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Statement by Ilkka Niemi

China - Country Assistance Strategy - Progress Report

We generally endorse the analysis in the Progress Report. As stated in the report, the development of China's economy is expected to be favorable, although the situation involves certain risks. It is expected that the Asian crisis will lead to reduced export growth and foreign investments and these factors will reduce overall growth somewhat. However, the report envisions that the growth of GDP will be over 7 percent in 1998 and in 1999. The fact that the growth prevails uneven in terms of the different regions remains a source of concern.

In case the growth of the economy slows down more than expected, the challenges of economic policy will become more severe. The possibility of weaker growth cannot be ruled out because of both external and internal circumstances. That would hamper the reforms China should pursue – financial sector reform, SOE reform and social welfare reform. Especially SOE reform will lead to job losses and the size of the problem will depend on the growth of the economy. Reform policies are much easier to implement if the economic environment is favourable.

The government of China has refused to devalue the currency in spite of weaker export demand. This policy has significantly enhanced stability in the whole Asia region. Chinese devaluation might lead to a round of competitive devaluations. But this policy also highlights the importance of domestic economic policies. The supply side of the economy should be strengthened: infrastructure bottlenecks should be reduced, human resources should be developed, and social and fiscal reforms should be carried out.

The information provided in the report confirms that the reform agenda and the main focus of the last CAS are still appropriate. While stressing the need for a balanced regional development, the report refers to the growing number of urban disadvantaged. The recent increase in the number of "floating population" in major Chinese cities critically underlines the importance of implementing the reforms the CAS outlines on social safety-nets.

Given the large commitment and portfolio in China the proposal to examine the options for addressing the issue of continued lending at present levels could be supported.

At the same time there are a number of considerations to be taken into account.

First, the Bank is moving toward smaller average size projects that are more targeted to reform and poverty issues in inland provinces. This means that the lending volume could fall below USD 2.5 billion envisaged in last year’s CAS. The projects will, however, not require less manpower and capacity in the Bank and in China to prepare, implement and monitor. The projects do carry both direct and indirect costs.

Second, recent OED figures have shown that the performance ratio in China, outstanding as it is, nevertheless is not free from problems. The ratio of unsatisfactory projects is increasing in conjunction with the shift to inland provinces.

Third, China’s exposure is increasing and within a few years China will be IBRD’s largest borrower. Further commitments will require increases in the reserves, which also need to be taken into account when the Bank prepares its project pipeline. The Progress Report proposes that this question be discussed in the next full CAS. Meanwhile I believe a careful approach to future lending levels could be applied.