Board Meeting of March 18, 1997
Statement by Eugene Miagkov

China - Country Assistance Strategy

We welcome this opportunity to discuss the Bank's Country Assistance Strategy for Peoples Republic of China. We believe that the CAS document is of excellent quality and gives clear answers how the Bank will be supporting economic and social development in different regions and sectors. We can also see that the Bank's strategy is fully owned by the Government, builds on its strategic priorities and hence is very likely to succeed.

We endorse the proposed Bank Group's Assistance Strategy for China and commend the Staff for the preparation of this through and well structured document. We would also like to express our appreciation of the useful informal briefing on the CAS paper offered to us prior to its Board discussion. Generally speaking, the content and the spirit of the document produce very good impression of continuously strong and effective partnership between the Bank Group and the Government of China.

Gradualism in SOE and financial sector reforms

We are pleased to see that on the basis of successful implementation of reforms in the environment of strong economic growth and improved macroeconomic stability the country's leadership is ready to address the most serious and complex challenge of reforming the SOEs and the banking sector. The key question is how to ensure the right combination of speed and quality of reforms in these areas of high economic complexity and social sensitivity. For example, one of the most difficult issues associated with SOE reform is rising urban unemployment. In our view, the Government's reform plans for the SOE and financial sectors are quite rational, and the proposed CAS provides relevant strategy of supporting their implementation. We are especially pleased to see the Bank's well defined and logically coherent strategy in this area which includes special ESW, technical assistance to prepare for future lending operations, and projects financed by the Bank Group that demonstrate how reform measures can be implemented. We see in this connection a greater scope for IBRD-IFC collaboration at level of specific projects where the IBRD can concentrate, for example, on issues of SOE's social assets divestiture and creating an appropriate framework for the sectors' operations, while IFC can bring a specific market expertise and finance for the development of economically viable entities.
China’s traditionally cautious and gradual approach to structural reforms remains a matter of a major theoretical and practical interest and debate. When studying China’s experience it is important to distinguish between the issues of country specificity and the lessons which may be applicable in other countries. Some radical economists have predicted that Chinese reforms will fail at the stage of SOE reforms and therefore made the case for a “big-bang” approach in this particular area. We do not share this opinion and believe that the quality of reforms plays a crucial role, especially when dealing with management of technologically and socially complex issues.

**Infrastructure development**

We fully recognize the rationale behind the high priority that the CAS places on infrastructure. Serious infrastructure constraints in China are increasingly affecting economic development and the quality of life. There is a strong link between alleviation of infrastructure bottlenecks and badly needed improvements on other fronts (e.g., rural and interior regions development and poverty reduction, air and water pollution control and health protection). Of course, the demand for infrastructure projects in China is huge and under no circumstances can be satisfied by the Bank alone. But the fact that half of the Bank’s new lending to China in FY97-99 will be in power and transport sectors is very welcome. We consider this as a demonstration of the Bank’s responsiveness and ability to ensure the consistency of its operations with the country’s development priorities. We also expect that the Bank in collaboration with the authorities will address in a constructive way the existing bottlenecks and shortcomings in administrative, financial and legal environment hindering private financing of infrastructure.

**Human Resource Development**

We recognize that human development agenda, including poverty reduction, education and health, is one of the crucial issues to be solved in order to share the results of the recent economic progress among broader population and ensure the irreversibility of reforms. The successes achieved so far in terms of lifting millions of people out of poverty suggest that the Bank’s funds have been well spent. At the same time, poverty alleviation agenda is very far from being closed and that is why we are pleased to see that “continued lending for poverty and the social sectors is at the heart of the bank’s assistance to China”. My understanding is that the decline of IDA resources is the primary cause of the Bank Group’s intention to promote IBRD-IDA blend and IBRD-only lending for poverty and social sectors. Creation of an appropriate resource transfer mechanism as well as the necessity to preserve the financial sustainability of bank-financed social projects are crucial issues in switching to a more expensive lending blend. We believe that the Bank and the Government will find the practical solutions to these complex problems. The relevant experience of China could then be shared through the Networks and used in similar purpose in other countries in transition.

**Technical assistance**
We see that technical assistance will remain an important pillar of the Bank Group's strategy for China, particularly in such areas as financial sector, public finance and environmental protection. Although the need to improve its effectiveness is underlined in the CAS paper, our overall impression about Bank's TA experience in China is quite favorable.

All ongoing TA projects are ranked as satisfactory both in terms of development objectives and implementation progress. There are also other indications proving these operations to be a success. Besides, we note that in the financial sector Bank's technical assistance will soon continue under the second TA project, and in the future there is a possibility of TA support to SOE reform.

Bearing in mind that the overall status of the Bank's TA activity leaves much to be desired, I believe we could draw very useful lessons from our good TA experience in China, lessons which would help improve the design and implementation of similar operations in other countries. The staff may wish to comment on that point.

**Portfolio**

It is not surprising that the Quality Assurance Group has found the China portfolio to be one of ten outstandingly good portfolios. I believe it also remains the best among the ten largest IBRD/IDA portfolios. Both Bank team working on China and the Chinese team working with the Bank deserve strong commendation for that.

Let us however add a word of caution. We have noticed that since the CAS Progress Report discussion a year ago the number of problem projects in China has increased from "only two" to "only seven". As a result, a declaration that all projects are expected to return back on track within twelve months sounds less convincing now than it did last year. Most of portfolio performance problems seem to be related to projects in rural areas. Hence, I wonder whether there are certain generic issues underlying these outcomes which have to be addressed in a systematic way. It is especially important in view of the declining IDA financing and the switch to a more expensive IBRD financing in social area and remote regions.

**IFC**

We are pleased to note the continued rapid expansion of IFC operations in China and its involvement in growing number of reform areas, including SOE reform. However, taking into account the increasing income gap between coastal and inland areas, we would encourage greater regional diversification of IFC activity with particular attention to the poorer interior provinces. This could play an important catalytic role in their economic development and contribute to poverty alleviation.

**Evaluation of Risks**

The CAS document which is compiled according to the new format contains a thorough and serious evaluation of risks to sustainable rapid growth in China. We believe that Chinese
Government is aware of potential downsides of slowing the reforms in the SOE and financial sector as well as the need to preserve the delicate balance between the pace of reforms and their eventual adverse social consequences. We therefore expect a continuation of a good policy dialog between the Government and the Bank. We also note that the Bank is prepared to work closely with Chinese authorities in addressing possible external shocks and identifying a feasible path for a comprehensive approach to trade liberalization. In any case, we are pleased to see that the Bank Group’s strategy refrains from linking the country’s program size to specific triggers or punitive conditionality.

Conclusion

The Bank Group’s CAS for China proves the outstanding quality of the policy dialog which is based on the underlying Government’s commitment to structural reforms and macroeconomic stability, good governance and discipline, on the one side, and exemplary quality of the Bank’s activities in China, on the other.

China is one of the main economic partners of Russia and further success of economic reforms in this country will lead to continuous expansion of our trade and investment cooperation.