelectric Dams. Traditionally, Bank energy project documents equated water resources with “hydroelectric resources.” Many of the large dams built with financing and assistance from the Bank were driven by the energy sector and met their objectives. But most of the investments were not part of integrated WRM plans for the catchments concerned. For the most part, the complementarities and conflicts

between energy and WRM objectives have not been systematically weighed in decisionmaking.

Notwithstanding widespread criticism of resettlement and environmental impacts of World Bank-supported dams in China (and elsewhere), an OED study on resettlement ranked China highly. The Xiaolangdi Dam, supported by the Bank, has been credited with drastically reducing silt and enabling continuous flow in the lower reaches of the Yellow River, something not achieved in the previous ten years.

On the negative side, hydropower has costs in silt accumulation in reservoirs, environmental damage, resettlement, loss of cultural heritage, and potential conflicts between peak energy demand and water supply/irrigation priorities.

Inland Waterways. Three Bank projects have supported the largest system of inland water transportation in the world. The Quality Assurance Group’s quality-at-entry report for the Second Inland Waterway Project noted the absence of an action program on key sector issues, an institutional component, and any effort to engage government in a policy dialogue.

Urban Water Supply and Wastewater Treatment Plants (WWTPs). Since 1985 the Bank has committed \$2.2 billion to finance major water investments (water conveyance, treatment, and distribution, and WWTPs). Because of the country’s high population concentration, urbanization, and rapid growth, the economic and health impacts of poor WRM are major costs to Chinese society, estimated variously at 5–15 percent of GNP. But although water supply and quality issues are entwined, management and regulatory systems remain fragmented among at least three government bodies with overlapping responsibilities. Bank WS/WWTP projects usually address, but have not significantly changed, the prevalence of local political interference, weak commercial management, distorted tariffs, variable legal and regulatory frameworks, unstable central-local relations, and the lack of long-term local finance. Overlapping agency responsibilities are compounded by conflicts with local financial interests and a desire to avoid the social unrest of closing high-polluting industries.

For water supply, China's sector performance relative to developing-country benchmarks has put the country in the *best practice* quintile of Bank clients. However, the costs of new water sources are very high, and there is a large gap between the current tariffs and those that are necessary to finance the new supplies.

Although a survey of 16 projects concluded that the three Bank-supported wastewater treatment plants in the sample were among the best operated in the country, WWTPs in general suffer from significant technical and financial problems—among them an absence of timely sewer connections, poor design, reliance on expensive combined-treatment plants, a lack of effluent guideline enforcement, and grossly inadequate funding from service fees.

Overall, WS and WWTP projects lack reliable estimates of usage, as well as realistic rates. Predicting the demand response to changes in tariff requires accurate measurement of consumption, as well as control and collection systems, and these are not well understood.

Rural Water Supply. The Bank has supported four rural water supply and sanitation (RWSS) projects, mainly in poor counties. Designs have evolved by combining the strengths of existing village administrations and community financial participation with international best practices in appropriate technology, financial cost recovery, decentralization of regulation, and financial autonomy. In the latest generation of RWSS projects, 75 percent of the investment cost is recovered in fees and 95 percent of villages abide by the tariff covenant—startlingly clear evidence that the poor can and are willing to pay tariffs that raise eyebrows when proposed for urban consumers.

Strengths and Weaknesses of the Bank's Operation in China

As part of a global study (*Bridge Over Troubled Waters*) of the Bank's 1993 Water Resources Management Policy, OED sampled 18 of 35 water projects for China. The study found China's projects to have a higher degree of compliance with the 1993 policy than any other large country. But out of 82 approved projects, only 29 had been completed and subjected to independent

evaluation by OED. The success of the Bank's attempts to influence water reforms in China also owes much to its humility in the policy sphere, the continuity of high-level professional staff, and earning the respect of its clients.

The Bank's strengths begin with its low-key, client-centered approach, ensuring good project performance by requiring cost recovery from beneficiaries, and taking risks that projects might not perform as intended. Critics would cite these same factors as being weaknesses—particularly the chance that beneficiaries will be saddled with foreign-exchange risk and that flexibility in procurement compliance will be exploited. On the other hand, the Bank's weaknesses include early compromises to its commitment to sound economic analysis in the evaluation of some irrigation projects. The analysis of expected economic rate of return (ERR) neglected important factors such as sustainability of water resources and their downstream opportunity cost. Failure to make an adjustment helped ensure a viable ERR and Board approval (not an uncommon Bank practice), but did not indicate the true economic cost of the projects.

The Bank may not have initially been sufficiently focused in its advice or forthright in criticism of the sustainability of China's emphasis on major investments in hydraulic structures. But with strong support from the Bank, China has now made a course correction and is putting more emphasis on WRM and less on new infrastructure.

Finally, the lack of coordination between Bank sector units is a recurrent theme, which is being addressed by the China Water Resources Assistance Strategy. It is mirrored by China's lack of a natural home for water resources management and river-basin projects among institutions that cannot transcend parochial sector and provincial interests. Given the enormity of the issues, it is disappointing that so little money has been applied to critical high-return projects to address institutional reform and demand management.

The Bank's Impact on Water Reform in China

China faces problems found in most countries—conflicts between upstream and downstream

users, overlapping jurisdictions, and quality and allocation problems. Overcoming these problems was initially treated as a problem of augmenting supply rather than devising a demand-led strategy for water management. While China has successfully used major hydraulic infrastructure to control, use, and manage water resources, it has not conserved resources to meet future needs. Efficient water allocation, pricing, groundwater and water quality regulation, and institutional reform were not given sufficient emphasis. While engineering expertise, money, and commitment to a structural approach have been partially successful in meeting social goals, success has often come at a high environmental and economic cost. With water, the economic tradeoffs have become starker as demand for municipal and industrial uses competes with agriculture.

The Bank has played a significant role in construction, capacity building, and knowledge transfer in the past. While its influence on achieving policy, demand management, and institutional reforms has worked slowly, it can point to significant innovations that could end up being applied all over China. SIDDs and WUAs, the Loess Plateau approach to watershed management, and new approaches to water saving have been taken beyond the pilot stage and prospects for replication are good. River basin management in the Tarim project and also in the Li River (a tributary to the Yangtze under the Yangtze Basin Project) has taken hold, providing practical examples to other more complex basins. Demand management with increased pricing is beginning to take hold in water supply.

Future success in Bank-China cooperation should continue to be based on pragmatism and pilot testing new ideas where they are most needed and most likely to succeed. The Bank should consider reordering its priorities in China to continue the following initiatives:

- Watershed management
- River-basin planning and management
- Self-managing irrigation districts
- Corporatization and privatization in the water supply and wastewater treatment sector
- Demand management and pricing
- Adequate funding of ESW/AAA

China must conduct a strategic dialogue on water policy at a level higher than that of the competing ministries. Duplication of data collection and divided responsibilities frustrate water resources management and must be rationalized through institutional reform, new administrative processes, and incentives attuned to sustainable development. Fundamental reforms are needed—not just changes in policies within the present institutional and regulatory framework. The coordination of water management responsibilities and decisions between ministries will not be resolved without a supraministerial body to push through reforms and “bang heads together.” The China–World Bank partnership in water resources management, which up to now has been fragmented between Bank sector units and Chinese line ministries, needs high-level oversight, perhaps at the level of the State Council, to implement the cross-sectoral China Water Resources Assistance Strategy.

ANNEX H: SUMMARY: TRANSPORT BACKGROUND PAPER

Rapid economic development since the opening of China's economy in the late 1970s has caused demand for transport to surge. Supply has not kept pace. In fact, limited capacity of roads, railways, and inland waterways is one of the most serious bottlenecks to the country's future economic growth. In response, the government's tenth five-year plan (2001–05) envisages an increase in total outlays of around 15–20 percent per year. Even if only a fraction of this is finally implemented, surface transport will be radically transformed.

Several trends are evident from international experience about the demand for transport: (1) freight transport will grow more slowly and passenger transport more quickly than the economy; (2) the infrastructure and assets needed to satisfy a given level of transport demand will increase as users demand higher-quality service; (3) rail's share of the transport total will fall; and (4) demand for multimodal transport services will grow faster than demand for single-mode services.

Transport Sector Performance and Policy Challenges

China's road network of 1.4 million kilometers ranks among the sparsest in the world relative to geographic area and population. Only about 16 percent of the network is high-grade highway. A few interprovincial expressways have been built, but about 20 percent of rural communities still have no all-weather vehicular access. More than half the nation's highways are exceeding designed traffic capacity limits, hindering foreign investment in other sectors.

The chief component of China's transport strategy is the development of the "national trunk highway system" (NTHS), a 35,000-kilometer network of 12 interprovincial highways that will link 95 major Chinese cities and 600 million people. The trunk system will link smaller roads and five north-south and seven east-west highway routes. Estimates of the capital required over the span of the tenth five-year plan range as high as \$20 billion annually. An expected doubling of car ownership (to 34 million cars) by 2010 will ensure that demand-side pressures remain high.

One of the consequences of improving the road system will be a large movement of people out of agriculture and rural areas. The rapidity of the urban transition usually catches most countries by surprise—and China is no exception. The Bank can provide assistance in addressing the transport problems of the growing urban areas, with their growing concentration of lower-income groups.

Of particular concern will be the growth of the medium-size cities, which lack the resources and experience to manage the rapid growth and which receive inadequate attention from central and provincial institutions. Early interventions can have a significant impact on the efficiency and equity of their growth. In urban transport, for example, early reservation of roadway rights of way can lay the basis for improved future mobility and efficient land use.

China's 68,000 km rail system serves all its provinces. Some 5,500 kilometers are provincially administered and locally maintained, in-

This annex summarizes the CAE Background Paper, "World Bank Assistance for China's Transport Sector," by Anthony Churchill and Cordula Thum, Consultants.

cluding 193 kilometers of urban track in Beijing, Shanghai, Guangzhou, Tianjin and Hong Kong—a remarkably small total given the area and population of these cities. China Rail aims to lay down 6,000 kilometers of new rail, 3,000 kilometers of double tracks, and 5,000 kilometers of electrified railways by 2005. Another 450 kilometers of urban rail in up to 10 major centers is envisaged. At around \$80 million per kilometer for subway construction, the latter commitment alone is a sizable undertaking.

China has a long history of using its waterway network, but inadequate funding has caused the infrastructure and floating equipment to deteriorate badly, reducing the net size of the navigable network from 170,000 kilometers in 1960 to 11,930 kilometers in 2000. Although China has 5,800 navigable rivers, 15 rivers more than 1,000 kilometers long, and 12 lakes with an area greater than 1,000 kilometers, the major inland waterways comprise only four rivers and one canal that carry 80 percent of total traffic. The lack of a multipurpose development plan among the various ministries in charge of infrastructure has contributed to the decline.

Impact and Direction of the Bank's Assistance Strategy

Transport accounted for a major share (close to 30 percent) of the Bank's total lending to China between 1983 and 2001. Since 1983, the World Bank has approved \$10.5 billion in loans and credits for 58 transport projects. At the end of fiscal year 2002, 31 projects had been completed and 22 were being implemented. In its transport sector lending program (as in the other sectors), the Bank has used a pilot-project approach to sector reform.

Since 1993, the Bank's comprehensive transport strategies have focused on increasing competition and efficiency, identifying the changing patterns of demand for transport, analyzing investment needs of the sector and their financing, suggesting improvements for transportation services and safety, and addressing problems of administrative rivalries.

Overall, highways have taken the lion's share of lending (59 percent), followed by railways (23 percent), ports and waterways (11 percent),

and urban transport (7 percent). The Bank has carried out a substantial amount of analytical and advisory activities (AAA), financed under a variety of trust funds as well as the Bank's own budget.

Bank highway projects in China focus on roads that have a strong development potential, but not yet enough traffic to be attractive to private lenders. In railways, the Bank is chiefly involved in financing lines to developing inland areas, and in waterways, to improving the major accesses to the principal rivers. The focus of urban transport projects is now moving away from the construction of ring roads, putting a new focus on corridor development, traffic management, and public transport.

Out of 28 transport sector projects rated by OED, all had satisfactory or better outcomes and were deemed to be likely or highly likely to be sustainable. On the other hand, only 19 were seen as likely to have substantial institutional development impact.

Roads. By 2001, total lending to China's highway sector had exceeded \$5.96 billion for 27 projects. Bank operations in the highway sector have been combined with technical assistance and training on a variety of topics related to the reform and modernization of the sector. Most projects were intended to increase road capacity and, to a smaller extent, to improve maintenance. The Bank strategy supports ongoing institutional development and sectoral reforms to modernize the highway system and its management, and investment in high-priority links of the NTHS and the provincial road network that feeds into it. Many World Bank transport projects in China are for roads that have strong development potential, but not yet enough traffic to be attractive to private lenders.

Railways. With project costs totaling \$8.6 billion, China is the Bank's largest borrower in the railway sector. The Bank's strategy focuses on providing sufficient transport capacity and ensuring that technical and management capabilities keep pace with economic growth. Most projects have included substantial funds for institutional components—training, studies, and consulting services.

The Bank strategy has been to support increases in capacity while at the same time introducing China Rail to modern railway management and technologies. Better track-laying technologies, modern communications, and axles designed to take heavier loads have all been part of the Bank's contribution to improving the efficiency and capacity utilization of the railways.

The Bank has also made a significant contribution to improving the social and environmental side of railway investments. The Bank's insistence on the application of various safeguard requirements appears to have proved acceptable and to have become an integral part of investment planning. The Bank has also introduced modern accounting, management, and financial practices into the overall structure of railway administration. In particular, the application of modern administrative tools has alerted China Rail to the real costs of many of its operations.

The issue for the Bank is how to support a reform process that is likely to take several decades. The relationship between the role of government as a regulator and the Ministry of Railways as an operator or enterprise remains an issue. Economic tariffs designed to reflect costs will become increasingly important as the railways face more and more competition. The debate has only begun on the extent to which China Rail should remain a monolithic structure or become more independent units designed to meet new competitive pressures.

There appears to be agreement on the need for a clear separation between the government's role and that of the railway. The government understands the principle (if not always the practice) that railways should be organized along lines of business, with clear financial goals, adequate compensation for public services, and sufficient authority to set tariffs. Major barriers such as redundant labor and employee welfare obligations will need to be removed.

Ports and Inland Waterways. The Bank played an important role in China's port improvement from 1983 to 1996; since 1993, the private sector has taken over funding. A 1999 OED evaluation found that through new management styles and re-

forms, operating systems and equipment, and effective Bank supervision, China's ports learned how to do business and substantially improve port performance in an environmentally sound way.

The Bank has been involved in the waterways sector since 1995 and has provided three waterways loans totaling \$433 million in support of more efficient and economic inland waterway transport. Through preparation of inland waterway projects, the Bank is helping to implement national policy guidelines for modernizing the inland waterway transport fleet at the provincial level. The major issue with respect to inland waterway projects is their relationships to water management. Given the close interrelationships between water use in agriculture, flood control, power, and transport, there is a strong case for making sure all investments take place within a comprehensive framework.

Urban Transport. The Bank has sought to enhance urban economic productivity by improving the efficiency of the urban transport system and to strengthen public sector management by improving the planning and management of urban transport. The Bank's lending to China's urban transport sector began in 1991 with the First Shanghai Metropolitan Transport Project, which increased capacity, reduced congestion, and improved efficiency while improving planning, programming, financing, and management of the city's urban transport system.

Fragmented administration and regulation are an obstacle to tackling urban transportation. Cities tend to focus on expensive building solutions, new highways, and urban rail systems, which appear to be more straightforward to administer and receive priority from the city leaders. But better management in several areas can multiply the benefits of such projects: better traffic management of the existing street system, greater autonomy and incentives to bus operators (with government restricting itself to a regulatory role), and effective control of the demand for transport through pricing policies. All these issues are now being examined in greater depth.

Analytical and Advisory Activities and Economic and Sector Work. Although the World Bank has loaned

more than \$10.5 billion to the Chinese transport sector, its most important contribution has been to introduce new ideas and stimulate new approaches to problems.

The 1999 OED assessment of the China transport portfolio determined that policy dialogue be-

tween China and the Bank needed strengthening. The issue of highway safety is just one area where a Bank study, drawing on global experience, could be of assistance to Chinese officials in identifying where institutional and other changes are required and how the Bank might help.

ANNEX I: SUMMARY: HEALTH BACKGROUND PAPER

China's gross health and nutrition indicators have always been impressive. In 2000, the World Health Organization ranked the country 61st out of 191 countries in overall quality of health. From the 1950s through the 1970s, the country achieved unprecedented reductions in infant and child mortality, as well as gains in nutrition and overall life expectancy—all due to broad public health improvements.

In the past two decades, as China adopted economic reforms, growth and prosperity have pulled up its health and nutrition indicators. But wide regional and rural-urban differences have appeared, as inequalities in development and access to care have grown. Gains in the fight against infectious diseases have slowed and in some areas regressed. Rates of immunization have dropped in some areas, and outbreaks of immunizable diseases have occurred. The percentage of malnourished children increased in rural areas between 1987 and 1992, while urban malnutrition dropped sharply in the same period. Meanwhile, TB and HIV/AIDS infection rates have grown exponentially. For both diseases, China is a country of global strategic importance.

Even some of China's encouraging health statistics can be misleading. The number of physicians per 100,000 population in China is estimated at 162—against India's 48, for example—but only a small proportion of rural “doctors” in China actually have post-secondary training. Funding of public sector facilities are based on numbers of beds, which encourages managers to increase the number of beds to tap national allocations. But the uninsured majority

cannot afford the costs of care at many such facilities, so scarce resources are spent on facilities inaccessible to the poor.

Nationwide statistics have masked the near crisis in the poorer rural areas. The national government now supports just 3 percent of health expenditures and has handed funding responsibility for health care to subnational governments, many of which cannot afford it. Without an outside infusion of funds, economically lagging regions are too poor to provide adequate health services and preventive care. WHO's report for 2000 ranked China 188th out of 191 countries for fairness of financial contributions to health care.

Fiscal decentralization and the country's transition to a market economy has reduced public financing of health care and services markedly. More than for any other sector in China, the major share of public expenditure for health is borne at the subnational levels. Close to 60 percent of total budgetary expenditure for health is the responsibility of counties and townships. Most subsidies pay for infrastructure costs and staff salaries, with little money left to cover services. The situation is compounded by the unequal subsidization of urban areas, which receive 80 percent of total public spending, leaving 20 percent for the rural areas in which 70 percent of the population lives.

Before this transition, rural Chinese were served by a Cooperative Medical System (CMS). Its “barefoot doctors” delivered free preventive and primary care services. Beyond basic services, patients paid coinsurance fees for drugs, hospi-

This annex summarizes the CAE Background Paper, “World Bank Assistance for China's Health Sector,” by Elaine Ooi, Consultant.

talization, and inpatient services. In this way, more than 80 percent of the population had access to care of reasonable quality and some protection against catastrophic expenses. Abolished in the mid-1980s, CMS programs were not replaced by an alternative financing system. Health facilities and providers looked to boost revenue to ensure economic survival, recover costs, or seize opportunities for tremendous profits.

Several trends drove the decline of public health and the rise of inequalities in health access. Government regulations set the prices of preventive care and essential public health services, such as immunization, below cost. Providers opted not to immunize or compromised on quality and safety. Profitable but inappropriate drugs, long hospital stays, and unnecessary diagnostic tests replaced prevention. Facilities began to purchase expensive equipment—such as CAT scanners—in order to charge high fees for their use. The system of cooperation, supervision, and referral broke down as facilities competed for paying clients and resisted referring patients as required.

The World Bank's Health Program in China

Since China became a member of the World Bank in 1980, the Bank's program of assistance in health has consisted of 11 projects and 3 economic and sector work (ESW) reviews. Bank assistance has emphasized the demonstration value of projects in order to pursue high-level dialogue on health policy reforms, health systems performance, and financing. Since the mid 1990s, projects have allowed experiments with rural insurance models and CMS-type schemes to improve health care access for the poor. Results have been mixed.

There is a wide consensus that during the period of Bank assistance, China's health system deteriorated in critical areas—it may serve much of the majority, but fails to supply a social safety net to the poorest. The problems are direct consequences of government policy, and not only health policy.

Bank dialogue with government agencies aims at increasing budget allocations to counties and townships to improve health system perform-

ance, but progress has been slow. Budgetary allocations and management do not fall under the purview of health authorities, so sustained reforms are less likely. The need remains to link health projects more closely with the larger issues of national budget priorities and public expenditures. The Bank has not fully exploited non-project and non-health avenues for health reform.

The constraints on good health policy in China—lack of public finance, disincentives for good health practices, and varying levels of health management competency—have not been addressed successfully. While Bank assistance has had considerable success in addressing management competency, the other problems are systemic and require interventions outside the health sector.

An example of a project designed to address all four of these constraints is the Basic Health Services Project of 1998. Primarily targeting systems reform, it faces difficult, politically sensitive issues, including personnel management, drug prescription behavior, and increased budgetary allocations to health at the county level. The project introduced innovative mechanisms to fund and monitor cost-effective health interventions for the very poor and hopes to demonstrate convincingly that fiscal transfers to poor areas will pay off. But the project will have to overcome political interference and loopholes created by those who stand to lose from project innovations.

Although not formally part of the country program, the WBI-China Network can greatly facilitate health finance reform. Established in 1991 at the request of China's Ministry of Health when non-health forces increasingly influenced health financing, the Network has made a good start in exposing senior-level officials and provincial governments to the complex problems faced by the health sector. Closer collaboration between WBI-China Network and the country program will be highly beneficial.

The Bank's projects were complex and addressed a wide range of health issues. Some focused on specific diseases, others on institutions and management; most combined them. Some have been highly innovative, especially in the Chinese context: shifting from health propa-

ganda to health promotion in support of tobacco control; maintaining anonymity in surveillance and treatment of HIV/AIDS; and increasing the use of social assessment instruments in project designs. Portfolio quality was generally high, reflecting best practices for the sector, even if overall sector performance was less than hoped for.

Future Bank-China Cooperation

Opening up of China's western regions and meeting the needs of migrants working in unregulated hazardous industries will require engagement with governmental departments over issues related to the environment and to occupational health and safety. The country is poised to undertake policies and reforms that will exert more pressure on the health system. Many of these challenges will test the limits of Bank expertise, capability, and experience. The Bank's health program will have to make strategic choices about its future role in China. Given the dynamic, complex situation, the Bank should consider several actions.

The Bank should be more involved with upstream policy advice so as to reach the decisionmakers who control broader fiscal and economic policies. The new leadership has to be convinced of the critical contributions of health to China's long-term productivity and growth.

Health concerns should be included in a country-level, macroeconomic dialogue with China. The Bank has a responsibility to link its

macroeconomic dialogue more effectively with sector dialogue, particularly on issues of health finance, the health work force, and civil service reform.

A health sector review for China is long overdue. Although the Bank has been working in the health sector in China for 18 years, the first Project Performance Assessment Report (PPAR) was part of an eight-project cluster. The Bank has not evaluated the extent to which other poorer regions outside Bank project areas have benefited from Bank projects and other assistance.

Nonproject and non-health-sector avenues for influencing health outcomes should be thoroughly exploited. Changes in other sectors will affect the health sector. To be part of this process, the Bank's health program must engage with other sectors and entities.

The Bank should follow up on its Provincial Public Expenditure Review 2002 to bring health issues to the forefront, with a target audience of senior country-level decisionmakers from the Bank and borrower.

Collaboration between the various channels for Bank interventions in health should be increased through ESW/AAA, anchor work, the WBI/China Network, and project lending. In order to achieve a sustained and well-directed effort for policy and reforms, inputs from these channels have to be better coordinated as parts of a common health strategy.

ANNEX J: CLIENT CONSULTATIONS IN PREPARATION FOR THE COUNTRY ASSISTANCE STRATEGY

In conjunction with preparation of the 2002–05 Country Assistance Strategy (CAS), a series of consultation workshops were held in Beijing, Liaoning, and Zhejiang provinces on the coast, and in Ningxia Hui Autonomous Region in western China in June 2002. Attending the workshops and sharing their views were representatives of all stakeholder groups—key government ministries; officials from these and many other provinces; project staff gathered from throughout China; and leaders of civil society involved in economic reform, gender equality, poverty reduction, environment, national minorities, rural development, health, and non-profit agencies. The results of those exchanges are described below. This annex is based on Annex C of the CAS.

Findings from Consultation with Civil Society Representatives

- The Bank's major contribution to China is the transfer of knowledge. The Bank has introduced new ideas, supported reforms, and helped to change management systems.
- The Bank's support to basic and higher education and the development of science and technology contributed significantly to China's development.
- Inclusion of social assessments in Bank projects is helpful and has improved project design and beneficiary participation.
- The Bank used to work only with the government, but in recent years provided support to information sharing and capacity building of China's nongovernmental organizations. Since NGOs play a complementary role to the government and are more innovative, the Bank

should expand its support for development of civil society/NGOs in China, particularly NGOs in western provinces and those dealing with issues such as sustainable development, laid-off workers, urban poverty, HIV/AIDS, etc.

Findings from Consultations with Central Ministries and Agencies, Provincial Government Officials, and Project Management Offices

They Value the Bank's Contributions and Procedures

- The major benefit is the Bank's advice on policy and management, technology transfer, human resources development, and introduction of knowledge and innovation.
- Bank projects introduced international best practice to China, such as competitive bidding procedures ensuring project quality and cost savings, a project supervisory system promoting successful implementation, use of international consultants, and helpful approaches to environmental and resettlement assessment. These all supported changes and reforms in the way institutions function. As a result, Bank-assisted projects have higher quality and better management than domestic projects.
- The Bank's project preparation cycle, procurement procedures, and the supervision system improve the chances for success. In some provinces, all civil works projects have adopted the Bank's project management procedures as standard practice.
- The Bank's environmental assessment and resettlement policies take a new, thoughtful approach to these issues.

- Competitive bidding, whether international or national, has reduced investment costs to levels much below original budgets. Bank procurement procedures may be less flexible than for some other donors, but they also provide more benefits.
- Bank expertise and the quality of its nonlending services are viewed as high quality.
- Bank assistance is particularly valued for health, water resources management, forestry, environmental protection, poverty reduction, and infrastructure. Future assistance was requested in some of these areas and for post-WTO training, rural employment, and cross-sectoral studies.
- The Bank's decentralization to Beijing facilitated efficient communications, timely Bank responses, and faster loan disbursement.

But Some See Room for Improvement, Sometimes in Areas Valued by Others

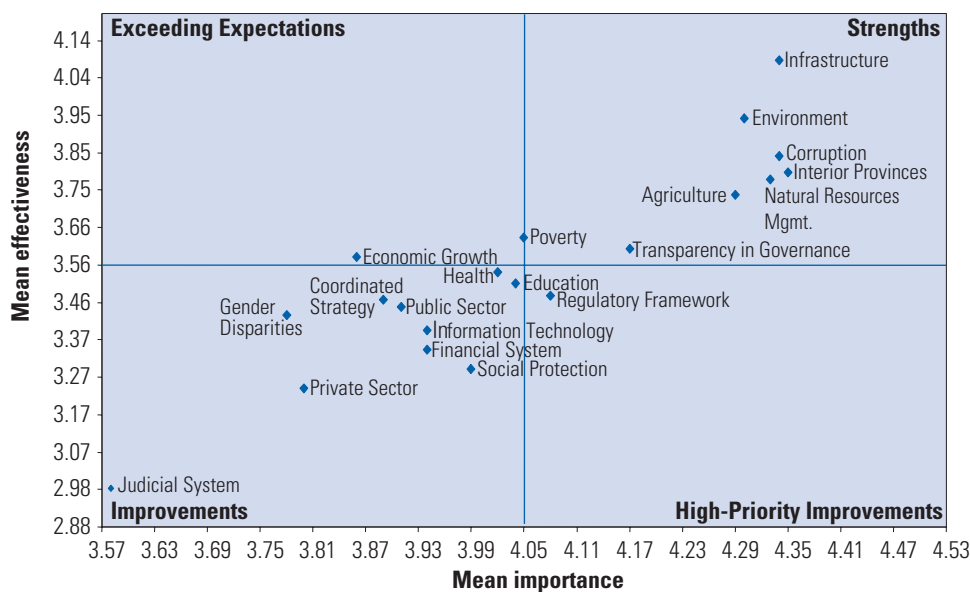
- The preparation and approval process for Bank-assisted projects should be further streamlined. Current procedures require borrowers to carry out duplicate tasks; they should be harmonized with local approaches.
- Projects sometimes have components that the borrower does not want and subsequently has difficulties in implementing.
- Procurement procedures should be more flexible. For example, the Bank requires award of contracts to the lowest responsive bidder, which in China might encourage bidders to offer very low prices to get contracts, with the result that prices must be increased later or quality suffers.
- The Bank should reduce the time for reviewing bidding documents by setting a deadline. In the case of procuring computers, borrower problems with the bidding and review process can cause delays and result in the purchase of already obsolete equipment.
- The use of international consultants to supervise projects is considered uneconomical, particularly in the case of consultants unfamiliar with China. Borrowers favor use of local experts, given the experience they have accumulated over the past decades.
- Chinese collaboration on studies is particularly important to ensure quality and relevance.
- Safeguard requirements are often seen as excessive and complicated.
- Representatives of poor western provinces would like to have concessional financing for projects, particularly for rural development projects.
- Bank lending terms are not attractive. The front-end fee is too high and a major burden. If indirect costs such as for international consultants and training are included, the costs of Bank loans are higher than financing from other sources.
- Counterpart funding requirements may be too high for poorer provinces.
- Loan commitment and front-end fees should be rebated when project components are adjusted and part of the loan is canceled.
- While missions are effective and useful, the timing (twice a year) may be too frequent and the length of missions too long. The number of supervision missions should be decided flexibly on the basis of implementation performance, so as to lower costs for both the Bank and the borrower.
- While the shift in the Bank strategy to the western provinces is correct, the eastern provinces still need new, innovative ideas; institutional improvements; and lessons from the Bank's experience, which come from continued lending.

ANNEX K: CLIENT SURVEY FINDINGS

The figure below is based on a Client Survey conducted by the China Department in 2002. It plots respondents' ratings of the relative importance of having the Bank involved in various areas vs. their ratings of Bank effectiveness in these same areas. The correlation between perceived importance and perceived effectiveness is high. The horizontal and vertical lines represent the mean ratings and permit a rough classification of activities into four quadrants representing perceived areas of *strengths*

(such as the environment) where Bank involvement is both important and effective; *high-priority improvements* (regulatory framework is the only example) where Bank involvement is seen as important, but relatively ineffective; *improvements* (for example, judicial system) where Bank involvement is seen as neither very important nor effective;¹ and *exceeding expectations* (economic growth) where Bank assistance is seen as less important, but relatively effective.

Respondents Rate Importance versus Effectiveness of Bank Involvement in Various Areas



ANNEX L: GUIDE TO OED'S COUNTRY EVALUATION RATING METHODOLOGY

This methodological note describes the key elements of OED's Country Assistance Evaluation (CAE) methodology.¹

CAEs rate the outcomes of Bank assistance programs, not clients' overall development progress.

An assistance program needs to be assessed on how well it met its particular objectives, which are typically a subset of the client's development objectives. If an assistance program is large in relation to the client's total development effort, the program outcome will be similar to the client's overall development progress. However, most Bank assistance programs provide only a fraction of the total resources devoted to a client's development by donors, stakeholders, and the government itself. In CAEs, OED rates only the outcome of the Bank's program, not the client's overall development outcome, although the latter is clearly relevant for judging the program's outcome.

The experience gained in CAEs confirms that program outcomes sometimes diverge significantly from the client's overall development progress. CAEs have identified assistance programs that had:

- Satisfactory outcomes matched by good client development
- Unsatisfactory outcomes with clients that achieved good overall development results, notwithstanding the weak Bank program
- Satisfactory outcomes with clients that did not achieve satisfactory overall results during the period of program implementation.

Assessments of assistance program outcome and Bank performance are not the same.

By the same token, an unsatisfactory assistance program outcome does not always mean that

Bank performance was also unsatisfactory, and *vice-versa*. This becomes clearer once we consider that the Bank's contribution to the outcome of its assistance program is only part of the story. The assistance program's outcome is determined by the *joint* impact of four agents: (a) the client, (b) the Bank, (c) partners and other stakeholders, and (d) exogenous forces (such as events of nature, international economic shocks, and so on). Under the right circumstances, a negative contribution from any one agent might overwhelm the positive contributions from the other three, and lead to an unsatisfactory outcome.

OED measures Bank performance primarily on the basis of contributory actions the Bank directly controlled. Judgments regarding Bank performance typically consider the relevance and implementation of the strategy; the design and supervision of the Bank's lending interventions; the scope, quality, and follow-up of diagnostic work and other analytical and advisory activities; the consistency of Bank's lending with its nonlending work and with its safeguard policies; and the Bank's partnership activities.

Evaluation in Three Dimensions

As a check on the inherent subjectivity of ratings, OED examines a number of elements that contribute to assistance program outcomes. The consistency of ratings is further tested by examining the country assistance program across three dimensions:

- (a) A *Products and Services Dimension*, involving a "bottom-up" analysis of major program inputs—loans, analytical and advisory activities, and aid coordination
- (b) A *Development Impact Dimension*, involving a "top-down" analysis of the principal

program objectives for relevance, efficacy, outcome, sustainability, and institutional impact

(c) An *Attribution Dimension*, in which the evaluator assigns responsibility for the program outcome to the four categories of actors.

Rating Assistance Program Outcome

In rating the outcome (expected development impact) of an assistance program, OED gauges the extent to which major strategic objectives were relevant and achieved, without any shortcomings. Programs typically express their goals in terms of higher-order objectives, such as poverty reduction. The Country Assistance Strategy (CAS) may also establish intermediate goals, such as improved targeting of social services or promotion of integrated rural development, and specify how they are expected to contribute toward achieving the higher-order objective. OED's task is then to validate whether the intermediate objectives produced satisfactory net benefits and whether the results chain specified in the CAS was valid. Where causal linkages were not fully specified in the CAS, it is the evaluator's task to reconstruct this causal chain from the available evidence and assess relevance, efficacy, and outcome with reference to the intermediate and higher-order objectives.

Evaluators also assess the degree of client ownership of international development priorities, such as the Millennium Development Goals, and Bank corporate advocacy priorities, such as safeguards. Ideally, any differences in dealing with these issues would be identified and resolved by the CAS, enabling the evaluator to focus on whether the tradeoffs adopted were appropriate. However, in other instances, the strategy may be found to have glossed over certain conflicts or avoided addressing key client development constraints. In either case, the consequences could include a diminution of program relevance, a loss of client ownership, and/or unwelcome side-effects, such as safeguard violations, all of which must be taken into account in judging program outcome.

Ratings Scale

OED utilizes six rating categories for **outcome**, ranging from highly satisfactory to highly unsatisfactory:

Highly Satisfactory: The assistance program achieved at least acceptable progress toward all major relevant objectives, **and** had best practice development impact on one or more of them. No major shortcomings were identified.

Satisfactory: The assistance program achieved acceptable progress toward all major relevant objectives. No best practice achievements or major shortcomings were identified.

Moderately Satisfactory: The assistance program achieved acceptable progress toward *most* of its major relevant objectives. No major shortcomings were identified.

Moderately Unsatisfactory: The assistance program did *not* make acceptable progress toward *most* of its major relevant objectives, *or* made acceptable progress on all of them, but either (a) did not take into adequate account a key development constraint or (b) produced a major shortcoming, such as a safeguard violation.

Unsatisfactory: The assistance program did not make acceptable progress toward *most* of its major relevant objectives, *and* either (a) did not take into adequate account a key development constraint or (b) produced a major shortcoming, such as a safeguard violation.

Highly Unsatisfactory: The assistance program did not make acceptable progress toward *any* of its major relevant objectives and did not take into adequate account a key development constraint, while also producing at least one major shortcoming, such as a safeguard violation.

The **institutional development impact (IDI)** can be rated as: *high*, *substantial*, *modest*, or *negligible*. IDI measures the extent to which the program bolstered the client's ability to make more efficient, equitable, and sustainable use of its human, financial, and natural resources. Examples of areas included in judging the institutional development impact of the program are:

- The soundness of economic management
- The structure of the public sector and, in particular, the civil service
- The institutional soundness of the financial sector
- The soundness of legal, regulatory, and judicial systems

- The extent of monitoring and evaluation systems
- The effectiveness of aid coordination
- The degree of financial accountability
- The extent of building NGO capacity
- The level of social and environmental capital.
- Technical resilience
- Financial resilience (including policies on cost recovery)
- Economic resilience
- Social support (including conditions subject to safeguard policies)
- Environmental resilience
- Ownership by governments and other key stakeholders

Sustainability can be rated as *highly likely*, *likely*, *unlikely*, *highly unlikely*, or, if available information is insufficient, *nonevaluable*. Sustainability measures the resilience to risk of the development benefits of the country assistance program over time, taking into account eight factors:

- Institutional support (including a supportive legal/regulatory framework, and organizational and management effectiveness)
- Resilience to exogenous effects, such as international economic shocks or changes in the political and security environments.

ANNEX M: MANAGEMENT ACTION RECORD

Recommendations	Management Response
<p>1. <i>Repayment system.</i> China's loan repayment system encourages good project performance, but distorts the allocation of resources. While continuing to pursue blend operations in the interim, the Bank should try to persuade the government of the need to modify the repayment system and to give high priority to reform of the overall inter-governmental fiscal system.</p>	<p>1. To increase resource flows to poor areas, China's new government leaders are strongly committed to reform of the fiscal system and intergovernmental fiscal relations, and have welcomed substantial Bank advisory support in this area. They are also considering innovative financing arrangements to expand on the donor partnerships that now facilitate Bank-China collaboration on poverty reduction.</p>
<p>2. <i>Improving the effectiveness of ESW.</i> The Bank should focus more on China and less on international experience; do more collaborative ESW; and increase its sector work to take stock of sectoral changes and lay the foundation for better policy dialogue and new directions in lending.</p>	<p>2. Our clients and we continue to see the need for policy advice based on a mix of international and Chinese lessons learned, as suited to issues and audiences. The question is not whether the Bank should rely more or less on international experience, but how it can bring to bear the most pertinent views on issues. As to our collaboration with local institutions on AAA, it is already substantial and still increasing as Chinese expertise expands. And our sector work program has expanded in line with budget allocations.</p>
<p>3. <i>Improving the effectiveness of lending.</i> The Bank's China portfolio is one of the largest and most successful. To improve it further in a period of lower lending levels, the Bank should take steps to improve portfolio management; strengthen the systemic use of safeguards within a collaborative framework; pursue new directions in infrastructure lending; and enhance the poverty impact of lending.</p>	<p>3. Ongoing measures to enhance investment effectiveness include: recruitment of a portfolio manager for FY05; harmonization and streamlining of safeguard procedures of the government and the Bank and joint formulation of regulatory guidelines for investments; design of investments—including those in infrastructure—to promote innovation and change, as appropriate, and address poverty issues; and identification of additional innovative financing arrangements to facilitate Bank support for poverty reduction and the Millennium Development Goals.</p>

1. General Observations

The Department agrees with the general thrust of the CAE. Put simply, China has performed very well over the past two decades. It has been very much “in charge” of the developmental agenda, and this is a major factor in explaining the country’s impressive accomplishments to date. The Bank has played an important but varying role in the process depending on the sector, issue, and time period—in part due to changing country circumstances and in part due to factors specific to the Bank. As noted in the Summary, “The main strength of the Bank has been its sustained support of an activity or program over a number of years.” This has allowed the Bank to “have a substantial cumulative impact in a number of areas” and to be “well-placed to take advantage of opportunities when China is looking for support for change.”

Against this broad premise, we are puzzled by the statement in the same paragraph that, “*The Bank’s view on issues has sometimes been less than fully transparent. Looking forward, the Bank should give more attention to trying to promote and participate in a much broader debate on policy and sector issues, not only among officials, but also among researchers and other stakeholders.*” While the Bank has publicly shared a broad range of its analytical work and participated in an open dialogue on most subjects, it has treated some sensitive issues more discreetly. Our aim in doing so is to reach our clients in a sensitive but effective way, not to educate an external audience. We have thus been able to maintain a dialogue on difficult issues being debated within the government and have helped our clients to shape important policy reforms.

The report notes areas where the Bank has been quite effective and areas where we have ei-

ther been short of the mark or less involved than warranted. We agree with many of these observations, but on some issues the judgment is too simplistic, particularly regarding how country circumstances can influence Bank priorities or the way the Bank has approached issues in China. Reform is not a smooth or a continuous process. For some issues, such as the financial sector (see more on this below), circumstances dictate when a topic is ripe for serious attention—particularly so in China where the political/planning process determines the timing, speed, and nature of how and when key reforms are to be addressed.

We recognize that the scale and diversity of issues facing China are unparalleled in world history and that the continuing progress of China is as remarkable as the complexity of the development challenges it faces. On the Bank’s side, while our performance may have varied across sectors and over time and Bank contributions could never be considered dominant, given China’s scale and government ownership (as the CAE notes), the Bank has certainly “punched above its weight.” In light of these two factors, it is not clear that more could have been accomplished or that performance was anything less than fully satisfactory. Any suggestion of “mixed success” on either the government’s or the Bank’s part seems to imply that total success would ever have been feasible in such a complex context.

In addition, while the report acknowledges that “China fits the Comprehensive Development Framework model of donor coordination more closely than most countries,” the Bank is criticized throughout for not being involved in every aspect of every issue. However, no one development institution—including the World

Bank—can be expected to assist all areas of a country’s development agenda, much less a country with an economy as diverse and complex as China’s. On issues that China’s other development partners were better placed to provide assistance or were already involved, the Bank has rightly taken a supplemental role in providing support or has even decided to forgo any involvement. So, although the CAE points out areas of limited or nonexistent Bank involvement, such as in the coal subsector, forestry sector work, or judicial reform, it should be recognized that development partners, such as the IFC for coal, the FAO and Ford Foundation for forestry, and bilaterals and the EU for judicial reform, provided the support required and probably better than we could have.

Broadly, then, we wonder at the tone of parts of the evaluation, which suggests that the Bank has failed to achieve results as though we were the sole implementers of change in China, rather than an adviser and facilitator. Reform in China is driven by the government and not outsiders such as the Bank. The current tone seems contrary to the opening statement in Chapter 5: “It would be presumptuous to think that the Bank could take credit for successes, or be held responsible for the failures, of such a large and dynamic economy.” We agree and would therefore urge that the report put China back in the “driver’s seat.”

2. Policy Agenda

Macroeconomic Management

We concur with the assessment’s highlighting of two critical periods that tested China’s macro management, the prominence of fiscal policy, and the remaining difficult issues. However, the description of the Bank’s role would benefit from a broader view.

- ***The discussion of the Asian Crisis*** should note that, despite supporting an expansionary fiscal policy, the Bank consistently flagged the risks if such a policy were not used as a temporary measure (see, for example, our fiscal policy notes in 1998, the CEM in 1999, notes on the tenth five-year plan in 2000, notes on the composition of public spending and on fis-

cal response in 2001 and 2002, and the domestic debt risks study in 2003). Avoiding deflation and competitive devaluation were important—and sometimes conflicting—concerns at different times; accordingly, the Bank offered advice on different occasions.

- ***The discussion of fiscal issues*** should note that the Bank has provided several written inputs and organized specialized workshops on the composition of public expenditures, the reform of the malfunctioning intergovernmental finance system, domestic debt risks, reform of the trade promotion and export tax regime, the management of rural public finance, and the coordination of fiscal-monetary and external policies. The Bank has positioned itself to be an adviser in this area as political windows open. Recently, the new government requested assistance (and the Bank responded) on issues related to increased external sector liberalization, reform of the financial sector and rural finance, and other issues tied to the sustainability of the fiscal situation.

Privatization

As the evaluation notes, the Bank has expressed impatience with the pace of reform while broadly supporting China’s phased approach. We recognized that, in the short run, an exclusive focus on privatization and assumptions that market discipline would provide good governance was unlikely to be appropriate in a country (and enterprise sector) as large and diverse as China. While pursuing privatization, there was an important parallel track of improving governance of public agencies and separating the functions of state-as-owner and state-as-regulator. Hence, the Bank was not “too timid in discussing privatization” as the evaluation states, but rather recognized that the issues are differentiated and complex. Indeed, privatization was a politically (and philosophically) sensitive issue in China during the 1990s and thus was more appropriately handled on a confidential basis; for example, in the mid-1990s, the Bank’s Regional Vice President raised this issue directly with the Vice Premier and both recognized the delicate nature of the topic.

Financial Sector

The CAE highlights the importance of financial sector reforms—which we agree with—and correctly notes that following some important early work, the Bank’s support for these reforms fell off during much of the 1990s. As in other areas, China’s experience has shown that unless a country is serious about addressing an issue, particularly in the financial sector, advisory or financial support from outsiders—whether the Bank or others—is likely to be ineffective. For much of the early to mid-1990s, China pursued financial sector reform slowly. Against this background, Bank advisory support and financial intermediation loans had limited impact. At the time, the Bank recognized that significant support in this area would be both costly and difficult and that until a stronger government commitment to reforms in this area emerged, a more ambitious assistance effort might be wasted. As noted by the CAE, in line with a renewed government commitment brought on by lessons of the Asian Financial Crisis, we have over the past few years mounted an ambitious financial sector reform program for China—the largest effort in the Bank—reflecting our perception that the government is now taking this issue more seriously.

Sector Strategy. While the evaluation is correct in noting no major sectorwide reviews after the influential 1989 report, it is incorrect in stating that the Bank never recast its strategy after that time. This issue received considerable managerial attention regarding implications for country vulnerabilities and searching for opportunities for constructive engagement. Meanwhile, implementation of the Financial Sector Technical Assistance Project kept the financial sector very much on our agenda. The sector was an important component in the Bank’s country assistance strategies during the 1990s, and several country economic memoranda, including the China 2020 report, devoted separate sections to policy issues and development strategy for the sector.

Involvement with State Banks. The CAE incorrectly attributes the Bank’s lack of involvement in the State commercial banks during the Asian crisis to our client’s lack of interest or confidence in

the Bank’s advice or support. We would instead point to the changed circumstances of those banks. At the time, both the World Bank and the government recognized that the rationale for continued Bank assistance for the credit operations of State commercial banks no longer existed: (i) the banks were flush with liquidity and did not need our financial support; (ii) without more serious policy efforts in dealing with non-performing loans (NPLs) and restructuring, World Bank lending would not likely be effective at any rate; and (iii) since the government relied on expansionary fiscal/monetary policy as a response to the Regional Financial Crises, Bank-supported credit operations were unlikely to be effective as an instrument for reform. Our scaled-back involvement, therefore, had a logical basis. Once these circumstances changed and the environment for our support improved, the government has sought our involvement on issues besetting the State banks and other sector institutions, as the CAE mentions.

Recent AAA. The evaluation casts doubts on the potential effectiveness of the more recent AAA for financial sector reform. This is contrary to the feedback consistently given to Bank management by the government and is puzzling in view of the rapidly increasing requests for assistance from the MOF, the central bank, financial regulators, and the planning commission on both general architectural and specific technical aspects of financial sector reform.

Poverty Reduction

While we agree with the CAE that regional and rural/urban *inequalities* have increased substantially and need to be addressed, it should be noted that the inequality issue in China differs from that in many other countries. It does not stem from one group or one region stagnating relative to others; rather, urban areas and coastal provinces are growing annually at near double digits, while growth in rural areas and some interior provinces is closer to 4 to 5 percent. Recommendations should therefore reflect this fact. Some of the problems are a consequence of an excessive concentration of riches, not poor performance more generally.

We also question the CAE's finding that the Bank was less successful in "persuading the government of the implications of broader *development policies for poverty and inequality*." For all three of the major issues cited—inter-governmental fiscal relations, grain pricing policies, and restrictions on migration—the Bank produced major economic reports in recent years that set out the necessary reform agenda. Further, the government has been moving in the right direction on all three fronts, albeit not so rapidly as one would have hoped in some areas. It is also debatable whether the government could or should have moved more aggressively than it did. For example, fiscal reforms in other large transition countries where revenues have also sharply fallen indicate that the necessary institutional changes and shifts in tax/revenue policies to promote more equity take years if not a decade or more to put in place. Similarly, while China's restrictive policy on migration has accelerated regional inequalities, in the view of many it has also made it possible for the country to avoid many of the undesirable social consequences that other developing nations have experienced regarding rural-urban migration in the face of weak social service systems. Now that such systems are beginning to take shape in China, cities and regions are better equipped to cope with pressures from more flexible migration policies, and this in fact is now happening. Finally, regarding grain prices, since 1997, the government has been purchasing smaller amounts of grain at the administered procurement prices—less than 10 percent of the crop in the latest years for which information is available. Overproduction since 1997 has resulted in a sharp divergence between official and free market prices, and the resulting losses of grain marketing entities, combined with the widespread rural distress that resulted from falling free-market prices, have resulted in a substantial relaxation of grain marketing quotas. Moreover, post-WTO developments are seen largely in the form of the removal of restrictions on crop diversification, and by making deep concessions in agriculture, China has essentially avoided going down the path of most countries that have subsidized increasingly inefficient food

production. In sum, then, we do not concur with the point made that the Bank has been "less successful in persuading the government" in these areas.

Infrastructure

Lending for Infrastructure. The CAE notes the positive role that Bank lending for infrastructure has played in China—in both stimulating growth and directly or indirectly reducing poverty and regional inequalities. We strongly concur. However, the CAE questions whether the share of lending for infrastructure should increase as proposed in the recent CAS. In terms of lending *amounts*, the proposed lending for infrastructure is actually declining as China mobilizes more from domestic resources for such investments. To illustrate, the Bank's infrastructure lending to China totaled \$5.5 billion in FY94–96, but only about \$2.3 billion in FY01–03. However, the *share* of infrastructure is increasing in the Bank program only because, with the loss of IDA, lending in the social sectors is much less than before. Moreover, given the substantial infrastructure needs in the interior provinces, the rationale for continued support is as strong today as it was 10 years ago in promoting growth and poverty reduction. The more relevant issue, therefore, is whether China should make more use of IBRD resources for social investments—a point with which we would agree.

We do, however, agree that a hard look is needed at our involvement in some infrastructure issues. For example, in view of the disappointing results regionally and globally with BOT (build, operate, and transfer) and PPI (private participation in infrastructure), it is sensible to re-examine the respective roles of public and private sources of financing for infrastructure.

Impact on Reforms and Institutional Change in Infrastructure Sectors. We agree that our policy impact has been more striking for energy than transport, with the proviso that we have made a significant difference in the urban transport arrangements in many cities and that a core group of national professionals are now viewing policies and issues differently compared with a

decade ago when we first started working in the subsector. In particular, we have helped develop a cadre of professionals around the country (mostly in the design institutes) who know how to study problems better and develop more effective solutions.

Regarding the institutional shortfalls in other transport subsectors, we wish to complement the report with the following information:

- In highways, the report notes three areas where the Bank has made little headway: fuel tax reform, establishment of a unified Ministry of Transport, and traffic safety. This, of course, has to do with constraints also noted in the report. Since Bank lending accounts for only a small share of China's resource flows, the Bank relied mostly on a dual-track approach of building trust through lending while promoting policy dialogue through sector work. This has led to a reduced efficacy in transport where success largely depends on achieving coordination across sectors and/or levels of government. We have therefore expanded our AAA program, including dissemination seminars to show (i) the unsustainability of the current financing mechanisms in the sector (which rely too much on toll financing), (ii) the necessity of intermodal coordination for logistics improvement and further market integration, and (iii) the need to mainstream sector development externalities such as traffic accidents.
- In railways, the dual-track approach stumbled on difficulties in building trust. Now that this has been achieved to some extent, the prospects for institutional reforms are improving.

Bank Group Involvement in the Gas and Coal Sectors.

The recommendation that the Bank should be involved in lending for gas and coal is questionable. In the context of the Bank's current poverty and growth objectives, coal and gas are clearly not priority areas for financing and are better addressed through policy-related work since the chief problems involve regulatory, environmental, and—for coal—serious social issues. IFC has, in fact, been actively involved in the mining sector, and since

2000 has co-hosted with the Ministry of Land and Resources annual conferences aimed at giving the overseas mining industry and potential investors a full picture of the present mining investment climate in China. In addition, a major IFC-supported "Study on Coal Sector Reform in China" was done in 2001 in collaboration with the government, followed early this year by a "China Coal Industry Administration and Regulation Workshop," which was based on several in-depth technical studies. The Bank has also maintained a dialogue with the government on clean coal technologies over the past five years through technical and policy studies, awareness workshops (the last one in September 2004), and recently a stand-alone GEF project. Several reports on the coal sector were also published by the Energy Sector Management Assistance Program (ESMAP).

Regarding the gas sector, the Bank has done extensive AAA and TA in the past three years. Some of our outputs include the 2001 studies on "Modernizing China's Oil and Gas Sector: Structure, Reform and Regulation," "Power and Gas Regulation," "Regulatory Framework for China's Downstream Gas Sector," and, in 2002, "Economic Regulation of Long-distance Gas Transmission and Urban Gas Distribution." In fact, the Bank's activities are helping to shape reforms in the gas sector.

Environment

We question the implication that the Bank had a limited impact on environmental issues. While China's rapid economic growth has posed immense environmental challenges, we suggest that the Bank has had a significant influence in this area and prevented existing problems from becoming even more severe. The recent CAS indicates the range of the Bank's support to China in addressing environmental issues, including those of global importance, the institutional and regulatory framework in China, and the challenges of protecting air, land, and water resources. We note that the CAE omits discussion of significant areas of the Bank's contribution to environmental management such as air pollution reduction, industrial pollution control programs, and strengthening of environmental monitoring and regulation in municipalities.

Water-Related Issues. There appears to be a disconnect between the views expressed in Annex G and the main text section on water. The general tone of the annex is that the Bank's assistance in the water sector has been effective, is on the right track, and is making significant contributions. The general tone of the main text seems to be that the Bank's assistance has been less than satisfactory, particularly in water resources management. Needless to say, we agree with the annex and not with the main text.

In general, the main text characterizes our performance as "mixed," despite achievements under projects such as those for the Tarim Basin, the Yangtze Basin, Water Conservation, the Loess Plateau, and others that have significantly contributed to *mainstreaming the environment into water sector operations*. On *institutional reform in water*, the report questions our performance, although the Bank has had considerable success in irrigation reform, river basin management, and watershed management. Water Users' Associations started under World Bank projects are now becoming national policy. River basin management is becoming more common, albeit slowly, and the Bank-assisted Tarim Basin and Yangtze Basin projects have played an important role in this. The Loess Plateau watershed management model is also being replicated. Regarding *integrated water resources management (IWRM)*, while progress has been slow, it is positive, as shown in various projects and in the Bank's Water Resources Assistance Strategy prepared in 2002. Achieving integrated water resources management is a monumental, very long-term process, and China—with Bank assistance—is on the right track, but still has some way to go.

Similarly, on *water supply and wastewater management*, we disagree with the report's conclusion that our impact on institutional development has been negligible. We believe that China's achievements of expanding and improving urban water supply and wastewater management services, as well as their financial and institutional frameworks over the last 15 years have been remarkable and compare well with those of other Bank borrowers. The Bank has made a significant contribution to this achievement. Advances that the Bank first pushed for as

innovations and that are now national norms include full cost recovery on water supply and recovery of at least the operating costs for sewerage services, formal independence of utilities, proper financial management, and proper investment planning and implementation. The Bank is now pursuing further institutional advances such as full commercialization of certain services and strengthening of the regulatory framework.

3. Operational Instruments

Analytical and Advisory Services

Changing Needs, Changing Products. The evaluation recognizes that our client's needs changed in the course of the 1990s and that AAA was therefore refocused on more quickly prepared technical pieces, sometimes of a multisectoral nature, and on issues that often defied easy solutions. At the same time, the CAE shows a nostalgic hope that the Bank will continue to produce long, general reports for senior leaders as if they still needed to be schooled in basic principles or required advice on the simpler issues of the past. As China's reform process shifted from the liberalization phase to the more difficult structural and institution-building phase, the Bank's ESW had to evolve by moving away from reports to a combination of policy notes, workshops, studies, and research. Moreover, WBI and Development Economics and Chief Economist Vice Presidency (DEC) activities have been integrated more closely with the need to provide a range of advisory services supported by capacity building and in-depth research on current as well as future challenges to economic management. The CAE should unequivocally acknowledge and endorse this shift. Otherwise, it runs the risk of being internally contradictory by acknowledging the change in knowledge requirements since the mid-1990s while criticizing the Bank's decision to shift away from reliance on the lengthy strategic documents produced during the early stages of its involvement in China.

In this regard, we would also point out the CAE's discussion of the themes of our 2002 CAS should also mention the major CAS emphasis on knowledge transfer. There is now a two-way ex-

change of knowledge between the Bank and China, in which the Bank is both a provider and a recipient of knowledge in its interactions with an ever more sophisticated and informed client. This mutually beneficial exchange reflects our new relationship.

International vs. Chinese Experience. The CAE recommends grounding policy advice more on Chinese experience as opposed to international lessons learned. However, we see the need to look at both sources, with the proper “mix” depending on the issue and the audience. We will continue to approach issues in this way, considering international and/or domestic experience as warranted. The CAE also recommends that the Bank draw lessons from Chinese experience for the benefit of other countries. This objective was built explicitly into the China CAS of 2002, and, as mentioned in the CAE, the upcoming Shanghai Conference on “Scaling Up Poverty Reduction” is a notable example.

Collaborative Work. The local research community’s desire to increase its work with the Bank is welcome, and we are doing this where possible. One of the strategic elements for the knowledge agenda and AAA program outlined in the 2002 CAS is, indeed, to accelerate the use of local experts and institutions. However, since local capabilities are still uneven, it will be important to continue to support institutional development as part of this collaborative work.

The Bank’s extensive use of trust funds to support AAA work supports such longer-term efforts to build local capacities, while also establishing networks of communication and expertise and sustaining reform. Research-support grants to Beijing University and the Chinese Academy of Social Sciences are examples. Moreover, formal cosponsorship with the authorities of important institutional mechanisms, such as the APEC Finance and Development Program, helps to transfer cutting-edge knowledge to local collaborators and, more broadly, to East Asia Regional networks.

AAA Budget. The portrayal of our budget allocations for AAA reveals a lack of understanding of

the overall budget situation for the China program. The Bank’s budget allocation system has consistently constrained funding for China below what might be regarded as “normal.” Given the substantial budget needs for project supervision and lending as a result of the large lending program, the amount available for ESW—particularly when expressed as a percentage of the overall program—seems low. Resource constraints, however, have become less binding recently, and the 2002 CAS, which recognizes the importance of the Bank’s advisory services relative to lending, could therefore envisage an increased share of resources for nonlending services.

China’s View of the Bank’s AAA. Regarding concerns about the Bank’s ESW expressed by Chinese officials, we strongly agree that many reports are produced for external and institutional purposes and not solely for Chinese technical specialists. This was true of the China 2020 report, which was timed for release at the Hong Kong Annual Meetings in 1997. This report was mainly produced to help the external world better understand China, and it remains one of the most requested World Bank documents on China. The report was not, however, without a Chinese audience. While it may have lacked immediate operable suggestions for macroeconomists, many line ministry and sector experts greatly appreciated it, particularly its companion background studies on the environment, social protection, health financing, food security, income disparities, and integration into the global economy. Other outputs were meant to serve the needs of macroeconomists, such as policy notes on the five-year plans. The first set of notes in 1995 was well received, and the Bank has been requested to provide similar support to the two plans since then.

Regarding the recommendation in box 4.1 that the Bank needs to do more work on urbanization, education, and urban transport, significant analysis has been carried out in all three areas and provided to the government, although not as yet to the public.

Quality of AAA. On the observation that the Bank needs to tighten management oversight over

task implementation and dissemination, we would point out that the EAP Region has formalized sector lead economist positions in all sector units, and these individuals have taken on greater quality assurance functions in their respective units, complementing the role being played by the country lead economists. At the same time, the focus remains on impact and results, which usually require a range of activities and which depend on what others are doing—features that are more difficult to reflect in the earlier QAG approach.

Absence of Forestry Sector Work. Despite lending for forestry of more than \$1 billion and a body of work that OED’s sector review of 2000 characterized as “a high point in one of the highest-quality portfolios,” no Bank sector work was done on forestry. As the OED review mentions, however, the Bank attempted to launch AAA activities, but our client did not see the need for such work because of the perceived relative health of the forest sector policy framework. Forest sector analytical work was, however, done by the FAO and the Ford Foundation, while the Bank used its resources for topics not well covered by other donors, such as rural development, poverty, grain marketing, and agricultural research.

Cross-Sectoral Work. This, indeed, poses challenges, especially for a large country like China. Three developments are worth noting to flesh out the evaluation. First, the shift in requests from the authorities for nonlending support in areas requiring meaningful cross-sectoral analysis is fairly recent, reflecting the complexity of the issues faced in moving from the stroke-of-the-pen liberalization phase to the current stage of building institutions for a rapidly growing, highly articulated, globalized, and market-oriented economy. In many instances, the immediate impulse to request such assistance from the Bank arose from the need to go beyond the compartmentalization (and the narrower perspectives that result from it) that exists among government departments. Second, the Bank has used the opportunity of the request for inputs into the five-year plans and the Western Region Development Plan to exploit some of the cross-sectoral

linkages and in the process helped develop useful policy analysis and design frameworks. Third, on a more limited scale, technical analysis in several sectors has combined perspectives from other sectors. For example, the China CEM 1999 carried out stress testing on the financial sector based on enterprise sector analysis. However, more needs to be done. In the area of enterprise and financial sector reform, for example, ESW under way on state-owned commercial bank reform and on domestic debt risks is building upon perspectives from banking, management of local government finance, social security reform, and the housing market and urbanization. In part, this has been facilitated by unifying the Poverty Reduction and Economic Management (PREM) unit with previous units for the financial sector and private sector development. More important, however, is the evolving focus of the authorities on regional and subnational development issues, which explicitly lend themselves to cross-sectoral approaches. The Bank is the leading agency among China’s development partners involved in providing analytical and advisory support on this set of issues.

Impact of Lending

The report characterizes Bank lending as “negligible” and never the main instrument of our strategy. However, the Bank’s financial contribution had an impact greater than its quantitative size would suggest and should not be considered too small to have had an effect. This was the case since: (i) Bank lending to specific geographic areas had a sustained, cumulative impact over time (for example, Xinjiang benefited from \$1.2 billion in support for more than 20 projects and Sichuan received more than \$2.3 billion under about 40 projects); (ii) for much of the 1990s until 1997/98, China’s reserves were still recovering from their near depletion in the early 1990s, so that during much of the decade foreign exchange was, in fact, an issue; and (iii) by viewing our lending from the perspective of national foreign reserves and revenue/GDP ratios, the report overlooks the fact that, unlike other countries, our lending in China is largely provincially based and most provinces have major fiscal and foreign exchange access issues, which the Bank helped to relieve.

Portfolio Management

The depiction of factors that improved the QAG rating in subsequent years appears incomplete by attributing the improvement to Regional efforts and increased scrutiny of the portfolio after issues surfaced under the Western Poverty Project (in May 1999). We, however, see the turnaround that began at the start of FY99 (in July 1998) as largely the result of efforts initiated by Country management during that year to (i) provide budget to accelerate decentralization of staff, task management, and core services to the field; (ii) designate a senior Beijing Office staff member to oversee portfolio performance as a de facto Project Adviser; (iii) increase funding of supervision—which averaged about 21 staff weeks per project in FY99 or 22 percent above the Regional goal of 17 staff weeks; and (iv) carry out a QAG-type supervision assessment with assistance from the Region's Operations Adviser, which found satisfactory supervision of the sample projects. The impact of these measures was reflected in QAG's FY99 RSA, which rated China's supervision at 85 percent, slightly higher than the Bank's average (at 82 percent). By the time of the RSA in FY00, China's supervision was rated 100 percent, compared with 92 percent Bankwide.

Safeguards

As noted in box 4.2, the Western Poverty Project was a major blemish on an otherwise relatively strong performance in the Bank's involvement in safeguard issues. However, this single operation should not detract from the reality that only one of some 250 investment projects during more than two decades has been subject to such controversy.

The criticism that line managers had rarely visited the six projects reviewed by a Panel assessing safeguards compliance seems unrealistic.

With some 120 active projects scattered over more than 20 provinces and with managers visiting China no more than twice a year, it would seem impossible for most projects to be visited more than once or twice by managers in the course of even five years.

4. Conclusion

Overall, we broadly endorse the recommendations of the evaluation, which in general are consistent with our current strategy. In particular, we strongly agree that many lessons from China's experience are applicable to other countries, and for this reason we are sponsoring an upcoming poverty conference in Shanghai aimed in part at sharing lessons from China with others in the development community. We also agree on the importance of broadening our dialogue and have therefore in the past few years reoriented our policy support to respond better to the needs of the government's most-senior decisionmakers. Testament to the effectiveness of this reorientation is the substantial increase in government requests for Bank assistance with the most complex institutional and structural policy issues, including the eleventh five-year plan. Further, we agree that our somewhat smaller lending program must be used strategically and are therefore designing each operation to introduce innovation and change in the sectors supported, where needed, including poverty reduction and infrastructure development. In our analytical and advisory work, we will continue to provide our client with objective advice that draws on relevant lessons learned from other countries as well as China. Maintaining the quality of this support is our top priority, and our approach on each issue will be tailored to ensure greatest effectiveness. At the same time, efforts to protect portfolio quality will continue, so that our future performance shows the excellent outcomes realized in the past.

中 华 人 民 共 和 国 财 政 部
Ministry of Finance, People's Republic of China

December 18, 2003

To: Mr. Gene Tidrick
Lead Evaluation Officer, OEDCR
The World Bank

From Zou Jiayi
Deputy Director General
International Dept
Ministry of Finance

Subject: Comments on Draft China Country Assistance Evaluation

1. General Observations

The Chinese Government agrees with the general evaluation conclusion of the development effectiveness of the World Bank assistance to China during the past decade. Since the beginning of its economic reform in 1978, China has achieved outstanding accomplishments to date. China maintained the highest rate of sustained economic growth in the world and lifted more than a quarter billion people out of poverty. The World Bank has played an important role in the process. The Chinese government appreciates Bank's sustained supports in various areas to the economic development of China and attaches great importance to the cooperation with the World Bank.

The overall outcome of the World Bank assistance to China is satisfactory. From 1981 to 2002, the World Bank has provided USD 36 billion of loans and credits to support more than 240 projects in various sectors in China. These operations plus non-lending

activities have made significant contributions to the economic development of China. To put it simply, the World Bank's assistance has helped China in the following aspects:

1. Facilitating the economic system reform in China. The World Bank's operations helped the implementation of reform agenda of the government. It provided international experiences which are very helpful in the process of China's economic system reform. Especially, some timely relevant policy suggestions it made have facilitated the market-oriented reform and expedited the China's economic integration to international economy.
2. Promoting China's social and economic development. The lending operations provided financial resources which have positive direct impact to the development of China's economy. The investments in education, health, agriculture, poverty reduction, infrastructures, environment and other sectors supported China's economic and social development, and have very good demonstration effects.
3. Introducing new management concepts, methods and technologies to China. The World Bank has brought innovations to China, especially during the early years of cooperation, including economic concept such as economic value of services, corporate governance reform; and international development best practice such as project cycle, project appraisal, international competitive bidding.

The cooperation between the World Bank and China could be better if there were no the following three developments:

1. The World Bank stopped lending IDA to China after 1998. The unfair decision made by the World Bank credit while China is still perfectly eligible for IDA credits lending constrains the cooperation between the World Bank and China. China losses a source of favorable financial support, but the World Bank losses greater opportunity in helping China in various areas as a major development institution.
2. The increasing of cost of doing business with the World Bank. The increase of the World Bank loan price has direct negative impact in using World Bank resources. The major elements for the increased costs of doing business include

overly stringent application of safeguard policy, long project preparation process and unrealistic project objectives, etc.

3. Inspection Panel Report on the Qinghai Component of the Western Poverty Project. Chinese government rejects the conclusions of the Inspection Panel Report. The World Bank's procedures were abused by some NGOs with clearly political agenda which is totally contradiction to its Charters. The event impairs the image of the World Bank as an independent development institution.

2. Detailed comments on the CEA

- 2.1 China has never stopped reform since 1978, the parlance of "Resumption of reform"(abstract page iii, paragraph 3) is not suitable.

2.2 Infrastructure

- 2.2.1 We do not agree with the opinions mentioned in paragraph 6.10, page 59 about "new directions in infrastructure". We believe that World Bank should consistently support the infrastructure projects especially in middle and western parts of China; and CAE should include the suggestions on adoption of more flexible policy to enhance the efficiency and quality of project operations.
- 2.2.2 We would suggest change "disagreements" to "lack of understanding"(page 29, paragraph 3.39, line 2); change "rail's share of the transport total will fall" to "rail's share of the transport total will keep at the same level or grow slowly" (page 89, paragraph 2); change "The Bank's insistence on the application of various safeguard requirements appears to have taken root and become an integral part of investment planning" to "The Bank's insistence on the application of various safeguard requirements appears to have accorded with investment planning of China Rail" (page 91, paragraph 17); change "The relationship between the role of government as a regulator and the Ministry of Railways as an operator or enterprise remains a subject of contention" to "The relationship between the role of government as a regulator and an operator or enterprise remains a subject of study for Ministry of Railways"(page 91, paragraph 18). We

don't agree to "In particular, the application of modern administrative tools has brought home the fact that China Rail knew very little of the real costs of many of its operations" (page 91, paragraph 17) and we suggest to cancel "and between market-driven and public service activities" (page 91, paragraph 19).

- 2.2.3 We do not agree with the statement of "transfer water from south China to north" (page 36, paragraph 2). "Transfer water from south China to north" is a historical, strategic program, and it will solve the severe problem of scarcity of water in north China region. At the same time, China government has adopted other policies in facilitating water conservation, the market-oriented price reform in water sector is a good example. Therefore, it is not contradictory between "transfer water from south China to north" Program and other policies.

2.3 Financial Sector

- 2.3.1 According to the statistic of China Banking Regulatory Commission, till the end of October, 2003, The Non Performing Loans ratio of four state-owned commercial banks is 21.4%.
- 2.3.2 We suggest to change "The lack reform in financial sector" to "incomplete reform in the financial sector"(page 18, paragraph 3.17).

2.4 Education and Health

- 2.4.1 The report missed an important part, that is, it did not evaluate the experiences and existed problems of education projects in the past ten years in China.
- 2.4.2 The report failed to put enough emphasis on the social development in China including the role the World Bank played in the health sector.

2.5 Environment

- 2.5.1 The statements of "China's air and water are the most polluted in the world, accounting for hundreds of thousands of death annually" (page 3, paragraph 1.2)

and “Seven of the ten most polluted cities in the world in the late 1990s” (page 3, paragraph 1.2) lack of basis

- 2.5.2 We suggest to change “A falling water table in the northern China implies that the rate and pattern of growth which has taken place in that region are unsustainable” (page 3, paragraph 1.2) to “the descending of the underground water level in the North of China have restricted seriously the sustainable development of the region”.

We looking forward to the further cooperation with the World Bank.

Sincerely Yours,



Zou Jiayi

Deputy Director General

International Department

Ministry of Finance

China and the International Finance Corporation (IFC)

China has the largest economy, and attracted the most foreign direct investments (FDI) in recent years, among countries in which IFC operates. In 2002, China surpassed the U.S. as the top FDI destination country. IFC approved its first investment in China in June 1985, a US\$17 million loan. For the next seven years, IFC activity levels remained low, gaining momentum only after 1992. By the end of FY03, cumulative commitments totaled \$811 million, and IFC's held portfolio stood at US\$510 million, about 3 percent of its total held portfolio. China now represents IFC's sixth largest country portfolio exposure and its third largest country equity portfolio. At the end of FY03, IFC's China held portfolio was about 49 percent equity, 44 percent loans (including guarantees and risk management facilities), and 7 percent quasi-equity. The equity share in the China portfolio was unusually high compared with the IFC overall portfolio equity share of about 20 percent.

IFC's Strategies

IFC's strategies in China have been relevant and well-tailored to the country context. IFC progressively adapted them initially to the market opportunities, and then later to more pioneering selectivity in line with IFC's corporate strategic priorities. The strategies reflected successively the evolution of the government's economic re-

form initiatives, IFC's potential to add value, and IFC's lessons from its difficult early portfolio experiences. Beginning with the country assistance strategy for 1997, IFC placed increased emphasis on developing capital markets, private sector participation in infrastructure and extractive industries, and SME development. Subsequent strategies (1999, 2001, and 2003) added priority consideration to frontier provinces and corporate governance—partly by expanding technical assistance and advisory services (TA totaled more than US\$10 million from 1997 to 2003)—and to improving access by private companies, particularly SMEs, to financing from local banks and financial markets. While less than 15 percent of total FDI flows into China to date has gone to the frontier provinces and less than 1 percent into the financial sector, IFC directed more than 20 percent and 30 percent, respectively, of its commitments to these two areas, demonstrating a strong pioneering and leadership role, in line with the CAS and corporate priorities of maximizing IFC's development impact additionality.

Project Outcomes

Despite China's large economy, above average GDP growth rate, stable political environment, low sovereign risk rating, and substantial FDI flows since 1993, IFC's mature projects (approved FY90–FY99) have had development and investment outcomes below the IFC averages. While the

This Executive Summary has been extracted from the report of the International Finance Corporation's Operations Evaluation Group (OEG), "China: Country Impact Review," dated March 29, 2004. Consistent with the provisions of IFC's disclosure policy, detailed profit contribution data have been removed. Questions on this document should be referred to the OEG Task Manager, Denis Carpio (DCarpio@ifc.org), 202-473-1013.

development outcome and investment outcome “win-win” success rate matches the average of the Transition Countries, the proportion of “lose-lose” outcomes for the China projects is substantially higher than for the Transition Countries and IFC as a whole. However, mature projects within two of IFC’s present strategic priorities, namely in the frontier regions of China and in the financial markets (excluding collective investment vehicles or CIVs)—together comprising 38 percent of the 29 mature projects evaluated, show a much higher proportion of “win-win” outcomes compared with projects in the coastal regions, and compared with all of IFC. The environmental performance of the China projects is better than the IFC average.

Profit Contribution. For the period FY90–FY03, the China loan and equity portfolio, excluding unrealized capital gains, made a negative cumulative contribution to IFC’s net income. Including the unrealized capital gains expected to be realized in future fiscal years, the net profit contribution remained negative.

Outcome Drivers. Four major factors mainly account for the poor project development outcomes and portfolio profitability.

- *Excess capacity and a challenging business climate.* Other than in the frontier regions, overcapacity in many manufacturing industries, particularly in the coastal regions, has resulted from FDI exuberance, government-directed or induced investments (including FDI) and the “soft” budget constraints on expansion of state-owned enterprises (SOEs) through their easy access to low-interest loans from government-owned banks, rather than market-based resource allocation. The overcapacity has depressed both profit margins and capacity utilization during the initial operating years of many IFC real sector projects, putting development outcomes and investment returns below satisfactory return thresholds. In addition, the difficult business climate for private companies has overwhelmed even some of the high-quality sponsors with well-implemented IFC projects (construction and oper-

ation phases) yielding less than satisfactory project outcomes, including exit problems for IFC’s equity investments, and has also limited IFC’s use of quasi-equity instruments.

- *Restrictions on private investments in sectors that have been most profitable for IFC worldwide.* Government policies restrict private sector, particularly foreign, sponsorship of projects in several major sectors in which IFC equity investments generally performed above average in other developing countries during the 1990s. These restricted sectors included extractive industries, infrastructure, and, until recently, petrochemicals/chemicals and financial markets.
- *High project-risk intensity.* About 87 percent of the 29 mature IFC projects in China approved in FY90–FY99, feature three or four high-risk factors (out of four evaluated). These projects have had much lower development as well as investment outcome success rates compared with the projects (13 percent) with two or fewer high-risk factors.
- *The rapid growth of IFC’s commitments in an unfamiliar environment prevented experience from informing IFC’s appraisal of later projects.* IFC increased its China project commitments in an unfamiliar country environment much faster than IFC could acquire lessons from mature projects approved earlier. Its appraisal work quality for the mature China projects was therefore weaker than for projects in countries with a much longer history of IFC operations (that is, non-transition countries), and was similar to the average for transition countries that also had rapid portfolio growth with lagged experience accumulation.

Prospects for Recent Projects

The most recent IFC projects (approved in FY00–FY03) show better project screening, appraisal and structuring quality, and feature relatively less layering of high-risk factors, compared to the evaluated mature projects approved in FY90–FY99. In addition, the new Chinese government appears intent on more aggressively addressing the problems related to the SOEs and the banking sector that contribute to a difficult business climate for the private sector, and overall there are indications that manufacturing

capacity utilization is higher now than during the past few years. Nonetheless, the overall risk level of the recent projects as a group is still high because: (a) SOEs are expected to continue their dominant role in the financial and other “vital sectors” for many more years, prolonging the “un-level playing field” for private sector firms competing with such SOEs, and (b) the high proportion, almost 50 percent, of equity investments in the recent IFC commitments, will continue to face exit and value realization risks, particularly in the financial sector where IFC’s equity commitments are concentrated. The outcomes of the recently approved projects may therefore not be significantly better than those of the mature projects.

Going Forward

Apply Lessons of Experience and Stress Strategic Priority and Quality over Quantity. China’s transition challenges and prospects—in the context of both new projects and the partial or full privatization of SOEs in the financial, energy, extractive industries, and infrastructure sectors—present opportunities for IFC, but also pose high risks. In addressing these opportunities, IFC should grow its investment operations, particularly equity investments, within its strategic priorities, and in pace with improvements in the business climate and exit avenues. The essential operational considerations for achieving better results from new IFC projects in China are:

- 1) Strategic selectivity at screening in favor of priority frontier provinces and sectors, and on the strength of IFC’s role and value added
- 2) Also greater selectivity in project screening, instrument selection, and pricing from awareness of past results for projects featuring similar intensity of high-risk factors, and in the use of equity investments, including more rig-

orous analysis and structuring of equity exit mechanisms

- 3) Better management of project-level risks in the appraisal and structuring of projects, particularly in assessing the future supply-demand balance and the role of SOEs in the product market or in the financial sector, as well as closer supervision
- 4) Reflecting in IFC’s loan terms and conditions, both the potential for higher income through contingent payments when projects do well (“loan sweeteners” and/or equity acquisition features), as well as the possibility of lost income from loan prepayments by successful client companies receiving attractive refinancing offers in a likely increasingly competitive banking system
- 5) Continue as a high priority for IFC (and the WBG), the use of technical assistance (TA) and advisory operations for project preparation and sector reforms to help accelerate the transition process and improve the business climate, including removal of the regulatory barriers to the use of quasi-equity instruments and the timely remittance in foreign currency of the full realized value of negotiated equity divestments by foreign investors.

IFC management should satisfy itself that the necessary incentives and procedures are in place for project selectivity applying the above criteria, portfolio oversight, and corporate monitoring of adherence to IFC’s strategic priorities as well as to project and investment instrument selection guidelines.

Consider How to Address the Finding of Low Profitability of Large Middle-Income-Country Portfolios.

The Board and IFC management should address the low net profitability levels of the combined portfolios of middle-income countries with large economies, FDI flows, and IFC exposure.

ANNEX Q: REPORT FROM THE COMMITTEE ON DEVELOPMENT EFFECTIVENESS (CODE)

On March 29, 2004, the Committee for Development Effectiveness (CODE) discussed *China: Country Assistance Evaluation (CAE)*, prepared by the Operations Evaluation Department (OED).

Background

The *China CAE* focuses on the period of FY93–02. The main findings of the evaluation are that the overall outcome of the Bank’s assistance strategy was satisfactory, with China holding the best performing portfolio in the Bank Group. The Bank made significant contributions in all of its key objectives and played an important role in poverty reduction, macro-management, and systemic reform. The CAE found that the Bank has been less successful in supporting financial sector reforms, in persuading the government to forge the linkages between broader development policies and poverty and inequality, and in environmental safeguard policy. The project repayment system has also constrained sector and regional allocation and the choice of project components. The CAE found that the Bank has generally played a relevant role in China, specifically due to its long-term engagement and working with the client more through dialogue and persuasion than conditionality, but the Bank now needs to adapt its strategy to a reduced lending program.

Conclusions and Next Steps

The Committee welcomed the opportunity to discuss the document and praised the impact that the World Bank Group had in support of China’s development during the past decade. The Committee commended the quality of the report, and broadly supported the findings and recommendations. Members noted there were many lessons to be learned from the develop-

ment partnership between China and the Bank, and suggested that these lessons should be transmitted to other clients, specifically middle-income countries (MICs). The challenges of developing further a program in China with reduced IBRD and no IDA allocations was raised. Some members expressed a view that OED’s evaluation of the Bank’s performance in China could well be rated higher than “satisfactory” for its exceptional contribution to assisting the country in its overall poverty reduction achievements. OED responded that the Bank has made some outstanding contributions, but that shortcomings in the financial sector and lapses on safeguards precluded a highly satisfactory rating.

Among the specific issues raised by the Committee were:

Fiscal Transfer and Income Inequality

Committee members expressed the view that China’s beneficiary repayment and fiscal transfer system has both rewarding and challenging effects. It has served China well by strengthening client ownership, which led to the development of coastal provinces. However, this system poses hindrances for poor inland provinces that may not have the ability to repay, consequently constraining the impact of the Bank’s interventions. Management responded that the Bank offered advice regarding beneficiary repayment, recommending ways to avoid the distortion of incentives. They further emphasized that the provincial expenditure review indicated that differentiation needs to be built into the repayment system to reflect the “ability to pay” of the region and the sector. Some members pointed out that income inequality across geographical areas and sectors in China has grown and should be addressed. Management explained that in-

equality in China can chiefly be attributed to faster growth of urban areas (8 percent over the past 20 years) *vs.* rural areas (4 percent over the past 20 years). Management also stressed that sustained rural growth can be considered successful by any standard and pointed out that poverty mapping was done on a regional basis, but agreed that inequality in terms of access to services needs to be addressed. It was further noted that the lessons drawn from this CAE should help the Bank and the country develop an appropriate strategy in this regard.

Dual-Track Approach and Country Ownership

Some speakers observed that the CAE clearly highlights the positive outcomes of the dual-track nature of the development partnership between the Bank and the country: a mix of investment operations bolstered by long-term and continuous dialogue, persuasion, and demonstration. The Management clarified that this system is successful with clients who have both a clear idea of their development direction and sufficient implementation ability. Some Committee members stressed the crucial importance of safeguards for the Bank's fiduciary responsibility, but emphasized that they be built into country systems to reduce their cost of implementation. The Management explained that China has formal safeguard standards similar to those of the Bank and that these are being

applied to all investments. Some members felt, and the Management agreed, that for the dual-track approach to continue to work in China (and also be applied elsewhere), careful balancing is necessary between country ownership and the Bank Group's mandate.

Deepening Reforms

Some members observed that investment lending strategy pursued in China should be utilized to support systemic reforms, private sector development, and inequality reduction. The members pointed out that "deepening" reforms could be effectively married with investment operations, especially in infrastructure for poor areas. The Management agreed with the observations of the Committee and confirmed that China continues to have basic infrastructure lending needs that the Bank could help finance.

Quality of ESW

Members broadly supported the finding of the CAE that the Bank needs to improve its ESW, particularly by focusing on timely delivery and relevant experiences, both Chinese and foreign. It was observed that China was one of the Bank's rare clients where the synergy between ESW and investment operations was probably used in a most productive manner. They noted the potential for high-quality and timely ESW on the Bank Group's lending activities.

Pietro Veglio, Acting Chairman

ANNEX R: REFERENCE TABLES

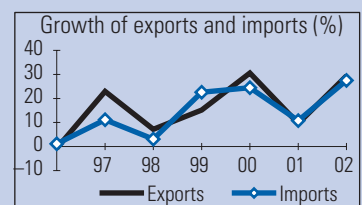
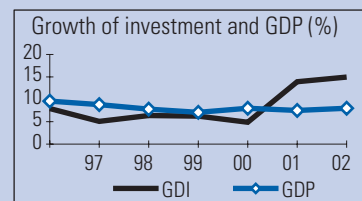
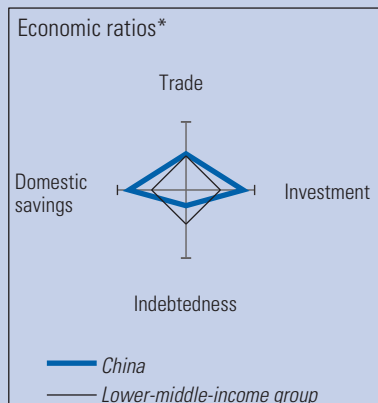
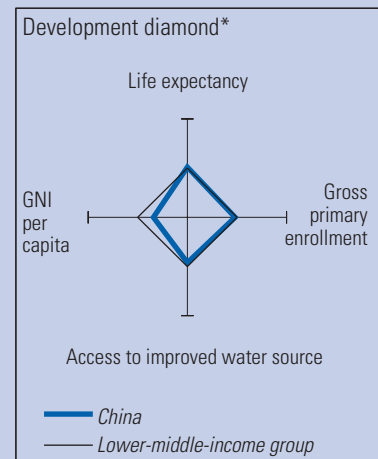
Table R.1:	China at a Glance
Table R.2:	Key Economic and Social Indicators—China and Comparisons, 1992–01
Table R.3a:	China: Average Annual Net Receipts from All Donors for 1980–98 (US\$m)
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Table R.7:	China: The World Bank’s Senior Management
Table R.8:	China: Poverty and Inequality
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Table R.1 China at a Glance

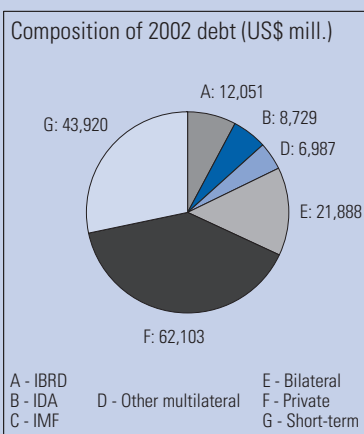
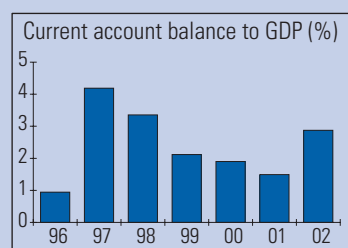
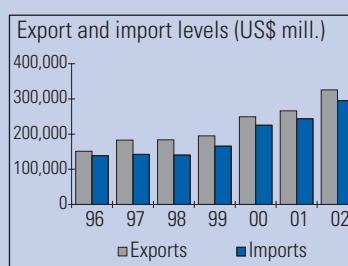
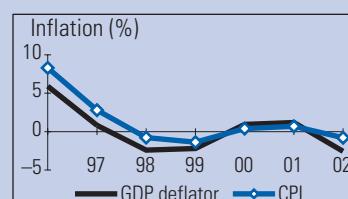
	China	East Asia and Pacific	Lower-middle-income	
POVERTY and SOCIAL				
2002				
Population, mid-year (millions)	1,281.0	1,838	2,411	
GNI per capita (Atlas method, US\$)	950	950	1,390	
GNI (Atlas method, US\$ billions)	1,219.1	1,740	3,352	
Average annual growth, 1996–02				
Population (%)	0.8	1.0	1.0	
Labor force (%)	0.9	1.2	1.2	
Most recent estimate (latest year available, 1996–02)				
Poverty (% of population below national poverty line)	5	..	..
Urban population (% of total population)	38	38	49	
Life expectancy at birth (years)	71	69	69	
Infant mortality (per 1,000 live births)	30	33	30	
Child malnutrition (% of children under 5)	10	15	11	
Access to an improved water source (% of population)	75	76	81	
Illiteracy (% of population age 15+)	14	13	13	
Gross primary enrollment (% of school-age population)	106	106	111	
Male	105	105	111	
Female	108	106	110	
KEY ECONOMIC RATIOS and LONG-TERM TRENDS				
	1982	1992	2001	2002
GDP (US\$ billions)	221.5	454.6	1,167.1	1,232.7
Gross domestic investment/GDP	33.2	36.2	38.5	41.0
Exports of goods and services/GDP	8.9	19.5	25.5	29.5
Gross domestic savings/GDP	34.8	37.7	40.9	44.0
Gross national savings/GDP	35.1	38.0	40.0	43.8
Current account balance/GDP	2.4	1.9	1.5	2.9
Interest payments/GDP	0.2	0.6	0.5	0.5
Total debt/GDP	3.8	15.9	14.6	12.6
Total debt service/exports	8.0	8.6	7.7	6.1
Present value of debt/GDP	..	..	14.1	..
Present value of debt/exports	..	..	51.8	..
	1982–92	1992–02	2001	2002
(average annual growth)				
GDP	9.7	9.0	7.5	8.0
GDP per capita	8.1	8.0	6.7	7.2
Exports of goods and services	5.9	14.3	9.6	29.4
STRUCTURE of the ECONOMY				
	1982	1992	2001	2002
(% of GDP)				
Agriculture	33.3	21.8	15.8	14.5
Industry	45.0	43.9	50.1	51.7
Manufacturing	37.3	33.1	34.2	44.5
Services	21.7	34.3	34.1	33.7
Private consumption	50.7	49.2	45.7	42.5
General government consumption	14.5	13.1	13.4	13.5
Imports of goods and services	7.3	18.0	23.1	26.5
	1982–92	1992–02	2001	2002
(average annual growth)				
Agriculture	4.6	3.7	2.8	2.9
Industry	11.6	11.3	8.4	9.9
Manufacturing	11.2	10.4	9.0	8.1
Services	11.7	8.4	8.4	7.3
Private consumption	11.4	8.1	2.8	1.9
General government consumption	9.9	8.4	10.5	7.0
Gross domestic investment	9.5	9.7	13.9	14.9
Imports of goods and services	9.7	12.8	10.8	27.5

Note: 2002 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.



PRICES and GOVERNMENT FINANCE	1982	1992	2001	2002
Domestic prices (% change)				
Consumer prices	6.0	6.4	0.7	-0.8
Implicit GDP deflator	-0.2	7.9	1.2	-2.6
Government finance (% of GDP, includes current grants)				
Current revenue	22.9	14.7	17.1	17.9
Current budget balance	..	2.0	1.1	0.0
Overall surplus/deficit	-0.3	-1.0	-4.7	-3.0
TRADE	1982	1992	2001	2002
(US\$ millions)				
Total exports (fob)	22,321	84,940	266,155	325,565
Food	2,908	8,309	12,780	14,623
Fuel	5,314	4,693	8,420	8,372
Manufactures	12,271	67,936	239,802	297,085
Total imports (cif)	19,285	80,585	243,610	295,203
Food	4,201	3,146	4,980	5,237
Fuel and energy	183	3,570	17,495	19,285
Capital goods	3,204	31,312	107,040	137,030
Export price index (1995=100)	41	85	83	78
Import price index (1995=100)	71	95	91	86
Terms of trade (1995=100)	58	89	91	90
BALANCE of PAYMENTS	1982	1992	2001	2002
(US\$ millions)				
Exports of goods and services	24,906	94,198	299,409	365,395
Imports of goods and services	20,555	86,752	271,325	328,013
Resource balance	4,350	7,446	28,085	37,383
Net income	376	249	-19,174	-14,945
Net current transfers	486	1,155	8,492	12,984
Current account balance	5,212	8,850	17,401	35,422
Financing items (net)	-995	-10,952	30,046	40,085
Changes in net reserves	-4,217	2,102	-47,447	-75,507
Memo:				
Reserves including gold (US\$ millions)	..	24,842	220,051	297,721
Conversion rate (DEC, local/US\$)	2.4	5.9	8.3	8.3
EXTERNAL DEBT and RESOURCE FLOWS	1982	1992	2001	2002
(US\$ millions)				
Total debt outstanding and disbursed	8,358	72,428	170,110	155,678
IBRD	0	3,752	11,550	12,051
IDA	1	4,287	8,654	8,729
Total debt service	2,125	8,618	24,297	22,688
IBRD	0	460	1,550	1,631
IDA	0	30	151	175
Composition of net resource flows				
Official grants	47	327	240	..
Official creditors	657	2,343	2,156	-839
Private creditors	-122	8,949	-4,017	-13,593
Foreign direct investment	430	11,156	44,241	49,308
Portfolio equity	0	1,243	3,015	2,286
World Bank program				
Commitments	330	1,865	782	563
Disbursements	1	1,131	1,791	1,733
Principal repayments	0	197	904	1,157
Net flows	1	1,134	887	576
Interest payments	0	293	797	649
Net transfers	1	841	90	-73



Note: This table was produced from the Development Economics central database.

Table R.2

Key Economic and Social Indicators—
China and Comparisons, 1992–01

Series name	China					
	1992	1993	1994	1995	1996	1997
GNI per capita, Atlas method (current US\$)	390	410	450	520	620	710
GNI per capita, PPP (current international \$)	1,810	2,060	2,340	2,650	2,900	3,110
GDP growth (annual %)	14.3	13.5	12.8	10.5	9.6	8.8
GDP per capita growth (annual %)	12.9	12.2	11.6	9.3	8.4	7.7
Agriculture, value added (% of GDP)	21.8	19.9	20.2	20.5	20.4	19.1
Services, etc., value added (% of GDP)	34.3	32.7	31.9	30.7	30.1	30.9
Industry, value added (% of GDP)	43.9	47.4	47.8	48.8	49.5	50.0
Manufacturing, value added (% of GDP)	33.1	34.5	34.4	34.7	34.7	34.6
Exports of goods and services (% of GDP)	19.5	17.1	25.3	24.0	21.0	23.1
Imports of goods and services (% of GDP)	18.0	18.6	23.4	21.7	18.9	18.3
Manufactures exports (% of merchandise exports)	78.7	80.6	82.3	84.0	84.4	85.4
Manufactures imports (% of merchandise imports)	80.4	84.0	83.9	78.5	79.1	77.1
Current account balance (% of GDP)	1.5	-2.7	1.3	0.2	0.9	4.1
Foreign direct investment, net inflows (% of GDP)	2.7	6.4	6.2	5.1	4.9	4.9
Total debt service (% of GNI)	2.1	2.4	2.1	2.2	2.0	2.1
Gross international reserves in months of imports	3.8	3.2	5.9	6.3	7.7	9.7
Current revenue, excluding grants (% of GDP)	4.2	3.0	6.4	5.7	5.5	5.8
Expenditure, total (% of GDP)	8.0	6.4	9.4	8.2	8.0	8.1
Overall budget balance, excluding capital grants (% of GDP)	-1.0	-0.8	-1.2	-1.0	-0.8	-0.8
Inflation, consumer prices (annual %)	6.3	14.6	24.2	16.9	8.3	2.8
Life expectancy at birth, total (years)	69.0	..	..	69.4	..	69.7
Illiteracy rate, adult total (% of people ages 15 and above)	21.5	20.8	20.0	19.2	18.6	18.0
Immunization, DPT (% of children under 12 months)	94.0	95.0	93.0	92.0	95.0	96.0
Improved water source (% of population with access)	71*	..	..	..	..	..
Improved sanitation facilities (% of population with access)	29*	..	..	..	..	..
Mortality rate, under-5 (per 1,000 live births)	47*	..	..	..	..	43.0
School enrollment, primary (% gross)	119.0	116.9	116.8	117.5	119.8	123.0
School enrollment, secondary (% gross)	55.0	56.8	61.0	65.8	68.9	58.9
Population, total (million)	1,165	1,178	1,192	1,205	1,218	1,230
Population growth (annual %)	1.2	1.1	1.1	1.1	1.0	1.0
Urban population (% of total)	28.9	29.7	30.5	31.4	32.2	33.1

*1990 Data.

Source: World Bank WDI & Central Database, data as of 12/10/02; and China Statistic Yearbook, 2001.

				Average 1992–01					
1998	1999	2000	2001	China	Brazil	India	Indonesia	EAP	World
740	780	840	890	635	3658	398	815	741	4,976
3,300	3,580	3,920	4,260	2,993	6,669	1,971	2,731	3,028	6,514
7.8	7.1	7.9	7.3	10.0	2.7	5.9	3.9	7.5	2.6
6.7	6.1	7.2	6.5	8.9	1.3	4.0	2.2	6.2	1.2
18.6	17.6	15.9	15.0	18.9	8.2	28.2	17.4	17.9	5.5
32.1	32.9	33.2	32.9	32.2	57.3	45.0	39.8	37.3	61.4
49.3	49.4	50.9	52.2	48.9	34.6	26.9	42.8	44.8	33.1
33.7	33.6	34.5	35.4	34.3	23.5	16.4	24.5	30.7	21.8
21.9	22.0	25.9	25.6	22.5	9.5	11.4	33.3	33.8	21.6
17.3	19.1	23.2	24.7	20.3	10.4	14.1	29.1	31.4	21.2
87.3	88.3	88.2	..	84.4	55.5	74.9	50.4	74.7	77.0
81.3	80.3	75.7	..	80.0	69.8	52.2	70.3	78.7	74.7
3.3	2.1	1.9	1.7	1.4	-2.6	-1.1	0.0	..	..
4.6	3.9	3.6	..	4.7	2.3	0.5	0.6	3.8	1.7
2.0	2.1	2.0	..	2.1	5.6	3.0	11.3	4.5	..
9.9	9.1	7.4	8.8	7.2	6.6	5.5	4.1	6.1	4.6
6.3	7.2	..	..	5.5	24.9	12.2	17.6	10.8	25.3
9.3	10.9	..	..	8.5	30.3	15.5	17.1	12.7	28.3
-1.2	-2.1	-2.8	..	-1.3	-6.9	-5.6	0.0	..	..
-0.8	-1.4	0.3	..	7.9	506.6	8.0	14.3	..	..
..	..	70.3	..	69.6	67.1	61.6	64.5	68.2	66.1
17.3	16.6	15.9	15.3	18.3	16.2	45.5	15.5	16.8	25.6
98.0	90.0	..	..	94.1	79.1	62.0	69.1	88.3	74.3
..	..	75.0	..	75.0	87.0	88.0	76.0	74.4	80.5
..	..	38.0	..	38.0	77.0	31.0	66.0	47.1	56.2
..	41.0	39.5	..	41.2	44.0	96.9	59.6	47.3	78.8
107.4	106.4	..	..	115.9	122.7	100.2	113.0	114.0	102.5
61.7	62.8	..	..	61.4	56.6	48.9	49.8	59.2	62.8
1,242	1,254	1,262	1,272	1,222	162.7	955.8	198.9	1,739.0	5,777.2
0.9	0.8	0.9	0.8	1.0	1.4	1.8	1.6	1.2	1.4
33.9	34.9	35.8	36.7	32.7	79.0	26.9	37.2	33.5	45.5

Table R.3a	China: Average Annual Net Receipts from All Donors for 1980-98 (US\$m)						
Donors	1981-90	1991-00	1991-95	1996-00	1998	1999	2000
IBRD	239.2	878.7	759.8	997.6	1,078.0	788.3	968.0
IDA	264.3	648.8	746.8	550.8	553.8	406.8	315.5
ADB	7.5	504.8	342.6	667.1	721.6	704.3	700.8
ADB Special Funds	0.9	7.8	15.6	..	..	..	..
JAPAN	1,392.9	2,146.0	3,566.7	725.4	968.9	-1,889.9	-2,295.8
EC + EU members	809.1	2,936.3	2,583.1	3,289.6	3,343.3	3,187.1	946.9
UNITED STATES	42.5	785.3	662.4	908.3	144.9	1,802.7	-393.3
Total multilateral	650.6	2,198.1	2,002.3	2,393.9	2,571.7	2,072.9	2,119.6
Total bilateral	2,327.1	6,118.5	7,189.5	5,047.6	4,643.3	3,294.1	-1,576.4
Other donors	17.0	298.7	372.7	224.7	529.2	143.8	210.8
Total of all donors	2,994.9	8,615.4	9,564.6	7,666.2	7,744.2	5,510.8	754.0

Table R.3b	China: Net Receipts from All Donors for 1980-98 (US\$m)						
Donors	1981-90	1991-00	1991-95	1996-00	1998	1999	2000
IBRD	2,391.9	8,787.23	3,799.17	4,988.06	1,077.97	788.34	967.99
IDA	2,643.26	6,488.03	3,734.15	2,753.88	553.82	406.81	315.48
ADB	75.38	5,048.38	1,712.75	3,335.63	721.59	704.32	700.83
ADB Special Funds	9.02	77.99	77.99	0	..	..	..
JAPAN	13,929.3	21,460.44	17,833.39	3,627.05	968.93	-1,889.94	-2,295.75
EC + EU members	8,090.92	29,363.33	12,915.34	16,447.99	3,343.27	3,187.07	946.94
UNITED STATES	425	7,853.27	3,312	4,541.27	144.85	1,802.73	-393.31
Total multilateral	6,505.84	21,981.12	10,011.54	11,969.58	2,571.66	2,072.88	2,119.55
Total bilateral	23,271.26	61,185.39	35,947.61	25,237.78	4,643.33	3,294.09	-1,576.42
Other donors	170.38	2,987.24	1,863.65	1,123.59	529.24	143.84	210.84
Total of all donors	29,948.78	86,153.9	47,822.95	38,330.95	7,744.23	5,510.81	753.97

Source: OECD Beyond 2020 CD rom data, 2002.

Table R.4

List of Economic and Sector Work
for China

No.	Document Title	Date	Report No.	Document Type
1	China - Country assistance strategy Vol. 1	1/22/2003	25141	Country Assistance Strategy Document
2	China - Agenda for water sector strategy for North China - summary report	5/9/2002	22040	Sector Report
3	China - National development and sub-national finance : a review of provincial expenditures	4/9/2002	22951	Economic Report
4	Technology assessment of clean coal technologies for China, Vol. 2	5/31/2001	23488	ESMAP Paper
5	China - Overcoming rural poverty	10/18/2000	21105	Sector Report
6	Assessing markets for renewable energy in rural areas of Northwestern China	8/31/2000	21359	ESMAP Paper
7	China - Managing public expenditures for better results : country economic memorandum	4/25/2000	20342	Economic Report
8	Strategic goals for Chinese education in the 21st century	11/30/1999	18969	Sector Report
9	China - Improving the technical efficiency of decentralized power companies	9/30/1999	ESM222	ESMAP Paper
10	China - Rural China : transition and development	5/28/1999	19361	Sector Report
11	China - Weathering the storm and learning the lessons : country economic memorandum	5/25/1999	18768	Economic Report
12	Power trade strategy for the Greater Mekong Sub-region	3/31/1999	19067	Sector Report
13	China - Country assistance strategy : progress report	5/6/1998	20541	CAS Progress Report
14	China - Forward with one spirit: a strategy for the transport sector	4/23/1998	15959	Sector Report
15	China 2020 : development challenges in the new century	9/18/1997	17027	Sector Report
16	China ' s management of enterprise assets : the state as a shareholder	6/5/1997	16265	Economic Report
17	China - Country Assistance Strategy	2/25/1997	16321	Country Assistance Strategy Document
18	China - Fruit and vegetable marketing performance	11/6/1996	15658	Sector Report
19	China - Container transport services and trade : framework for an efficient container transport system	10/10/1996	15303	Sector Report
20	China - Renewable energy for electric power	9/11/1996	15592	Sector Report
21	China - Pension system reform	8/22/1996	15121	Sector Report
22	China - Issues and options in health financing	8/12/1996	15278	Sector Report
23	China - Energy for rural development in China : an assessment based on a joint Chinese/ESMAP study in six counties	7/31/1996	ESM183	ESMAP Paper
24	China - Higher education reform	6/27/1996	15573	Sector Report
25	China - Reform of state-owned enterprises	6/21/1996	14924	Sector Report
26	China - The Chinese economy : fighting inflation, deepening reforms	5/31/1996	15626	World Bank Country Study
27	China and Vietnam - project evaluation by the ESMAP Technical Advisory Group (TAG)	3/24/1996	18671	ESMAP Paper
28	China - Social sector expenditure review	2/29/1996	17348	Sector Report

(Table continues on the following page.)

Table R.4**List of Economic and Sector Work
for China (continued)**

No.	Document Title	Date	Report No.	Document Type
29	China - The emerging capital market	11/3/1995	14501	Sector Report
30	China - Public investment and finance	10/18/1995	14540	Economic Report
31	China - Country assistance strategy	5/4/1995	14454	Country Assistance Strategy Document
32	China - Investment strategies for China ' s coal and electricity delivery system	3/8/1995	12687	Sector Report
33	China - Strategies for road freight development	2/17/1995	12600	Sector Report
34	China - Energy efficiency and pollution control in township and village enterprises (TVE) industry	12/31/1994	ESM168	ESMAP Paper
35	China - Internal market development and regulation	12/31/1994	13664	World Bank Country Study
36	China - Urban environmental service management	12/31/1994	13073	Sector Report
37	China - GNP per capita	12/15/1994	13580	Economic Report
38	China - Country economic memorandum : macroeconomic stability in a decentralized economy	10/26/1994	13399	Economic Report
39	China - Power sector reform : toward competition and improved performance	9/15/1994	12929	Sector Report
40	China - Agro-industrial crop marketing	6/17/1994	12974	Sector Report
41	China - Environmental action plan of China 1991-2000	3/31/1994	E37 Plan	Environmental Action Plan
42	China - Internal market development and regulation	3/17/1994	12291	Sector Report
43	China - Foreign trade reform	2/28/1994	12914	World Bank Country Study
44	China - Highway development and management : issues, options, and strategies	2/24/1994	11819	Sector Report
45	China - Industrial organization and efficiency case study : the automotive sector	12/31/1993	12134	Sector Report
46	China - Southeast coastal region : strategic issues in ports and shipping development	12/10/1993	11771	Sector Report
47	China - New skills for economic development : the employment and training implications of enterprise reform	11/24/1993	11785	Sector Report
48	China - Budgetary policy and intergovernmental fiscal relations	7/28/1993	11094	Sector Report
49	China - Strategic options for power sector reform : summary, speeches, and documents from a Workshop, Beijing July 8 - 10, 1993	7/10/1993	ESM156	ESMAP Paper
50	China - Updating economic memorandum : managing rapid growth and transition	6/30/1993	11932	Economic Report
51	China - Yellow river basin investment planning study	6/30/1993	11146	Sector Report
52	China - Animal feed sector study	6/24/1993	10922	Sector Report
53	China - Foreign trade reform : meeting the challenge of the 1990s	6/18/1993	11568	Sector Report
54	China - Involuntary resettlement	6/8/1993	11641	Sector Report
55	China - The achievement and challenge of price reform	3/31/1993	11772	World Bank Country Study

No.	Document Title	Date	Report No.	Document Type
56	China - Railway strategy	2/25/1993	10592	Sector Report
57	China - Energy conservation study	2/4/1993	10813	Sector Report
58	Industrial restructuring : a tale of three Chinese cities	12/15/1992	10479	Sector Report
59	China - Long-term issues and options in the health transition	10/31/1992	11269	World Bank Country Study
60	China - Strategies for reducing poverty in the 1990s	10/31/1992	11245	World Bank Country Study
61	China - Urban land management : options for an emerging market economy	10/1/1992	10692	Sector Report
62	China - Statistical system in transition	9/22/1992	9557	Economic Report
63	China - Reforming the urban employment and wage system	6/30/1992	10266	Sector Report
64	China - Strategies for reducing poverty in the 1990s	6/29/1992	10409	Sector Report
65	China - Country economic memorandum : reform and the role of the plan in the 1990s	6/19/1992	10199	Economic Report
66	Price reform in China	5/28/1992	10414	Economic Report
67	China - Environmental strategy paper	4/30/1992	9669	Sector Report
68	China - Telecommunications sector study : survey, assessment and strategy recommendations	2/14/1992	9413	Sector Report
69	China - Implementation options for urban housing reform	1/31/1992	10315	World Bank Country Study
70	China - Options for reform in the grain sector	7/31/1991	9804	World Bank Country Study
71	China - Provincial education planning and finance sector study	6/26/1991	8657	Sector Report
72	China - Urban housing reform : issues and implementation options	6/26/1991	9222	Sector Report
73	China - Economic development in Jiangsu Province	6/25/1991	9354	Economic Report
74	China - Managing an agricultural transformation : grain sector review	4/9/1991	8652	Sector Report
75	China - Efficiency and environmental impact of coal use	3/20/1991	8915	Sector Report
76	China - Financial sector review : financial policies and institutional development	12/31/1990	PUB8415	World Bank Country Study
77	China - Revenue mobilization and tax policy	6/30/1990	PUB7605	World Bank Country Study
78	China - Long term issues and options in the health transition	6/25/1990	7965	Sector Report
79	China - Reforming social security in a socialist economy	6/25/1990	8074	Economic Report
80	China - Electronics sector report	6/21/1990	7962	Sector Report
81	China - Country economic memorandum : between plan and market	5/8/1990	8440	Economic Report
82	China - Fuelwood development and conservation project Hunan province	12/31/1989	ESM105	ESMAP Paper
83	China - Revenue mobilization and tax policy	6/15/1989	7605	Sector Report
84	China - Macroeconomic stability and industrial growth under decentralized socialism	6/12/1989	7483	Economic Report

(Table continues on the following page.)

Table R.4**List of Economic and Sector Work
for China (continued)**

No.	Document Title	Date	Report No.	Document Type
85	County - level rural energy assessments : a joint study of ESMAP and Chinese experts	5/31/1989	ESM101	ESMAP Paper
86	China - Rural industry : overview, issues, and prospects	3/1/1989	7267	Sector Report
87	China - External trade and capital reform issues and options	9/30/1988	PUB6680	World Bank Country Study
88	China - Finance and investment	9/30/1988	PUB6445	World Bank Country Study
89	China - Growth and development in Gansu province	9/30/1988	PUB6064	World Bank Country Study
90	China - External trade and capital reform issues and options	10/20/1987	6680	Sector Report
91	China - Technical and vocational education development	8/7/1987	6789	Sector Report
92	China - Zhejiang : challenges of rapid urbanization	8/3/1987	6612	Sector Report
93	China - Textbook development	7/1/1987	6735	Sector Report
94	China - Finance and investment	6/11/1987	6445	Economic Report
95	China - Water transport sector study	2/12/1987	6383	Sector Report
96	China - Livestock sector study	1/15/1987	6589	Sector Report
97	China - Growth and development in Gansu province	11/20/1986	6064	Economic Report
98	China - Issues and prospects in education	5/31/1986	18954	World Bank Country Study
99	China - Management and finance of higher education	5/31/1986	5912	Sector Report
100	China - Long-term issues and options	5/31/1985	5206	Economic Report
101	China - The health sector	4/30/1984	4664	Sector Report
102	China - Socialist economic development	8/31/1983	PUB3391	World Bank Country Study
103	China - Recent economic trends and policy developments	3/31/1983	4072	Economic Report
104	China - Shanghai sector memorandum	12/15/1982	4227	Sector Report
105	China - Rural finance : a sector study	8/31/1982	3864	Sector Report
106	China - Socialist economic development	3/2/1982	3391	Economic Report

Source: Imagebank, data as of 11/10/02.

Table R.5a	Allocation of Investment Lending by Sector (%), 1993-02					
	China	Brazil	India	Indonesia	Other EAP	Bankwide
Economic policy	0.2	0.0	0.3	0.0	0.2	0.5
Education	3.0	17.3	8.4	13.8	13.7	10.6
Energy and mining	19.6	2.1	17.7	16.0	22.5	14.3
Environment	4.8	5.5	2.1	2.8	2.4	3.6
Financial sector	0.4	1.0	4.0	4.6	3.1	3.8
Global information/communications technology	1.1	0.0	0.4	4.7	3.2	1.0
Health, nutrition, and population	3.2	9.8	17.5	7.3	6.0	8.3
Private sector development	0.0	2.6	2.0	1.4	2.0	3.9
Public sector governance	1.3	4.8	0.0	3.2	2.5	2.6
Rural sector	24.1	17.3	19.3	6.4	11.4	14.7
Social development	0.5	0.0	0.0	0.0	0.0	0.2
Social protection	1.2	0.1	0.1	4.8	4.5	4.4
Transport	29.1	25.8	19.0	19.4	17.2	19.9
Urban development	2.8	4.8	4.5	14.6	6.6	6.1
Water supply and sanitation	8.6	8.9	4.8	1.0	4.5	6.1
Total	100.0	100.0	100.0	100.0	100.0	100.0
Total investment lending (million US\$)	22,762.8	8,126.58	17,467.9	7,654.287	18,307.5	146,791.4

Source: World Bank data as of 12/16/02.

Table R.5b		Project Rating by Sector and Exit FY: China and Comparisons							
Sector Board		Number of projects	Total net comm. (\$m)	Outcome, % satisfactory		Sustainability, % likely		Institutional development impact, % substantial	
				By number	By net comm.	By number	By net comm.	By number	By net comm.
Education	1998-02								
	Brazil	6	818.0	50	49	67	68	17	12
	China	5	558.2	100	100	100	100	100	100
	India	5	812.0	100	100	100	100	80	85
	Indonesia	7	364.0	100	100	14	13	29	24
	EAP	23	1,550.0	96	99	57	72	61	73
	Bankwide	120	7,323.0	82	85	64	72	41	45
Education	1993-97								
	Brazil	1	140.0	100	100	0	0	100	100
	China	5	489.6	100	100	80	88	60	61
	India	0							
	Indonesia	7	637.0	86	92	86	92	71	68
	EAP	22	1,753.0	91	87	86	84	68	69
	Bankwide	98	4,592.0	74	76	50	56	31	39
Energy and mining	1998-02								
	Brazil	3	484.0	100	100	100	100	67	46
	China	6	1,028.9	100	100	80	93	80	93
	India	12	2,731.0	58	72	55	66	58	51
	Indonesia	7	1,040.0	43	46	0	0	43	35
	EAP	30	3,479.0	69	68	57	54	45	52
	Bankwide	131	13,818.0	68	68	59	61	46	50
Energy and mining	1993-97								
	Brazil	3	555.0	0	0	100	100	0	0
	China	14	2,198.1	79	81	71	78	57	36
	India	26	4,606.0	58	70	62	72	27	26
	Indonesia	7	1,275.0	71	91	86	93	29	29
	EAP	40	5,002.0	85	82	80	81	50	50
	Bankwide	206	20,200.0	62	70	53	64	32	36

Environment	1998–02								
	Brazil	3	181.0	67	80	100	100	67	80
	China	3	564.7	67	57	100	100	33	36
	India	4	351.0	75	60	50	36	50	36
	Indonesia	2	61.0	50	76	50	76	0	0
	EAP	5	625.0	60	59	80	98	20	33
	Bankwide	41	1,819.0	78	70	77	79	54	40
Environment	1993–97								
	Brazil	3	156.0	100	100	67	72	33	40
	China	2	0.0	100	100	100	100	0	0
	India	0							
	Indonesia	0							
	EAP	2	49.0	50	61	50	61	0	0
	Bankwide	9	275.0	56	74	44	58	22	29
Financial sector	1998–02								
	Brazil	0							
	China	1	114.2	0	0	0	0	0	0
	India	2	557.0	50	31	100	100	50	31
	Indonesia	3	256.0	0	0	0	0	0	0
	EAP	12	6,331.0	50	92	50	92	18	23
	Bankwide	70	11,920.0	71	90	70	87	46	50
Financial sector	1993–97								
	Brazil	1	184.0	0	0	0	0	0	0
	China	2	300.6	100	100	100	100	0	0
	India	2	266.0	50	30	50	30	50	30
	Indonesia	4	609.0	75	61	75	61	50	37
	EAP	12	1,465.0	55	71	55	71	25	36
	Bankwide	63	8,876.0	56	58	44	53	37	47
Global information & communication technology	1998–02								
	Brazil	0							
	China	1	208.2	100	100	100	100	0	0
	India	0							
	Indonesia	1	288.0	100	100	100	100	100	100
	EAP	4	536.0	100	100	100	100	50	59
	Bankwide	15	1,082.0	100	100	100	100	73	74

Table R.5b		Project Rating by Sector and Exit FY: China and Comparisons (continued)							
Sector Board		Number of projects	Total net comm. (\$m)	Outcome, % satisfactory		Sustainability, % likely		Institutional development impact, % substantial	
				By number	By net comm.	By number	By net comm.	By number	By net comm.
Health, nutrition & population	1993–97								
	Brazil	3	214.0	100	100	100	100	67	72
	China	1	93.8	0	0	0	0	100	100
	India	4	412.0	100	100	75	88	25	12
	Indonesia	4	212.0	75	82	100	100	50	67
	EAP	7	393.0	71	67	86	76	43	60
	Bankwide	47	1,688.0	68	84	55	68	23	32
Health, nutrition & population	1998–02								
	Brazil	2	376.0	100	100	100	100	50	42
	China	4	288.7	75	64	100	100	75	62
	India	6	459.0	83	82	83	85	33	34
	Indonesia	4	127.0	50	95	50	95	25	57
	EAP	11	562.0	64	74	60	76	36	45
	Bankwide	87	4,207.0	65	75	58	69	33	39
Public sector governance	1998–02								
	Brazil	3	810.0	100	100	67	87	67	87
	China	1	82.6	0	0	0	0	0	0
	India	2	400.0	100	100	100	100	50	38
	Indonesia	2	512.0	100	100	0	0	0	0
	EAP	8	1,168.0	88	93	67	84	50	41
	Bankwide	82	5,748.0	86	91	83	91	60	57
Public sector governance	1993–97								
	Brazil	1	24.0	0	0	0	0	0	0
	China	1	20.0	100	100	100	100	100	100
	India	0							
	Indonesia	2	140.0	100	100	100	100	100	100
	EAP	4	179.0	75	90	75	90	75	90
	Bankwide	62	2,559.0	48	73	36	47	19	34
Transport	1998–02								
	Brazil	4	504.0	100	100	100	100	100	100
	China	13	2,705.6	100	100	100	100	100	100

Transport	India	4	370.0	75	49	75	49	75	49
	Indonesia	5	468	100	100	100	100	100	100
	EAP	28	3,881.0	100	100	93	98	82	90
	Bankwide	121	10,516.0	91	92	77	84	72	76
	1993–97								
Rural sector	Brazil	4	695.0	100	100	50	42	50	67
	China	15	1,711.4	100	100	100	100	47	38
	India	4	721.0	50	48	50	48	0	0
	Indonesia	7	1,018.0	100	100	43	57	29	40
	EAP	37	3,618.0	92	95	76	80	30	31
Rural sector	Bankwide	135	9,956.0	72	82	51	52	31	32
	1993–97								
	Brazil	19	1,943.0	84	72	79	79	68	41
	China	11	1,531.6	82	87	73	69	36	34
	India	23	2,745.0	65	67	17	21	35	39
Rural sector	Indonesia	15	999.0	73	67	40	29	33	18
	EAP	42	3,161.0	74	81	55	60	38	29
	Bankwide	296	15,606.0	66	74	39	48	33	36
	1998–02								
	Brazil	9	882.0	78	58	89	74	88	79
Water supply & sanitation	China	11	1,978.8	100	100	100	100	91	90
	India	13	1,090.0	85	83	82	80	69	57
	Indonesia	8	342.0	71	73	14	4	14	26
	EAP	29	3,084.0	86	96	67	87	46	70
	Bankwide	197	10,480.0	68	79	53	69	40	52
Water supply & sanitation	1998–02								
	Brazil	2	383.0	100	100	100	100	50	36
	China	2	195.7	50	57	50	57	50	57
	India	3	271.0	67	64	33	34	67	64
	Indonesia	3	317.0	100	100	33	14	33	14
Water supply & sanitation	EAP	8	650.0	88	87	50	38	50	39
	Bankwide	60	3,815.0	59	58	42	36	31	24
	1993–97								
	Brazil	2	360.0	100	100	50	22	50	22
	China	1	75.9	100	100	100	100	0	0
Water supply & sanitation	India	4	318.0	75	60	75	91	75	60
	Indonesia	1	42.0	100	100	0	0	0	0
	EAP	7	296.0	86	87	57	64	0	0
	Bankwide	47	3,248.0	60	58	32	27	23	16

Table R.5c		Portfolio Status Indicators: China and Comparisons				
Country	Number of projects	Net commitment amount	Projects at risk (%)	Commitment at risk (%)	Projects at risk (%)	Commitment at risk
Brazil	52	4,899.5	7.7	6.7	4	328.4
China	97	15,400.4	5.2	2.6	5	397.1
India	67	12,725.3	9.0	8.6	6	1,093.5
Indonesia	43	3,404.6	23.3	28.8	10	979.5
EAP	242	24,868.3	13.2	8.8	32	2,197.8
Bankwide	1,435	100,075.5	18.0	16.3	258	16,280.3

Source: World Bank data as of 11/08/2002.

Table R.6		Costs of Bank Programs for China and Comparison Countries, FY91-01			
Regions/countries	Total costs, \$m	Lending costs, \$m	Supervision costs, \$m	ESW costs, \$m	
Bank	3,478.1	1,243.0	1,150.8	1,084.2	
EAP	523.6	205.1	172.7	145.9	
China	154.0	69.4	59.4	25.2	
Brazil	82.9	28.5	38.4	15.9	
India	166.0	68.5	65.8	31.7	
Indonesia	116.8	44.6	47.2	25.0	
Cost Structure by Percentage					
Bank	100	36	33	31	
EAP	100	39	33	28	
China	100	45	39	16	
Brazil	100	34	46	19	
India	100	41	40	19	
Indonesia	100	38	40	21	

Efficiency Table

Regions/countries	Total costs, \$m	Number of projects approved in FY91-01	Gross commitment, \$m	Gross commit. of sat. & nonrisky projects, \$m	Average costs per approved project, \$1,000	Average costs per \$1,000 of gross commitment	Average costs per \$1,000 of gross commitment of sat. & non-risky projects	Average project size, \$m
Bank	3,478	2,671	242,060	208,551	1,302	14.4	16.7	91
EAP	524	448	62,095	56,042	1,169	8.4	9.3	139
China	69	151	26,306	24,217	1,020	2.6	2.9	174
Brazil	29	82	12,398	10,733	1,011	2.3	2.7	151
India	69	112	21,071	19,182	1,482	3.3	3.6	188
Indonesia	45	102	12,977	10,999	1,146	3.4	4.0591	127

Note: Total costs include lending completion, supervision, and ESW costs/ Lending, supervision, and ESW costs are actual costs covering all projects in FY91-01.

Source: World Bank data as of August, 2001.

Table R.7

China: The World Bank's Senior Management

Year	Vice President	Country Director	Chief/Resident Representative
1990	Attila Karaosmanoglu	Shahid Javed Burki	Edwin R. Lim
1991	Attila Karaosmanoglu	Shahid Javed Burki	Attila Sonmez
1992	Gautam S. Kaji	Shahid Javed Burki	Attila Sonmez
1993	Gautam S. Kaji	Shahid Javed Burki	Pieter P. Bottelier
1994	Gautam S. Kaji	Nicholas Hope	Pieter P. Bottelier
1995	Russell J. Cheetham	Nicholas Hope	Pieter P. Bottelier
1996	Russell J. Cheetham	Nicholas Hope	Pieter P. Bottelier
1997	J. Khalilzadeh-Shirazi (Acting)	Nicholas Hope	Pieter P. Bottelier
1998	Jean-Michel Severino	Yukon Huang	
1999	Jean-Michel Severino	Yukon Huang	
1999	Jemal-ud-din Kassum	Yukon Huang	
2000	Jemal-ud-din Kassum	Yukon Huang	
2001	Jemal-ud-din Kassum	Yukon Huang	
2002	Jemal-ud-din Kassum	Yukon Huang	

Source: The World Bank Telephone Directories, 1990–02.

Table R.8

China: Poverty and Inequality

	1978	1980	1985	1990	1993	1996	1998	1999	2000	2001
Official estimate										
Total headcount	250		97	86	76	59	43			2.9
National (%)	26		9.2	7.5	6.4	4.8	3.4			2.3
Rural (%)			11.9	9.5	8.2	6.3	4.6			
Urban (%)			0.4	0.4	0.3	0.3	0.3			
PPP (\$)										
Total headcount	490			375		212	223	224	204	
National (%)	51			32.9		17.4	17.8	17.8	16.1	
Rural (%)				44.4		24.8	26.2	27		
Urban (%)				1.0		0.4	1.0	0.5	0.5	
Inequality										
Gini coeff.		28.8 ^a		33.5			40.3	41.6		
Urban/rural	2.9	2.7	1.9	2.2	2.7 ^b			2.7		
Urban/rural (real)		3.4	2.2	2.3		2.8 ^b		2.7		

a. 1981.

b. 1995.

Source: World Development Indicators and China Statistical Yearbook.

Table R.9

Millennium Development Goals: China

	China Country Profile			
	1990	1995	1999	2000
1 Eradicate extreme poverty and hunger				
<i>2015 target = halve 1990 \$1 a day poverty and malnutrition rates</i>				
Population below \$1 a day (%)	..	..	18.8	..
Poverty gap at \$1 a day (%)	..	..	4.4	..
Percentage share of income or consumption held by poorest 20%	..	..	5.9	..
Prevalence of child malnutrition (% of children under 5)	17.4	12.9	9	10
Population below minimum level of dietary energy consumption (%)	16	..	9	..
2 Achieve universal primary education				
<i>2015 target = net enrollment to 100</i>				
Net primary enrollment ratio (% of relevant age group)	97.4	97.9	93.2	..
Percentage of cohort reaching grade 5 (%)	86	93.8	97.3	..
Youth literacy rate (% ages 15–24)	94.7	96.5	97.6	97.8
3 Promote gender equality				
<i>2005 target = education ratio to 100</i>				
Ratio of girls to boys in primary and secondary education (%)	81.1	87.3	88.6	..
Ratio of young literate females to males (% ages 15–24)	94.3	96.1	97.1	97.3
Share of women employed in the nonagricultural sector (%)	..	..	..	..
Proportion of seats held by women in national parliament (%)	21.3	..	65.0	..
4 Reduce child mortality				
<i>2015 target = reduce 1990 under 5 mortality by two-thirds</i>				
Under 5 mortality rate (per 1,000)	47	43	41	39.5
Infant mortality rate (per 1,000 live births)	38	36.2	33	32
Immunization, measles (% of children under 12 months)	98	93	90	..

Note: In some cases the data are for earlier or later years than those stated.

Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2 target: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

Goal 3 target: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

Goal 6 targets: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

Goal 8 targets: Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system. Address the special needs of the least developed countries. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

Source: World Development Indicators database, April 2002.

	China Country Profile			
	1990	1995	1999	2000
5 Improve maternal health				
<i>2015 target = reduce 1990 maternal mortality by three-fourths</i>				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	60	..	..
Births attended by skilled health staff (% of total)	..	85	..	..
6 Combat HIV/AIDS, malaria and other diseases				
<i>2015 target = halt, and begin to reverse, AIDS, etc.</i>				
Prevalence of HIV, female (% ages 15–24)	..	..	0	..
Contraceptive prevalence rate (% of women ages 15–49)	84.6	90.4	83	..
Number of children orphaned by HIV/AIDS	..	..	4,500.00	..
Incidence of tuberculosis (per 100,000 people)	..	..	103	..
Tuberculosis cases detected under DOTS (%)	..	..	32	..
7 Ensure environmental sustainability				
<i>2015 target = various (see notes)</i>				
Forest area (% of total land area)	15.6	..	..	17.5
Nationally protected areas (% of total land area)	..	6.4	6.4	..
GDP per unit of energy use (PPP \$ per kg oil equivalent)	1.8	3	4.2	..
CO2 emissions (metric tons per capita)	2.1	2.6	2.5	..
Access to an improved water source (% of population)	71	..	..	75
Access to improved sanitation (% of population)	29	..	..	38
Access to secure tenure (% of population)	..	..	..	..
8 Develop a Global Partnership for Development				
<i>2015 target = various (see notes)</i>				
Youth unemployment rate (% of total labor force ages 15-24)	..	2.9	3.1	3.1
Fixed line and mobile telephones (per 1,000 people)	5.9	35.9	120	177.6
Personal computers (per 1,000 people)	0.4	2.3	12.2	15.9
General indicators				
Population (billion)	1.1	1.2	1.3	1.3
Gross national income (\$)	368.1 billion	622.7 billion	978.1 billion	1.1 trillion
GNI per capita (\$)	320	520	780	840
Adult literacy rate (% of people ages 15 and over)	76.9	80.8	83.4	84.1
Total fertility rate (births per woman)	2.1	1.9	..	1.9
Life expectancy at birth (years)	68.9	69.4	..	70.3
Aid (% of GNI)	0.6	0.5	0.2	0.2
External debt (% of GNI)	15.6	17.2	15.8	14.1
Investment (% of GDP)	34.7	40.8	37.2	37.3
Trade (% of GDP)	31.9	45.7	41.2	49.1

ENDNOTES

Chapter 1

1. See World Bank (1997a) for a lower bound estimate.

2. Still, the decollectivization of agriculture after 1979 was quite radical—and arguably the most far-reaching and beneficial reform in the developing world in the past quarter century—but China’s overall approach to reform has been gradualist. Sachs and Woo (1997) have argued that China had the luxury of being able to choose a gradual reform path because, unlike most other transition economies, it had a large agricultural sector.

3. See the background paper by Khan (2002). See also Khan and Riskin (2001) and Kanbur and Zhang (2001). The Gini Index rose from 28.8 in 1981 (Chen and Wang 2001) to 40.3 in 1998. By this widely used measure of inequality, China has gone from one of the most equal income distributions to a distribution more unequal than average. Figures for comparator countries at the end of the 1990s (from *World Development Indicators 2002*) were Brazil (60.7), India (37.8), and Indonesia (31.7).

4. Based on WHO’s list of most polluted cities in terms of air quality. Cited in OECD (2002), p. 589.

5. For an expression of concern by Chinese scholars, see Wang, Angang, and Yanzhu (2002).

Chapter 2

1. World Bank (1982), *China: Socialist Economic Development* (3 volumes). The Bank worked with Chinese counterpart teams, which included Zhu Rongji, then head of the State Economic Commission.

2. In FY88, lending to China was \$1,693.6 million, and through May 30, 1989, total Bank lending to China was \$1,348.4 million (of which 38 percent was IDA over the two years). No projects were taken to the Board between May 30, 1989, and February 27, 1990. Five projects totaling \$590 million (all IDA)

were approved in FY90. On January 29, 1991, IBRD lending resumed and total lending during FY91 was \$1,579.3 million.

3. Kapur, Lewis, and Webb (1997), pp. 24 and 25, respectively. Jacobson and Oksenberg (1990) also rate this period as a big success, but note that the Bank was not the source of reform, only a facilitator (p. 140). They also list a number of challenges and trouble spots, including long project-processing times by the Bank, access to data, the level of IDA, and various issues regarding the pace and extent of reform (pp. 152–54).

4. The Bank’s first formal assistance strategy statement in 1991 stated, “Since China’s change in representation in 1980, the fundamental objective of the Bank’s lending activities, economic and sector work and associated technical assistance has been to provide analytical and material support to China’s economic reform and modernization process.” The report goes on to list six elements of the CAS, four of which highlighted reform as the key component.

5. This book provides a useful historical perspective on the limited impact outsiders have typically had in China.

6. Lending for infrastructure was about half of lending to China during both FY83–92 and FY93–02. The Bankwide average share of infrastructure in investment lending fell from 46 percent to 35 percent in the respective periods; as a share of total lending Bankwide, infrastructure lending fell from 39 percent to 25 percent.

7. For comments by the Bank’s Regional staff on this and other issues, see Annex N.

8. Transfer of foreign exchange resources has been even less an objective. At the end of 2001, total reserves minus gold were more than \$215 billion—equivalent to 70 years of World Bank lending at the highest annual rate achieved in the mid-1990s.

9. See Annex N.

Chapter 3

1. The link made by the Bank between macro-management and system reform is well illustrated by the title of the 1996 Country Economic Memorandum (CEM), *The Chinese Economy: Fighting Inflation, Deepening Reform* (World Bank 1996a).

2. See Harrold, Hwa, and Jiwei (1993), Lu (2002), and discussion below.

3. Although the Bank supported an expansionary fiscal policy in the aftermath of the Asian crisis, it stressed in numerous reports and policy notes that such a policy was risky if it was not a temporary measure. See Annex N.

4. This uses the IMF definition, which differs from the official definition in that losses of SOEs are classified as expenditures, rather than negative revenues.

5. Calculated from World Bank (2002a), Table 2.6. In 1998, Shanghai's per capita government expenditures were 19 times those of Hebei Province in 1998 (Table 2.5). Per student recurrent expenditure on compulsory primary education was more than 10 times higher in the top-spending province than in the bottom-spending province (Table 6.6). The central government transfers a large portion of its revenue to the provinces but, because most transfers are tax rebates based on source, the transfers are not equalizing.

6. Extrabudgetary funds (EBFs) may account for as much as 20 percent of GDP (World Bank 2002), so the overall tax "take" may not have declined. This gives the worst of both worlds: high tax burdens combined with the inefficiency, inequity, and lack of transparency of EBFs.

7. See Annex N.

8. Qian (2002) provides a good review of China's approach to reform and the reasons it has been largely successful thus far. For a review of the early reform period and the debate over gradual vs. "big bang" reform, see Tidrick (1994).

9. This does not mean that price reform is complete, but relative prices are not significantly out of line with those in other countries. Utility prices are still mainly regulated, but cost-based. See also the next section on progress in agriculture.

10. China, National Bureau of Statistics (2001) and earlier years. Although the Chinese term (*guoyou konggu qiye*) is often translated as "state-holding enterprises," the term "state-controlled shareholding companies" would be more accurate. Comparisons are approximate because of changes in definitions over time.

11. See the background paper by Lu (2002).

12. The return on assets of SOEs was estimated at 6 percent in 1996, compared with 8.4 percent for collectives and 9.9 percent for joint ventures. Part of the poor financial return may reflect ongoing social obligations.

13. See Annex N.

14. The Bank's study of pension reform worldwide (World Bank 1994a) and the follow-up report on China (World Bank 1996c) helped persuade China to follow a "three-pillar model," which includes a mandatory pay-as-you-go defined-benefit component, a mandatory defined-contribution component, and a voluntary defined-contribution component. The workshop was the "China Development Forum on Social Security Reform," sponsored by the Development Research Center of the State Council in 2000.

15. For an overview of the issues and the Bank's advice, see Tenev and Zhang (2002). Nolan (2002) also criticized the Bank for failing to support the government's strategy of creating globally competitive enterprise groups. It is unclear that the Bank either would be effective or should be involved in pursuing this objective.

16. The ambitious Shenyang Industrial Reform Project supported technology upgrading and reorganization of the Shenyang Machine Tool Company, including a component supporting severance payments for redundant workers. The technology upgrading appears to have been successful, but the reform impact has been minimal. The severance payment component was superseded by a municipal scheme, and continuing disputes over the company's debt repayment obligations to the municipality suggest a failure to replace the prevailing bargaining culture of SOEs with a binding hard budget constraint.

17. See Annex N.

18. Other ESW included a review of capital market development (World Bank 1995a), but this did not alter the Bank's approach to banking sector development.

19. The issues include bank supervision, deposit insurance, interest rate liberalization, and state commercial bank reform.

20. See Annex N.

21. See Annex N.

22. Decollectivization and a gradual move to higher, market-determined prices increased incentives; partial abandonment of the goal of grain self-sufficiency at the local level and relaxation of constraints on rural

marketing helped reverse distorted cropping patterns; and industrial planning and marketing reforms permitted the rapid expansion of rural township and village enterprises (TVEs), which generated about 65 million jobs in the first decade of reforms.

23. However, recent unpublished research by A.R. Khan indicates that there may have been a reversal in the trend of inequality during the past two or three years.

24. See the background paper by Khan (2002).

25. Jalan and Ravallion (1998) estimated that living in a designated poor county raised consumption by 1.1 percent per year during the period 1985–90. Park, Wang, and Wu (2002) estimated the effect on rural income growth in designated counties at 2.28 percent during the period 1985–92 and 0.91 percent during 1992–95; the rates of return on poverty investments were 15.5 percent and 11.6 percent, respectively, for the two periods.

26. In 1995, an average rural household paid net taxes of 0.5 percent of income, while the average urban household received a net subsidy of 11 percent. Net tax per capita of extremely poor rural households in 1995 was 36 times higher than that of nonpoor households. In urban areas, transfers accounted for 5.4 percent of the income of poor households, compared with 11.1 percent for the nonpoor. If the distribution of net urban subsidies in 1995 had been merely equal, the increase in the urban Gini coefficient between 1988 and 1995 would have been half of what it actually was. See Khan (2002) and Khan and Riskin (2001).

27. “International Conference on China’s Poverty Reduction Strategies in the Early 21st Century” in May 2000, cosponsored by the government, the World Bank, UNDP, and the Asian Development Bank.

28. See Jalan and Ravallion (1998), Chen and Wang (2001), and Ravallion and Chen (1998).

29. Projects are classified as “poverty-targeted interventions” if they have a specific mechanism for targeting the poor or the proportion of poor among the beneficiaries is significantly higher than the proportion of poor in the total population. This is an assessment made at the time of Board approval. The figures for China are for 1990–01, and those for India are for 1994–99. See Annex F for further discussion of PTI projects.

30. See Annex R, table R.4, for a list of ESW products.

31. Many people inside and outside China (for example, Brown 1995) still view self-sufficiency in grain production as an important economic objective. As the background paper on agriculture (Findlay 2003, citing Feng Lu 1996) notes, however, “The answer to the question of ‘who will feed China’ is that China will feed itself through trade.”

32. DECRG has sponsored some useful analytical work on WTO accession, culminating in an international “Seminar on WTO Accession, Policy Reform, and Poverty Reduction in China” in June 2002.

33. The Bank supported four rural credit projects; the last one was approved in 1990 and closed in 1996. These ceased because of a growing realization that no progress was being made in developing an independent and sustainable rural financial system. Although subproject rates of return were high, the portfolio of the Agricultural Bank of China remained poor, suggesting that banks did not use credit analysis for general lending, but to select subprojects for the Bank to finance.

34. The CAE could not cover all sectors. Health rather than education was selected for review because the Bank’s education lending has declined in the 1990s and has been less poverty-oriented.

35. See background paper by Ooi (2002).

36. Of the six completed projects, three have been rated highly satisfactory, and one each satisfactory, marginally satisfactory, and marginally unsatisfactory.

37. Water supply and sanitation projects accounted for an additional 8.6 percent of lending. These are considered in the next section.

38. As in other sectors, there were many criticisms of the (increasing) cost of doing business with the Bank, especially from the Ministry of Railways, but there was nearly unanimous appreciation for the Bank’s role in bringing new technology and management concepts.

39. Water production and the length of the water network also grew by more than 50 percent during the decade. The Bank’s role in the water sector is covered in the section on the environment.

40. See Findlay (2003) for evidence of increasing integration of grain markets.

41. As argued later, however, the use of toll roads has been overdone and is largely inappropriate for the low-density traffic outside the coastal regions. Still, it was a clever piece of financial engineering, which helped overcome a financing constraint at the time.

Moreover, Bank participation and subsequent securitization helped attract private sector finance by eliminating the risk of construction delay, which is a major impediment to private investment in such projects. In the longer term, even when toll roads are appropriate, it will be important for the government to compare the cost of finance through private investment with the cost of long-term government borrowing.

42. In coal, this was because of Chinese reluctance. In gas, the Bank has been reluctant to become involved for fear of crowding out the private sector, but given the risks associated with lack of a regulatory infrastructure and explicit public support, a large Bank or IFC presence might actually help bring in private sector involvement.

43. See Annex N for Regional comments on this and other infrastructure issues.

44. In energy, policy changes could be decided within a single ministry. In transport, not only has the fuel tax been stalled, but the Bank has made little headway in gaining acceptance for its arguments for a unified Ministry of Transport or for incorporating safety components into highway projects (because safety is under the jurisdiction of another ministry). There was also little response to an excellent Bank report (1995b) on coordination and tradeoffs of investments in rail transport, coal-washing, mine-mouth generation, and transmission lines. This is perhaps not surprising because the degree of coordination implied by this study never existed, even at the height of central planning. China was a command economy, but never a centrally planned economy to the same extent as the Soviet Union. The potential for efficiency gains remains, but it might be more productive to concentrate on introducing reforms in market structure and differential pricing in order to create incentives for optimization of intersector investment decisions.

45. Smil (1993) argued that China could not sustain its high rate of economic growth without an environmental disaster, and Brown's (1995) question, "Who Will Feed China?," received international attention and fueled a debate about China's environmental degradation, exhaustion of natural resources, and the unsustainability of a "growth at any cost" policy. For an up-to-date assessment of the state of the environment in China, see UNDP (2002).

46. SEPA drafts environmental legislation, oversees regulation and monitoring of environmental policy, and provides technical direction to provincial

environmental protection bureaus. SEPA has ministry status, but it is not a cabinet ministry (that is, it is still not involved in some important government decisionmaking processes).

47. A previous Bank report, *Clear Water, Blue Skies* (1997b), was technically more sophisticated, but has been criticized in China for being too much a Bank product. *Air, Land, and Water* was criticized within the Bank (by QAG) as insufficiently cutting-edge technically, but it seems to have had more impact in China.

48. "Agenda for Strategy for North China" is available on the Beijing Web site and at www.worldbank.org.cn

49. The study noted that "sooner, rather than later, Yellow River planners will have to squarely face equity vs. efficiency issues. Policymakers seem to be operating under the assumption that the Yellow River is a free good with low opportunity costs or none.... Until there are realistic allocation provisions that YRCC [Yellow River Control Commission] can enforce, the upper and middle reach regions will probably continue to follow what we have termed the 'first-come, first-served' rule, to the potential detriment of basin-wide economic performance."

50. Safeguards and EIAs should, in fact, go beyond the "do no harm" principle. One of the main shortcomings of safeguard analysis as now conducted in China is that it should be employed upstream at the design stage, rather than simply as damage mitigation at a later stage.

51. This may have increased unsustainable logging in other countries to meet China's import demand.

52. From 1993 to 2002, the Bank supported 47 water-related projects, most of them with environmental implications. By subsector, these included 9 in agriculture/irrigation, 5 in watershed management/forestry, 18 in urban water supply and waste management, 6 multipurpose/hydropower dams, 3 inland waterways, 4 water resources/flood control, and 2 rural water supply. See the background paper on water (Varley 2002) and Annex G.

53. Since 1985, the Bank has committed \$2.2 billion of total project costs of \$7.7 billion to finance major water investments (water conveyance, treatment, and distribution and WWTPs.)

54. See Annex N.

55. The Bank has not been involved in privatization in China, and the government has adopted a cau-

tious approach. The misallocation of project risks between public and private sectors has limited the scope for nonrecourse project-based lending—build, operate, transfer (BOT) projects are in reality a noncompetitive form of public procurement (returns are guaranteed, the assets are largely for bulk-water and remain in public control and even management, while water distribution is off-limits to investors).

56. See Annex N.

Chapter 4

1. This is an official classification. The eastern region includes 11 provinces of Liaoning, Hebei, Beijing, Tianjin, Shandong, Jiangsu, Shanghai, Zhejiang, Fujian, Guangdong, and Hainan; the central region includes 8 provinces of Heilongjiang, Jilin, Shanxi, Henan, Hubei, Hunan, Anhui, and Jiangxi; and the western region includes 12 provinces of Inner Mongolia, Xinjiang, Ningxia, Gansu, Qinghai, Shaanxi, Sichuan, Chongqing, Tibet, Guizhou, Yunnan, and Guangxi.

2. For 1993–97: $t = 5.97$, Adj. R-squared = 0.5443. For 1998–02: $t = 1.00$, Adj. R-squared = 0.0001.

3. The government considers Tibet eligible only for grants, not loans, because of low repayment capacity.

4. Other donors have also stressed infrastructure projects in China, though the trend is downward. Bilateral official development assistance (ODA) commitments for infrastructure were 61 percent of the bilateral total during 1993–97, falling to 38 percent during 1999–01. The corresponding figures for health plus education were 9 percent and 14 percent in the respective periods.

5. The repayment system is also one of the main sources of inequity and perverse incentives. See chapter 6 for a discussion of this dilemma.

6. It is difficult to test for the existence of a halo effect because good policy is normally associated with better outcomes. That such an effect exists, however, is shown by the example of Indonesia, which saw its combined percentage of satisfactory and highly satisfactory ratings drop from 79 percent in FY92–97 to 47 percent in FY98–02, mainly because of a sharp increase in marginally satisfactory ratings. The decline surely owed as much to changes in perceptions of Indonesia's overall performance after the Asian crisis as to actual changes in performance of investment projects exiting during that period.

7. Of the 82 projects approved during FY96–02, only 13 have been completed and 8 evaluated.

8. The improvement in disbursements and availability of counterpart funds may be a response to lower interest rates on IBRD loans. After the Asian crisis in 1997, the government lowered domestic interest rates, causing many provincial and local governments to substitute domestic borrowing for use of Bank project funds.

9. See Annex N.

10. This section draws on a workshop with Chinese officials and researchers on AAA, supplementary interviews, a specially commissioned review of AAA and system reform (Lu 2002), other sector and thematic background papers, and internal assessment reviews of ESW.

11. Later named the State Council Organization for Reform of the Economic System (SCORES). In November 2002, SCORES was merged with the State Development and Planning Commission to create the National Development and Reform Commission.

12. Trust funds and central research and network budgets supplement spending on China-related ESW, but it is unlikely that this significantly affects China's relative position. The budget allocation for ESW increased by two-thirds between FY01 and FY03, however.

13. See Annex N.

14. This complaint is not unique to China. See report by OED (2003b) on knowledge services.

15. The Bank's ESW has multiple purposes, as well as other audiences than Chinese officials and researchers. ESW informs the Board, other donors, and the broader development community of the Bank's assessment of developments in China, and it provides the analytical underpinning for Bank strategy and lending.

16. See Annex N.

17. See Annex N.

18. This is as much a commentary on the Bank's approach to risk management as on the China program. Low management engagement in supervision is a Bankwide problem.

19. According to the Region, the company's management told the supervision mission that some employees had been working up to 30 percent overtime, but they assured the mission that overtime is voluntary (indeed, workers are eager for the overtime) and that workers are paid overtime premiums as required by law.

20. Perceptions may have been influenced by the fact the Bank was not formally involved in judicial re-

forms before the August 2002 approval of two sub-projects under the Economic Law Reform Project.

21. The share of transport will rise from 24.6 percent during 1993–02 to 34 percent in the coming CAS period. (The figures refer to the share of number of projects, which is the only figure presented in the CAS.) Using a broad definition of infrastructure that includes energy, transport, urban, and water supply and sanitation, the share by number of projects will rise from 51.5 percent to 65 percent. The Bank's regional staff has noted that, though the share of infrastructure lending will rise, the absolute amount will fall because of the smaller lending program. See Annex N.

22. CAE mission members were, in fact, surprised to be told repeatedly by local officials that the biggest advantage of Bank projects was the introduction of competitive procurement and other project management techniques because these practices had supposedly diffused throughout China years before. One senior official explained that Bank involvement still provides a barrier to political interference in procurement, resulting in large procurement savings on big ICB projects. If this is the case, the Bank may need to look for other instruments than direct involvement in project finance.

Chapter 5

1. See Annex N.
2. See background paper by Lu (2002), chapter 6, and Annex E.

Chapter 6

1. Both the Bank's Regional staff and the government have reservations about the recommendations in this section. See Annexes N and O, respectively.

Annex D

1. The Henan (Qinbei) Power project (Loan 3980, approved in fiscal 1996) was canceled at China's request before being declared effective.

Annex K

1. The rating for the judicial system may reflect the fact that Bank activity in this area only began in 2002.

Annex L

1. In this note, *assistance program* refers to products and services generated in support of the economic development of a client country over a specified period of time, and *client* refers to the country that receives the benefits of that program.

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