Board Meeting of Thursday, May 28, 1998
Statement by Joaquim Carvalho

China: Country Assistance Strategy – Progress Report

We welcome this progress report on China’s Country Assistance Strategy. It is timely, and it reflects the serious efforts the Chinese authorities continue to undertake to put their economy on the right track. We would like to commend the staff for this candid and comprehensive assessment of the Chinese achievements over the years.

The Chinese authorities, too, deserve to be commended for their perseverance in maintaining sound macro-economic fundamentals and for their far-reaching reform program in a number of areas. The progress achieved in growth, stabilization, structural adjustment, as well as in political reform has been remarkable. A few years ago, whenever China’s growth prospects were discussed here in the Bank, serious concerns were often expressed about the dangers of economic overheating. While these fears may still be real today, it is comforting to note that inflation is still under 3 percent in China. This is largely the result of the prudent management policies adopted by the Chinese authorities,

This impressive economic performance may, however, not be shockproof in itself, particularly given the fact that a weakening of China’s domestic demand has been compounded by prospects of reduced export growth and foreign investment as a result of the Asian financial crisis. It is in this regard that we fully share the view in the report that China’s main challenge is to deal with the three key issues of SOE reform, financial sector reform, and social welfare reform. Taking this three-pronged approach would help in addressing the challenges of employment insecurity, growing inequality, stubborn poverty, and monitoring environmental problems.

On the issue of state-owned enterprise (SOE) reform, we believe that China is striking the right balance by improving the performance of large SOEs considered strategic for national development while letting go of a large pool of small and medium enterprises. While it is absolutely important for any country to review the issue of SOEs and their impact on budget policy, it is equally necessary to do so in such a way that will not be detrimental to the economy. SOEs which contribute significantly in maintaining economic and social stability should not be merely dismantled, but must be restructured in a way that their role in the development process becomes more relevant and effective.
On the area of pensions and welfare reforms, we also believe that China is on the right path, although it still has a long way to go. More specifically, welfare reforms, which complement fiscal reform, will require proper sequencing to minimize their negative impact on the vulnerable groups. For example, higher rents in housing reforms would become less painful but more effective if they were to be preceded by a well-structured salary review. Doing it otherwise would create a new set of problems since wages in a number of countries have been complemented or subsidized by certain welfare benefits such as housing facilities.

Given the size and diversity of the Chinese economy, both the Bank Group and its other borrowers can benefit from the Chinese experience in terms of the country's many success stories and reasons for some of its failures in the implementation of Bank projects. This brings me to the issue of portfolio management in the report. The good performance of the Bank’s portfolio is a result of the very high-level government involvement and ownership of the programs, with generally strong local implementation capacity. We also note, however, that China does have a number of problem projects in its portfolio, mainly due to less familiarity with Bank procedures in regions where lending is only beginning to shift; weak implementation capacity, and difficulty in providing counterpart funds. Clearly, this is a mix of diverse experience within one country from which the Bank can draw many valuable lessons. The challenge for the Bank, therefore, is to help regions that are only beginning to benefit from Bank lending to build capacities in project preparation and management. In this regard, we would urge that the Bank’s effort to strengthen client involvement by including government counterparts in the initial project concept review meetings in Beijing should also involve officials from the remote and poor areas of China.

While we have no difficulty with the Bank’s current exposure to China, since it is still within the limits of the new approach to portfolio concentration, we would urge management to continue monitoring this situation as disbursements from the existing pipeline and proposed lending program progress. In particular, efforts must be made to address any potential adverse consequences that this portfolio may have for the adequacy of Bank reserves.

Finally, we are confident that China’s determination to implement reforms will continue to gain momentum over the years. We, therefore, strongly support the infrastructure projects being discussed together with this CAS progress report, which should enhance the basis for sustainability in the country’s reform efforts. We wish the Chinese authorities success in their endeavors.