Folder Title: Country Files: China - Correspondence 02

Folder ID: 1774658

ISAD(G) Reference Code: WB IBRD/IDA EXC-09-3965S

Series: Country files

Sub-Fonds: Records of President A. W. Clausen

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For Friday, Feb 12 meeting

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. A.W. Clausen

DATE: February 8, 1982

FROM: Mahbub ul Haq, Director, PPR

SUBJECT: CHINA CPP: Major Policy Issues

1. China's decision, after years of isolation, to reach out to the larger world is an event of historic significance. By joining the World Bank, China has given this international institution a chance to play a critical role in the process of bringing one billion people more fully into the international community. In this context, I question whether the Bank's assistance strategy, proposed in the CPP obviously under severe constraints, is an adequate response. The recommended approach will not enable the Bank to grasp the unique opportunity it has to provide strong international leadership.

2. The main problem with the CPP is that it is cast in the conventional mold. Hence, the assistance strategy envisaged is severely limited by the current constraints on Bank and IDA operations. Some two years have passed since China joined the Bank and we have continued to act much as though China was just another new member country, which must share in our increasingly limited resources. We have merely created one more programs division (though well staffed), produced an introductory economic report (certainly excellent) and brought to the Board just one modest lending operation. For the future, the CPP envisages that the Bank would lend over the next five years no more than $1 per head per year on IBRD terms and no one expects much IDA to be made available. N.B

3. In our dealings with top Chinese officials, we have not been able to live up to the hopes engendered by our initial contacts, even though our promises were imprecise and couched in reservations. Consequently, those among the Chinese leadership that have advocated outward oriented policies and a collaborative relationship with the Bank have found their position challenged by their more conservative colleagues. The Bank is in real danger of appearing to the Chinese as unwilling to offer China equitable treatment that recognizes the country's size, poverty and development needs. Thus, we risk throwing away our chance to help meaningfully the largest developing country and to act as a key international intermediary in opening up China to the world economy.

4. To respond effectively to this exceptional opportunity, I propose that:

- the Bank create a special fund for China as a vehicle for mobilizing international financial assistance;
- traditional Bank assistance (IBRD, IDA, staff technical assistance) over the longer term should be offered to China on a basis at least comparable to that available to India; and

- Bank lending should be concentrated on those sectors and types of projects where the Bank has both an evident comparative advantage in terms of its technical expertise and the best possibilities for mobilizing cofinancing.

IBRD/IDA Allocations and the Need for a Special Fund

5. IBRD finance that can be made available to China is inevitably constrained by creditworthiness and the related portfolio considerations. The CPP argues convincingly that China's creditworthiness for conventional borrowing is limited by the uncertain potential for its oil exports, its unproven capacity to find rapidly expanding markets for its manufactures and by the need for huge imports to help modernize its productive sectors. Nonetheless, its present indebtedness is low and there is considerable potential for energy saving through more efficient energy use, which would ease the external constraint. On balance, we see no great risk for the Bank in building up China's share in its portfolio to 10 percent over the long term (say by the mid 1990s) and inititally to allocate a somewhat higher share of the IBRD lending program. In this context, the expansion of IBRD lending up to the 12 percent share in FY87 proposed in the CPP is justified.

6. The situation with regard to IDA is admittedly more difficult. China, like India, is too exceptional for its IDA share to be determined by the same yardsticks of population, income level and performance applicable to other borrowers. However, on grounds of equity, there is good reason to treat these two giants on a comparable basis. China's large size approximately offsets India's lower per capita income. While we recognize that China was not included in IDA 6 and that therefore its IDA assistance for FY81-83 must come from IBRD profits, the Bank should argue strongly for comparability of treatment for China in IDA 7.

7. The limited amounts of IBRD and IDA that the above represents would not be adequate to enable the Bank to play the leadership role suggested earlier. We would be forced, as we are now, into a defensive posture that carries little credibility with the Chinese leadership. The Chinese, like the Indians, would be forever pressing us for increased allocations more in proportion to the size of their population. And, for our part, the Bank would be constantly trying to defend Africa's share in IDA. There would be risk, too, of constant friction with different IDA contributors, each with their own different view on the appropriate allocations for China. Why not turn around this situation by creating a special fund to be a new focus for financial assistance to China, both Bank and bilateral, public and private, unconstrained by existing structures and arrangements? The Bank would contribute to the special fund China's share of IBRD and IDA resources proposed above. We would then confront donor agencies and other financial institutions with an appeal for additional contributions. Obviously, the timing and presentation of such an initiative should be carefully tailored to mesh with the new approaches to IDA 7 replenishment. The Bank would offer to provide the framework for channelling these resources into sound investments and would seek to mobilize additional cofinancing.

8. The creation of such a Special Fund (or any other special mechanism that may prove even more politically viable) would thrust the Bank into a decisive central role as the financial and technical intermediary between China and the rest of the world. To abate donor fears, it should be conceived as a transitional arrangement for a limited duration that would allow us to escape the constraint of IDA "burden sharing". It would transform the Bank's position from a defensive one to that of positive leadership, comparable to that achieved over the past year in the case of Africa. If the initiative fails, the blame will lie largely with the Part I countries and the Bank will still be able to fall back on its limited IBRD and IDA assistance as a minimum "safety net".

Priorities in Bank Lending

9. While we agree with the CPP (paragraph 24) that the Bank's strategy should be "to intervene where intervention is likely to make the greatest difference", we propose that the two key considerations here should be (i) the Bank's comparative advantage in providing technical expertise and (ii) the scope for mobilizing cofinancing. Clearly the extent of the Bank's intervention will be determined by the Chinese Government's views about an appopriate Bank role as well as the Bank's own evaluation of the priorities for Chinese development. Nonetheless, the key here from our viewpoint should be selectivity.

10. It is evident that energy is likely to be the most crucial single factor in China's economic growth and creditworthiness over the next decade. Improvements in China's energy policies, both in terms of development and conservation, should therefore be given the highest priority in the Bank's economic and sector work and in its dialogue with the Government as well as in its lending. Improvements in transport facilities and efficiency (which are closely related to energy conservation) also warrant high priority. Finally, industrial development is of great importance from the standpoint of expanding exports and achieving efficient import substitution. Another major reason for focussing on these three sectors is that they appear to have the greatest potential for cofinancing, which could be of particular importance for China in view of its large capital inflow requirements and its limited experience with commercial lenders.

11. For the present, we suggest agriculture, education and health be placed somewhat lower in the list of priorities, both because China has already done relatively well in these areas and because their potential for attracting cofinancing is more limited. But we agree that they are important for China's longer term development and that the Bank can probably make a substantial contribution based on its experience in these areas. In addition, the Bank should be able to learn much of value to other countries from the detailed study of Chinese accomplishments in these fields.

- In summary, we recommend that Bank lending should be concentrated on energy, transportation and industry projects.

Attachment

cc: Management Review Group

COMPARATIVE COUNTRY ANALYSIS

Despite having an industrial base comparable to that of most middle income countries, 71 percent of China's labor force is engaged in agricultural production. In the past decade China experienced a moderately good GDP growth rate and a high export growth rate. Both savings and investment are comparable to other socialist countries. A notable decline in the crude birth rate has resulted in a population growth rate for 1980 of only 1.2 percent per annum. Other social indicators are also favorable.

	CHINA	INDIA	ROMANIA	YUGOSLAVIA
Economic Structure				
Population 1980 (millions) a/	976.7	673.2	22.2	22.3
GNP Per Capita 1980 (US$) a/	290.0	240.0	2340.0	2690.0
% Agriculture in GDP 1979 d/	31.4 b/	38.0	14.0 m/&n/	12.0
% Industry in GDP 1979 d/	43.7 b/	27.0	49.0 m/&n/	44.0
% Labor Force in Agriculture j/	71.0	71.0	32.0	31.0
p.c.p.a. Energy Consumption j/&k/	0.6	0.2	4.8	2.4
Index of Food Procuction p.c. 1976-79 (1969-71=100) j/	120.0	92.0	151.0	117.0
Debt Service Ratio 1979 (%) d/	4.6 b/&c/	11.0 L/&v/	19.4 m/,o/&u/	16.6 r/,s/&u/
Economic Performance d/	1970-79	1970-79	1970-79	1970-79
Real GDP Growth Rate	5.8 b/&e/	3.4	10.6	5.9
Real Exports Growth Rate	8.0 f/	4.6	4.7 t/	4.7
	1979 b/	1978/79 L/&s/	1980 t/	1980 r/
Gross Domestic Investment/GDP	31.1	24.1	34.2	31.4
Exports and NFS/GDP	6.0 f/	7.3	23.2	18.7
Resource Balance/GDP	-1.0 f/	-0.5	-5.9	-9.6
Gross Domestic Savings/GDP	30.1	23.6	28.3	21.8
Government Revenue/GDP	27.3 g/	19.1	48.0 q/	36.8 i/
Recent Social Indicators j/	1976-79	1976-79	1976-79	1976-79
Population Growth Rate	1.2 b/&h/	2.1	0.9	0.9
% Change in Crude Birth Rate 1960-79 d/	-47.4	-23.1	-5.7	-24.6
% Change in Crude Death Rate 1960-79 d/	-42.6	-40.5	5.6	-13.3
Infant Mortality Rate (per 1,000)	56.0	125.0	31.4	33.6
Life Expectancy (years)	64.0	51.9	71.0	70.3
Adjusted Enrollment Ratio				
- Primary	93.0	79.0	106.0	99.0
- Secondary	51.0	28.0	84.0	82.0
Adult Literacy Rate	66.0	36.0	98.0 i/	85.0

Lending Program	FY77-81 b/	FY82-86 b/	FY77-81	FY82-86	FY77-81	FY82-86	FY77-81	FY82-86
Nominal IBRD/TW MUS$	100.0	3200.0	1454.0	3420.0	1402.8	1526.0	1621.0	1650.0
Nominal IDA MUS$	100.0	2600.0	5440.5	8319.0	-	-	-	-
p.c.p.a. Lending $US	-	1.2	2.1	3.6	12.7	13.8	14.6	14.9
p.c.p.a. Grant Equivalent $US	-	0.6	1.6	2.5	2.9	3.1	3.3	3.4
p.c.p.a. in Constant 1981 $US	-	0.9	2.4	2.9	14.6	11.5	17.2	12.3

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a/ World Bank Atlas, 1981.
b/ China CPP, December 1981.
c/ Projected figure for 1981.
d/ World Development Report, 1981.
e/ NMP Basis.
f/ Goods only.
g/ Excludes foreign borrowing.
h/ 1980 figure.
i/ 1975 figure.
j/ Social Indicators Data Sheets, EPD, May 1981.
k/ Thousands of kilograms of coal equivalent.
L/ India CPP, July 1980.
m/ Romania CPP, March 1980.
n/ 1978 figures.
o/ 1978 in convertable currency only, net DSR 7 percent and gross DSR 9.2 percent.
q/ Romania President's Report, June 1981
r/ Yugoslavia CPP, July 1980
s/ Estimate.
t/ EPD and Regional Estimates
u/ Includes private non-guaranteed debt
v/ Excludes private non-guaranteed debt

Program Review Division
Policy Planning and Program Review Department

2/27

Did not call per AWC

Try again on ~~April 1~~ -

Check with AWC before calling, however -

Try April 29th

14 FU-Dec.4-1 ACTION

11-24-81

Mr. Cao Weigong hand delivered this letter. Do you want to set a brief visit with him? The Division Chief for China, Caio Koch-Weser, thinks it would be nice since there are only two PROC employees in the Bank and you probably will want to do it for your friend the Minister.

11-30-81 HH

Helen

HOOT GIBSON'S FRIEND!

HE'S A MINISTER IN "TROUBLE" (?)

→ BUT, yes. I'LL SEE HIM SOMETIME NEXT 2 WEEKS!

OK TO SET UP ON

Short* notice!

11-30-81

* i.e. - call when anything is to come up in a couple minutes! But not today!

2/22

Call Cao Weigong
about 3 45 to
come in to meet AWC
(Do not call in
advance) bi

Dec 14

Dec. 47

To call Cao Weigong to come in for min

74439

Helen-
??
12/9

November 23, 1981

Dear Mr. Minister:

Thank you for your letter introducing Mr. Cao Weigong. I have not yet had the opportunity of meeting him because of my very heavy schedule, but I am looking forward to doing so in the near future.

Your kind words on my new role as President of The World Bank are generous indeed and much appreciated. You can be assured that I attach great importance to the development of a strong and efficient cooperation between the People's Republic of China and The World Bank.

I hope it will not be too long before I have the pleasure of seeing you again.

Warm regards.

OK
A

Sincerely,

A. W. Clausen

His Excellency
Tang Ke
Minister of Metallurgical Industry
Ministry of Metallurgical Industry
46 Zhushi Dejie
Beijing, People's Republic of China

OL:HH:ml

1083

Room 413

Cao Weigong

74439

ACTION

hand delivered

中华人民共和国冶金工业部

November 3 1981

Mr. A. W. Clausen
President
The World Bank
Washington D.C.
U. S. A.

Dear Mr. Clausen,

It gives me great pleasure to introduce to you by this letter Mr. Cao Weigong who is a relative of mine and is going to join The World Bank as a power engineer in the Projects Department of East Asia and Pacific Office. I shall consider it a personal favour if you would give him the benifit of your help and valuable advice.

Recently, a mission has been sent by your Bank to China, and has made some investigations in our metallurgical field as well. I hope the cooperation established between our two countries through our past contacts will flourish under your personal attention.

I have been informed that The World Bank and

中华人民共和国冶金工业部

IMF meetings were very successful. I feel that The World Bank is in capable hands. I would like to congratulate you every success in assuming the leadership in such an important international organization.

Hope to see you again and with best wishes.

Sincerely Yours,

唐克

Tang Ke
Minister
Ministry of Metallurgical Industry
People's Republic of China.

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1981 NOV 16 AM 10: 28

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File Title	Barcode No.
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Document Date	Document Type
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Correspondents / Participants

To: Mr. Timothy Thahane, SEC

From: WANG Liansheng, Chinese ED

Subject / Title

Nov. 13, 1981 Issue of the Weekly Supplement of the Development News

Exception(s)

Additional Comments

Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Shiri Alon	17-Mar-17

This news item appeared on page 60 of the October 1981 issue of:

ASIAN BANKING (HK)

(Journal of Asia-Pacific Financial Markets)

Flak and flux at a multi-lateral financing institution

This report is compiled by Jo McBride

Written over thirty-five years ago, in the same era that spawned the Marshall Plan, the first of the World Bank's Articles of Agreement has not changed.

Yet over the intervening period the public's shifting perception of the institution has frequently served to present a bowdlerised picture of its intent.

Today that distorted image could present a stumbling-block to achieving its central purposes which are not charitable or philanthropic but wholly economic, and susceptible to the mechanisms of the financial market place at both the output and the input ends.

It is worth noting that the articles of the bank do not charge it with being a redistributive mechanism either between or among nations or among individuals within countries.

Even though the hand which created sovereign states was sometimes capricious, making some rich in resources while leaving others minimally endowed, permitting some culturally homogeneous groups access to the world's fora by bestowing on them the nomenclature of nationhood but dividing others along boundaries demanded by a political rationale long since defunct, the bank must deal with them and their problems as they exist today.

Indeed, section 10 of the fourth of its Articles of Agreement states that:

'The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political characters of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article 1.'

If the role of the International Bank for Reconstruction and Development (as its more popular title of World Bank suggests) is to help maximise through a banking mechanism resources across a now heavily-populated globe, it must concentrate its efforts in those nations — however irrationally defined — presently unable to undertake that task for themselves.

It does this largely by substituting its own credibility as a borrower for that of country entities which have not yet gained such standing, and by conducting its business with them in a manner which will help them achieve it — for example by writing stringent rate of return clauses into all loan agreements.

It thus plays a dual role. It not only helps nations achieve the immediate end of increased wealth through growth in productive capacity and trade, but also assists in developing the financial management means through which they achieve those ends.

On the liabilities side of its balance sheet the World Bank, like any other bank, must look to the capital resources against which it borrows and it has just embarked on a programme designed to increase its authorised capital from US$36 billion to $80 billion by 1986.

Given the bank's conservative capital to lending ratio of 1:1 and its ability to identify and analyse fundable projects, this will allow it a total asset exposure (including loans to sister agencies) of $80 billion perhaps by the mid-1990s. Granted the level of potential demand from its market this is peanuts.

And it may not make even that level if the United States government continues to quibble about the level of the $8.8 billion its 22 per cent shareholding in the institution makes it liable for but only 7.5 per cent of which ever need be paid in. (The remaining 92.5 per cent stays in members' national treasuries where it serves as the ultimate security for World Bank bond issues.)

Last year the bank has thought to borrow $6.6 billion but it limited itself to $6.1 billion in US dollars, D-marks, yen, Dutch guilders, Swiss francs and sterling — when high interest rates disrupted its borrowing plans toward year-end (30 June 1981).

Funds borrowed during the period had an average maturity of 7.5 years at an average cost of 9.55 per cent while those lent had maturities of around the 20-year mark and carried interest on average 0.5 per cent above the bank's cost of funds.

This year the bank plans to borrow $8.2 billion from the world's capital markets. Notwithstanding the advent of the era of one-off borrowings by individual corporations of $12 billion, an annual operation of this size is significant and means that the bank will be entering the market — to do either private or public placements — some two or three times a week.

But even a borrower of such magnitude must bow to the realities of the market place in which long-term, fixed rate funds are becoming increasingly scarce and the base over which floating rate funds hover is extremely volatile.

While some observers expect investment managers in capital surplus countries—essentially the Middle Eastern oil exporters—to soon turn aside from their quest for liquidity in favour of more stable long-term investments, the World Bank cannot wait indefinitely for this to happen and must confront the situation as it exists today.

If this more optimistic scenario holds true in the longer term, it will not only let some sanity back into financial markets, but will also benefit the World Bank's client nations. This benefit could come directly, with Middle Eastern investment flowing to entities in the industrialising world, or indirectly, with investment being pumped into OECD countries where the consequently buoyed demand will create the need for more imports from developing nations.

While the market place is in disarray with those countries which have had little choice but to borrow from it at floating rates suffering in consequence, there are other nations which have cushioned themselves from accepting its disciplines through the use of World Bank funds — or more particularly those which its soft loan affiliate the International Development Association (IDA) is able to make available. IDA facilities are funded not from

the commercial market place but through subscriptions (in effect donations) to various replenishment schemes of which developed countries provide 95.8 per cent.

A case in point is that of India and two factors have recently combined to make changes in India's relationship to the institution only a matter of time.

The first is the constraint on the World Bank's ability to raise funds at rates sufficiently low to allow countries to borrow from it to meet their development finance needs.

The natural consequence of this restraint is that the bank must, as dictated by the first of its Articles of Agreement, look at which are the most useful and urgent of projects requiring funding and which of those cannot be implemented by the use of private sector funds.

Clearly, much of the financing need is not for projects such as steel mills or textile plants, which elements of the Reagan administration feel to be strictly the province of the private sector, but for road building and electrification schemes in which the role of private enterprise is, at best, arguable.

The second is the recent admission to bank membership of China which, given the present criteria of size of population, GNP per capita and export earnings governing access to IDA loans, clearly qualifies for a large slice of the Association's funds, as does India.

Today, under a little-known agreement worked out several years ago, India is virtually guaranteed 40 per cent of IDA's total loans, in return for the country's not applying for Asian Development Bank assistance. Yet India, and China, can now demonstrably borrow in the Euromarkets.

This raises the issue of whether the IDA access formula which the World Bank uses is relevant any longer, especially when section 1 (c) of IDA's Articles of Agreement stipulates that: 'the association shall not provide financing [for a particular project] if in its opinion such financing is available from private sources on terms which are reasonable to the recipient or could be provided by a loan of the type made by the [World] Bank.'

As yet no consensus is emerging on this point within the bank, but the question is certainly being asked as is whether India could continue to raise funds so readily in the Euromarkets if it were not known to be the recipient of 40 per cent of IDA loans — the grant element of which is constantly increasing.

Interestingly, the debate is informed by some close knowledge of the problem since the bank's number two slot of vice president for operations is now filled by Ernest Stern, previously vice president for South Asia.

While the present criteria remain in place, India could, and does, argue that it is eligible not merely for 40 per cent but over 50 per cent on the basis of its population, GNP per capita, etc. And China could legitimately postulate the same argument, thus leaving nothing available for the poorest countries who have no access to the Euro or any other overseas financial markets.

Although the World Bank regards its 40 per cent IDA commitment to India as a sacred trust which it cannot break, India is free to alter the game plan by applying for funds to the Asian Development Bank. Some staffers at the ADB think 'it would be crazy not to do so' at the same time recognising the potentially disastrous implications for the institution if it did.

Such a move could be triggered by India's perception of a weakening of the hand which it has played over the years with the World Bank. This arose because of the bank's — again like any other bank's — need to lend a lot of money to justify its existence. At the same time India needed to borrow a lot of money, *ergo* the two needed each other.

But somewhere along the line, India managed to convince the World Bank that it needed India more than India needed it. New Delhi played this hand very shrewdly and used its position to

Table one

World Bank loans to Asia-Pacific nations at 30 June 1981

US$ millions

	disbursed	undisbursed	total	approved but not yet effective
Australia	93.8	—	93.8	—
Bangladesh	57.1	—	57.1	—
China	—	—	—	100.0
Taiwan	201.6	—	201.6	—
Fiji	37.9	42.2	80.1	—
India	828.9	874.2	1,703.1	—
Indonesia	1,087.0	2,143.3	3,230.3	332.0
Japan	241.8	—	241.8	—
Korea	1,794.2	1,050.0	2,844.2	200.0
Malaysia	542.1	467.7	1,009.8	127.0
New Zealand	14.7	—	14.7	—
Pakistan	374.5	39.9	414.4	—
Papua New Guinea	7.0	24.0	31.0	6.0
Philippines	1,079.7	1,321.8	2,401.5	250.0
Singapore	122.7	0.3	123.0	—
Sri Lanka	32.4	—	32.4	—
Thailand	818.8	802.2	1,621.0	327.9
Total Asia-Pacific	7,334.2	6,765.6	14,099.8	1,342.9
Total Worldwide	25,483.6	21,526.8	47,010.4	6,551.9

Source: World Bank Annual Report 1981

Table two

International Development Association credits to Asia-Pacific nations at 30 June 1981

US$ millions

	disbursed	undisbursed	total	approved but not yet effective
Bangladesh	1,028.5	614.8	1,643.3	122.7
Burma	152.6	259.9	412.5	—
China	—	—	—	93.6
Taiwan	14.3	—	14.3	—
India	5,425.0	3,619.9	9,044.9	570.0
Indonesia	593.2	346.0	939.2	—
Korea	113.0	—	113.0	—
Laos	8.5	23.5	32.0	—
Pakistan	857.6	415.3	1,272.9	140.9
Papua New Guinea	59.4	23.2	82.6	25.0
Philippines	37.9	84.3	122.2	—
Solomon Islands	—	—	—	1.5
Thailand	40.0	83.2	123.2	—
Vietnam	31.1	28.9	60.0	—
Western Samoa	6.9	5.5	12.4	1.8
Total Asia-Pacific	8,368.0	5,504.5	13,872.5	955.5
Total Worldwide	12,876.2	8,729.8	21,606.0	2,225.6

Source: World Bank Annual Report 1981

'The Asian Development Bank would probably follow any increase in gearing'

implicitly justify its temperamentality when it came to accepting the stringent conditions attached to World Bank loans.

One of the more gritty observations on this point came to Asian Banking not in a round of World Bank interviews recently conducted, but by way of eavesdropping in a World Bank elevator where one official concluded a conversation with another saying, 'When these situations cropped up in the past [with India] we used to say "a dialogue is continuing." Now there is no such thing as a dialogue.'

Ironically, it was just at this time that New Delhi's lobbying had shifted across Washington's 19th Street to the headquarters of the International Monetary Fund — an institution which has, until now, attached to the use of its facilities stringent stipulations covering the entire economic management of borrower nations.

Not so this time it would appear, since the $5.68 billion for India that the Fund is likely to approve next month is quite different in character from its past facilities which have been used to help nations through long or short-term balance of payments difficulties.

Instead, India is free to use the loan — the biggest the IMF has made in its 30-year history — to fund investment in oil production or other industries. This has raised some hackles within the US Reagan administration which is known to want both Bretton Woods institutions to tighten the economic controls they apply to borrowers.

The question marks the administration has raised are currently most poignant in the case of the soft-loan IDA since it is to this institution's Sixth Replenishment Scheme that the US government is proposing to stagger its allotted contribution of $3.2 billion (27 per cent of the total) over three years, thus seriously delaying its implementation as 80 per cent of the total of $12 billion must be pledged before the scheme can become operational.

The extent to which this impinges on the operations of the World Bank, however, is restricted, since the bank has its own criteria for lending and it assumes none of the risk for IDA loans which are the province solely of that institution itself.

The bank is currently looking at a range of options which might enable it to extend its own operations and, in the words of one senior official, 'nothing is being ruled out'.

One matter which it must however approach circumspectly in its quest for funds is the possibility of widening the range of currencies in which it borrows. For the World Bank's Articles of Agreement specifically forbid it to accept foreign exchange risks in intermediating funds.

Rather, it is the institution's borrowers who severally shoulder this burden through a currency pooling system for the seventeen currencies in which the bank presently has borrowings.

Much discussion, both outside and inside the institution, has been devoted to whether it should increase its highly conservative loans to capital ratio of 1:1 and whether this would damage its triple A rating in the bond markets.

The bank is naturally very aware of its standing, as is the Asian Development Bank which would probably feel free to copy any increase in gearing, but it seems unlikely to make such a move before the difficulties over the United States' contributions have been finally resolved.

Rather than attempt to disburse directly to borrowers such a doubling in its borrowings, the World Bank might decide to devote some of this extra cash to various other mechanisms designed to pursue its purpose.

Alternatively it could look to boosting the economic

Table three

Commercial bank co-financings with World Bank in Asia-Pacific last year

Borrower	Sector	Participants	Role	Amount US$ millions
Fiji	power	Bank of New South Wales	manager	2.0
		Tokai Bank	manager/agent	3.0
				5.0 total
Korea	railways	Associated Japanese Bank	manager	6.25
		Canadian Imperial Bank of Commerce	manager	6.25
		Clydesdale Bank	participant	2.0
		International Energy Bank	participant	2.0
		Japan International Bank	manager	6.25
		Midland Bank	manager	10.5
		Royal Bank of Canada	manager	6.25
		Samuel Montagu	manager/agent	10.5
		Société Générale de Banque	participant	5.0
				55.0 total
Malaysia	power	Amex Bank	participant	1.5
		Bank Bumiputra Malaysia	participant	1.0
		Bank of Tokyo	participant	2.0
		Chuo Trust & Banking	participant	1.0
		Citibank	participant	2.0
		Daiwa Bank	participant	1.0
		First Chicago	participant	2.0
		Fuji Bank	participant	1.0
		Industrial Bank of Japan	participant	2.0
		Lloyds Bank International	participant	2.0
		London Multinational Bank	participant	2.0
		Long-Term Credit Bank of Japan	participant	1.0
		Manufacturers Hanover	participant	2.0
		Midland Bank	participant	2.0
		Mitsubishi Bank	participant	1.0
		Mitsui Bank	participant	1.0
		Morgan Grenfell	manager/agent	0.5
		Sanwa Bank	participant	1.0
		Tokai Bank	manager	3.0
		William & Glyn's Bank	participant	1.0
				30.0 total
Philippines	central bank	Bank of Hawaii	participant	
		Crédit Agricole	manager	
		Daiwa Europe	participant	
		Hokuriku Bank	participant	
		Indian Overseas Bank	participant	
		Industrial Bank of Kuwait	participant	
		International Commercial Bank	participant	

.../

development of its industrialising country members through mechanisms which involve only staff costs rather than the disbursement of funds — such as giving technical and financial advice on projects which it is not financing.

The problem here is that when such advice is not linked to an injection of cash it lacks persuasion. The pro-increased technical assistance camp argues, however, that since the financing which the World Bank provides is only a drop in the ocean of most of its members' needs, the leverage which it is commonly thought to wield is more reputed than real.

A number of mechanisms to which the bank could choose to devote both effort and funding were first investigated in 1977 and 1978 by the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, known for short as the Development Committee.

At the end of 1978 the committee produced a (publicly available) report on Developing Country Access to Capital Markets, which was not only remarkable for its clarity — especially by the standards of international bureaucracies — but also because it represented the best survey of realities and opinions which it was possible to make.

Specifically, the report examined the possibility of the World Bank acting as guarantor for loans which it did not fund, as its Articles of Agreement already allow it to do; the establishment of an underwriting and liquidity fund, and of an international investment trust; plus the potential for more co-financing of loans with commercial banks

The initial discussion of the question of guarantees concentrated on 'the possibility of establishing a new multilateral guarantee fund, probably managed by the World Bank (possibly in association with the regional development banks), but with resources of its own ... and for the specific purpose of facilitating access to external bond markets.

'Apart from the obvious advantage of making these additional resources available to suitable developing countries, a fund established solely to provide guarantees could operate under a charter specifically designed for the purpose and avoid most, if not all, of the purely technical difficulties arising from the charters of the development banks [which are obliged to book guarantees as liabilities] themselves in this regard.

'... discussion, however, showed that there was very little support for the idea both from developing and developed countries ... with some countries opposing the idea of a guarantee facility *per se*.'

The committee stayed with the notion long enough to look at the possibility of some part of the capital increases planned by development banks being made available for guarantee purposes and whether such commitments could be restricted to partial guarantees.

The giving of partial guarantees, it pointed out, would 'necessarily entail a more active evaluation of the credit by the investor and thus encourage the likelihood of an earlier possible acceptance of the borrower purely on its own merits.'

The question of guarantees is still being actively studied by a committee working group under its new executive director, Hans Kastoft, and it hopes to present its further deliberations on a possible 'modest but separate' scheme to a meeting of the full committee in Helsinki next month.

Other mechanisms to expedite and improve the access of some higher-income developing countries were also discussed by the committee which acknowledged that:

'Most investors do not wish to be necessarily obliged to hold securities in their portfolios until final redemption by the borrower and have a strong preference for bonds or similar instruments in which there is a two-way market at competitive prices' and that

(Continued from page 64)

Borrower	Sector	Participants	Role	Amount US$ millions
		Lloyds Bank International	manager/agent	
		Long-Term Credit Bank of Japan	manager	
		National Bank of North America	participant	
		Nederlandsche Middenstandsbank	participant	
		Nippon Credit International (HK)	participant	
		Nippon Trust & Banking Co	participant	
		Nomura Europe	participant	
		Northwestern National Bank of Minneapolis	participant	
		Philippine National Bank	participant	
		PKbanken International (Luxembourg)	participant	
		Rabobank Nederland	participant	
		Saitama International (Hong Kong)	participant	
		Taiyo Kobe Finance Hong Kong	participant	
		Tat Lee Bank	participant	
		Tokai Asia	participant	
		Union Bank	participant	
		Union Trust Company of Maryland	participant	
				100.0 total
Thailand	gas	Bank of Nova Scotia International	manager	7.0
		Chase Manhattan Bank	manager	7.0
		Chemical Bank	manager/agent	7.0
		Daiwa Bank	participant	5.7
		Deutsche Bank	manager	7.0
		Gulf International	participant	5.7
		Hongkong & Shanghai	participant	5.7
		Long-Term Credit Bank of Japan	manager	7.0
		National Westminster Bank	participant	5.7
		Royal Bank of Canada	participant	5.7
		Security Pacific National Bank	participant	5.7
		Toronto Dominion Bank	participant	5.7
				74.9 total
Thailand	hydro-electric	Bank of Tokyo	manager/agent	6.0
		Citibank	participant	2.5
		Dai-Ichi Kangyo Bank	participant	2.0
		Fuji Bank	participant	2.5
		Morgan Guaranty	manager	4.5
		Tokai Bank	participant	2.5
				20.0 total

'Korea may be next to take the plunge with a national investment trust'

'the external debt instruments of developing countries are particularly illiquid'.

It noted too, that of the 23 developing country issues made in US markets in 1971-75, only two were offered publicly and the 55 issues in European markets enjoyed a similarly narrow distribution. Only six of the total 78 issues in both centres were for amounts of $50 million or more, making widespread distribution impossible.

In turn the overwhelming reason why issue sizes were kept so small was found to be the perceived difficulty in attracting a large and diverse body of investors to them.

Hence the committee went on to ponder the creation of a fund to undertake underwriting and secondary market-making activities on a semi-commercial basis, with any surplus revenues being devoted to purely promotional and technical assistance activities.

It found private sector institutions' reactions to the idea 'somewhat mixed': most considered, not surprisingly, that if sufficient investor demand were stimulated by purely promotional efforts, private sector underwriting funds could always be made available and there was little need for them to share underwriting revenues with possible official sources.

'But some took the view that additional financial support, particularly in secondary markets, could be useful.

'There was, however, generally insufficient support to justify pursuing the matter, at least at the time.'

While the Development Committee's discussion on improving access to bond markets focused exclusively on issues by government and quasi-government entities, it went on to consider the suggested establishment of an International Investment Trust (ITT) designed to encourage additional foreign portfolio investments in securities issued by private firms.

Such a trust could, it postulated, benefit a country in three ways:

- through additional inflow;
- through a possible reflow via the trust of funds held abroad by citizens of developing countries;
- by effecting a stabilising influence on the security markets in which it operated.

Moreover it could prove an attractive vehicle for investors if the pattern of the mid-1970s holds true. Then the rate of return on US equities was between three and six per cent, while that in 21 countries studied by the committee was between 14.85 per cent and 16.25 per cent when calculated on a comparable basis. (Calculated by the methods commonly used by the countries themselves it averaged 19.5 per cent.)

These returns did not, though, take into account the effects of either dividend repatriation taxes or differential taxes on foreign dividends by some capital exporting countries. Even taking these factors into account, the rate of return was still positive but may be too small to lure investors to an ITT.

The committee thus called for more study of the problems involved and suggested that developing country governments remove various disincentives to investment in their markets.

It also asked the International Finance Corporation (see separate story) to explore the possibilities in establishing or expanding national investment trusts allowing both national and foreign investment in domestic securities. With the Mexico Fund now an established fact, Korea may be the next country to take the plunge in this respect.

All this exotica aside, the Development Committee also looked at the possibilities of the World Bank increasing the number of loans it co-finances with commercial banks. But since its work mainly concerned mechanisms through which developing countries could gain access to international capital markets, and many already had access to the Eurodollar loans market, it went no further than to give the notion its general blessing.

Co-financing was pioneered in 1975 by the Bank of America, then headed by A.W. Clausen, when it led a syndicate that raised $55 million to part-fund a government-controlled steel company in Brazil, to which the World Bank provided $95 million.

Now president of the World Bank, Clausen is known to be still keen on the concept which the World Bank has pursued more heavily in Asia (see table 3) than has the Asian Development Bank (see Asian Banking, June 1980).

Though it is only covertly acknowledged, the World Bank is 'not ruling out' the possibility of making some loans on a floating rate basis as part of its struggle to match the cost of its funds to its loan portfolio. And yet this institution has somehow become embroiled in, and hindered by, the debate in the United States on the rectitude of making available foreign 'aid'.

Last year the World Bank's lending rate was averaging just below 11 per cent — higher than the prime rate in countries such as Malaysia, which manage their economies on the basis that cheap credit helps hold down inflation.

Shortly before Robert McNamara relinquished his presidency of the bank on 30 June he was making three points about why the United States should support the institution:

- Inflation. Because the World Bank finances production of essential commodities, the scarcity of which could raise world prices.
- Strategic interest. Because lower rates of economic and social growth in developing countries are certain to bring political instability to the US, adding to its military costs and affecting its national security.
- Economic growth. Because developing nations take roughly one third of US exports and if lack of financial support erodes this market domestic production and employment will suffer accordingly.

Just as the US's Marshall plan — and the World Bank — helped the war-ravaged nations of Europe stand up and run in the world-wide trade stakes following World War II, so could the World Bank play its part today. ▽

Ernest Stern — in the number two slot of vice president for operations
World Bank photo by G. Franchini

This news item appeared on page of the October 3, 1981 issue of:

THE ECONOMIC AND POLITICAL WEEKLY (Bombay)

A Theory of adJustice

World Development Report 1981

S Guhan

World Development Report 1981; The World Bank, Washington, DC, August 1981; pp viii + 192.

THE World Development Report (WDR) 1981 is the fourth in the series, the experiment having been initiated by Robert S McNamara in 1978 on the basis, if recollection is right, of a desire expressed in the London summit of OECD powers in 1977. Presumably, the summit felt that since it might take a while to deal satisfactorily with international development problems, such problems should be at least satisfactorily documented once a year. McNamara, always ready to accept a challenge, decided that these reports should be produced in the World Bank. His reason for this decision, as expressed in his foreword to WDR 1978, was as follows: "The World Bank, with its broad-based membership, its long experience, and its daily involvement with the development problems of its members is in a unique position to analyse the inter-relationships between the principal components of the development process". On the need for the document, he was equally clear: "... whatever the uncertainties of the future, governments have to act. They are faced with the necessity of daily decisions. And hence the quality of the information, and the range of available choices on which those decisions will have to be made become critically important. That is why we have undertaken this analysis". The WDR then is the document that relates the World Bank's "daily involvement with development problems" to the need of governments to "take daily decisions" in regard to the development process.

Unlike the preceding WDRs, WDR 1981 does not focus on any single theme or set of themes but rather on the whole process of the changes that have occurred in the 1970s in the international economy. These have been principally in regard to trade flows, capital flows and oil price increases. What the report seeks to do is to analyse the interaction of these changes, and the manner in which and the extent to which different groups of countries have 'adjusted' themselves to the changing international environment and the impact of such adjustment on their growth performance. The attempt is "to offer an integrated discussion of international and national economic policy issues ... with the main dimensions of adjustment in the global economy, their counterparts in national economies and interactions between the two". Proceeding from the analysis of the 1970s, the WDR sketches the prospects for the 1980s and tries to draw some possible lessons for the coming decade based on the experience of the previous one. The issues dealt with in the report are clearly of central concern to world development. This WDR comes at the beginning of a decade during which these issues will not only be of continuing importance but are likely to reach crisis proportions. *Prima facie*, one would expect it to make an important contribution to the international development debate.

The report is organised as follows. The first is an introductory chapter. The second chapter contains a perspective of growth in the 1970s, prospects for the 1980s and the implications for poverty. The third entitled 'Growth through Trade' is devoted to issues arising from trade performance and of trade policy. The fourth to the energy transition. The fifth is on external finance for adjustment and growth. The sixth is a review of country experience. The seventh chapter is a brief reminder that human development is a continuing imperative which is threatened, but must not be allowed to suffer, during the period of adjustment. In the final chapter, the entire discussion is overviewed and a table given containing in one place the World Bank's policy prescriptions for different country groups on how they should go about adjusting. Thus within the compass of this report we have documentation, analysis and a set of prescriptions.

The Seventies

The main body of the factual content of the report lies in its analysis of developments in the 1970s. In relation to the 1960s, the 1970s represented a whole series of unanticipated changes and new configurations in the international economy. In 1973-74, there was a four-fold increase in nominal oil prices. This was followed by a fall of 9 per cent in oil prices in real terms between 1975 and 1978, and a sharp increase of 83 per cent in 1979-80. Consequently, there were significant alterations in the direction and magnitudes of capital flows between different groups of countries. These alterations were not only the result of the increases in oil prices but also the ways in which countries adjusted themselves to it. What is evolving, as the WDR points out, "is a different pattern of economic power, with new centres of production, finance and trade, and new forms of interdependence".

It will be useful to follow these changes in terms of country groups. Growth in the industrial countries decelerated from over 5 per cent per annum in the 1960s to erratic annual fluctuations around an average of 3.3 per cent. Stagflation was born in the 1970s. Inflation and high unemployment came to co-exist with poor growth, a slow down in technological innovation and investment, a slackening of productivity growth, and increasing tensions in resolving the claims different groups such as government, business, labour and consumers. The industrial countries were however able to tide over the effects on their balance of payments of the 1973-74 increase in oil prices. Their collective deficit in 1974 of $ 8 billion was turned into a collective surplus of $ 30 billion in 1978. This was because the oil-exporters mainly imported their capital goods, consumer goods and food requirements from the industrial countries and also lodged most of their financial investments in these countries. Another factor was that the industrial countries were able to reduce the rate of growth of their oil imports because of a growing supply from domestic sources, and through conservation measures.

The 1970s were a period of rapid growth for the oil-exporting developing countries as a whole, although at 5.2 per cent per annum over the decade it was less than 6.5 per cent achieved in the 1960s. One group of them with larger populations and more diversified economies — Algeria, Indonesia, Iran, Venezuela and Nigeria — were able to absorb their increased

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513

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: October 14, 1981

FROM: Caio Koch-Weser, Chief, AEADF

SUBJECT: CHINA: Mr. Clausen's Meeting with the Chinese Delegation to the Annual Meetings, September 24, 1981

Present: Messrs. Li Baohua — President, People's Bank of China
Li Peng — Vice Minister of Finance
Shang Ming — Vice President, People's Bank of China

Fei Lizhi
Li Miao
Cao Guisheng
Wang Liansheng
Chen Hui

A.W. Clausen
E. Stern
S. Shahid Husain
E.V.K. Jaycox
C. Koch-Weser

1. Mr. Li Baohua explained that Finance Minister Wang Bingqian was unable to attend the Annual Meetings because of a heavy workload at home. Mr. Clausen asked Mr. Li to convey his best regards to Minister Wang; he remembered the luncheon he had had with the Minister earlier this year. He hoped that the relationship between the Bank and China would broaden and deepen in the future, after an interruption of many years. Mr. Li said that China was grateful for excellent cooperation on the part of the Bank. The Bank had written a long economic report and a few projects were being processed. However, China had not yet started using World Bank funds to implement projects - to do this would require a concerted effort by both sides. The economic report was favorably received by all parts of the Government. Mr. Clausen said that he was grateful for China's cooperation in producing this first economic report.

2. Vice Minister Li Peng said that so far the cooperation between China and the Bank had progressed well, and he expressed his belief that this would continue to be the case under Mr. Clausen. The first education loan to China had been approved by the Board, but it had not yet been signed because IDA VI was not in effect at the time of Board approval. Mr. Stern explained that although IDA VI was now effective, the Bank had fewer funds available now than when it had received advance contributions from donors. The IDA Deputies would meet during the Annual Meetings; he hoped that agreement on the release of additional funds could be obtained and that US legislation on the second tranche would soon be passed. When this was accomplished, China would certainly receive high priority in obtaining funds for the first credit. Mr. Li Peng observed that he did not mean to set a timetable, but since this was the first loan, he hoped that the agreements could be signed at an early date. Messrs. Clausen and Stern agreed.

3. Mr. Li Peng thanked Mr. Clausen for his efforts in assuring Board approval of China's recent special capital increase. Mr. Clausen said that Messrs. Wang and Chen had been most helpful in this respect. The Bank's management was of the opinion that China should assume the position it would have held without the long interruption in the relationship. The shareholders had agreed with this approach. Also, China needed the additional shares to maintain its relative position in the Board and to be directly represented with its own Executive Director.

4. Mr. Li Peng enquired about the prospects for IDA VII. Mr. Clausen replied that it was difficult to assess the prospects for IDA VII when IDA VI was still "a horse that was barely pointed to the barn". The IDA VII negotiations would have to start in early 1982. The problems would be the same as for IDA VI: the strong nations were suffering severe economic problems themselves and taxpayers were increasingly opposed to aid programs. The IDA VII replenishment level would have to be higher than the IDA VI level, but the system would probably have to be redesigned so that IDA would provide concessional funds rather than grant money. Within four or five weeks, an answer to Mr. Li's question might be easier to give in light of the outcome of the IDA Deputies meeting and US action on IDA legislation. The important thing was that there had to be a substantial IDA VII replenishment - and it would have to take China's needs into account.

5. China had managed its foreign debt very well and had in fact only incurred foreign debt in recent years. Therefore, the country had access to market resources denied to other countries and its creditworthiness was good. As a result, China's economic managers have various options in pursuing development. Mr. Clausen emphasized that he had pointed to China's creditworthiness and access to commercial capital markets not as an alternative to borrowing from the Bank Group but as an additional option; China had access to IDA and IBRD resources as well as to commercial funds. Mr. Li Peng observed that China had been borrowing from various quarters, but at present the country was undergoing economic readjustment, which made it difficult to shoulder high interest rates. At a later stage these high interest rates would be acceptable. Mr. Clausen remarked that nobody liked high interest rates; even the Bank faced a serious problem because it had to borrow large amounts in capital markets.

6. Mr. Li Peng said that China had not participated in IDA VI and that there was concern in his Government with regard to the prospects for IDA VII. He raised this issue also on behalf of other LDCs. China would also borrow from other sources, but the blend of IDA and IBRD resources was attractive, as was the Bank's technical assistance. Mr. Clausen said that the latter was the most valuable resource of the Bank and it made the cost of Bank lending seem very inexpensive. Mr. Li Peng emphasized that China was indeed interested in the Bank's technical assistance. In its borrowing from the Bank, China would emphasize infrastructure projects with a long gestation period, such as ports, power facilities and mines. Mr. Clausen said that the Government and the Bank had identified several priority areas for Bank lending and that the necessary economic and technical analysis

was now being carried out as a prerequisite for project lending. The Bank was anxious to help China in the development process, and he looked forward to a strong association in the years ahead. He recognized the importance of IDA VII to China.

7. Finally, Mr. Li Peng raised the issue of Taiwan. The Vice Minister of Foreign Affairs, Zhang Wenjin, had recently discussed this question with Mr. Thahane in Beijing. The issue involved the feelings of one billion Chinese. It was China's position that the Bank should handle the issue as other international institutions, e.g. the UN, had done, namely not having Taiwan appear as a separate entity.

8. Mr. Clausen replied that he recognized the importance of this issue to China; Messrs. Wang and Chen had made this clear in the Board. However, the Bank was different from the UN; it had to disclose to the outside world the indebtedness of countries that had borrowed from the institution. The Bank, of course, recognized the one-China concept, but he thought that referring to Taiwan as "Taiwan, China", at least for the purposes of the Annual Report, had been an important compromise. He hoped that the Government would recognize the different requirements of the Bank and would work with the Bank in finding an acceptable solution.

9. Mr. Li Baohua said it was his Government's hope that for the next Annual Report the Bank could find a better way of handling this matter. He hoped that Taiwan would not be mentioned at all. Mr. Clausen pointed to the fact that this document was a report of the Executive Directors; therefore a broad constituency needed to be satisfied on the issue. This year's compromise had preserved the one-China concept and could be supported by all. Mr. Li Baohua expressed again his hope that the Executive Directors would think of a better solution. Mr. Clausen concluded that he would try to keep an open mind and to find a solution satisfactory to himself and all the EDs.

10. In concluding the meeting, Mr. Clausen said that it had been an honor to receive the Delegation and that he looked forward to meeting Messrs. Li Baohua and Li Peng again as the program of cooperation between China and the Bank develops in the coming years.

cc: Messrs. Stern, Husain, Kirmani, Jaycox, Hasan, Wyss

CKoch-Weser:mt

RECEIVED

1981 OCT 20 AM 9:31

OFFICE OF THE PRESIDENT

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Olivier Lafourcade, EXC

DATE September 23, 1981

FROM: Caio Koch-Weser, AEADF

SUBJECT: CHINA -- Mr. Clausen's Meeting with Chinese Delegation

9.24.81

The following members of the Chinese delegation to the Annual Meetings will attend Mr. Clausen's meeting tomorrow:

Mr. LI Baohua, President of People's Bank of China, Governor for Fund;

Mr. LI Peng, Vice Minister of Finance, Alternate Governor for Bank and Acting Governor for the Bank for the duration of the Annual Meetings (because of Minister Wang Bingqian's absence);

Mr. CAO Guisheng, Minister-Counselor, Embassy of the People's Republic of China

Mr. FEI Lizhi, Division Chief, External Finance Department, Ministry of Finance

Mr. LI Miao, Section Chief, External Finance Department, Ministry of Finance

Mr. WANG Liansheng, Executive Director, World Bank

Mr. CHEN Hui, Alternate Executive Director, World Bank

cc: Messrs. Stern, Husain, Jaycox

CKoch-Weser/hk

From the Bank the following staff members will attend:

S. Shahid Husain, Vice President
Kim Jaycox, Director, Country Programs Dept
Caio Koch-Weser, Division Chief for China

Record Removal Notice

The World Bank Group Archives & Records Management

File Title		Barcode No.
Country Files: China - Correspondence 02		1774658
Document Date	**Document Type**	
September 23, 1981	Memorandum	

Correspondents / Participants

To: Mr. A.W. Clausen

From: H. Golsong

Subject / Title

China

Exception(s)

Attorney-Client Privilege

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Shiri Alon	17-Mar-17

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Country Files: China - Correspondence 02	1774658

Document Date	Document Type
August 10, 1981	Letter

Correspondents / Participants

To: The Lord Trevelyan, KG, GCMG, CIE, OBE, Chairman, Chinese Bondholders Committee

From: Heribert Golsong, Vice President and General Counsel

Subject / Title

Credit to China to finance a university development project.

Exception(s)

Attorney-Client Privilege

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Shiri Alon	17-Mar-17

FORM No. 89
(2.66)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL FINANCE CORPORATION

ROUTING SLIP

Date: Aug. 4, 1981

OFFICE OF THE PRESIDENT

Name	Room No.
Mr. Golsong	
Mr. Forget	
pl. draft appropr. reply	
HJ 08/04	

	To Handle		Note and File
	Appropriate Disposition		Note and Return
	Approval		Prepare Reply
	Comment		Per Our Conversation
	Full Report		Recommendation
	Information		Signature
	Initial		Send On

Remarks

A similar letter addressed to Mr. McNamara, dated May 19, was received and sent on to your office. — [And answered by Mr. Golsong June 12, copy to Mr. McNamara. F Forget. 8-5-81]

From

CHINESE BONDHOLDERS COMMITTEE

TELEPHONE: 01-236 3641
TELEGRAMS: BONDHOLDER LONDON E.C.2.

c/o *Council of Foreign Bondholders,*
9-12, Cheapside,
London,
EC2V 6AB.

OUR REF:

YOUR REF:

Chairman: The Lord Trevelyan KG GCMG CIE OBE

361/576 MG/JP

30th June 1981

Dear Mr President,

Please accept the congratulations of the Chinese Bondholders' Committee on your taking up your appointment as President of the World Bank.

I am writing to you, as I have done to your predecessor, to draw your attention to the continuing default by the People's Republic of China on sterling Bonds issued or guaranteed by the Chinese Government before the war. It is quite wrong, in the view of this Committee for China to expect to receive generous loans from the international community while refusing even to discuss the settlement of the comparatively small amounts still owing on its defaulted sterling obligations.

I trust that the World Bank, under your Presidency, will make use of its unique position to influence the Government of the People's Republic of China to enter into discussions with representatives of the Bondholders with a view to the honourable settlement of these long outstanding debts.

Yours sincerely,

Trevelyan

Chairman

Mr. A.W. Clausen,
President,
International Bank for Reconstruction and Development,
1818 H. Street N.W.
Washington D.C. 20433
U.S.A.

THE HANNAFORD COMPANY, INC. PUBLIC RELATIONS & PUBLIC AFFAIRS
LOS ANGELES • WASHINGTON, D.C. • NEW YORK • SACRAMENTO

August 6, 1981

Mrs. Nina Smith
Assistant to the President
The World Bank
1818 H Street, NW
Washington, DC 20433

Dear Mrs. Smith

Thank you very much for your assistance in arranging an appointment with Mr. Clausen for Mr. Martin Wong of the Coordination Council for North American Affairs. Mr. Wong was an Executive Director of the World Bank in 1972 and has been handling major economic matters for Taiwan for some twenty years now. His distinguished record of service to the Republic of China includes representing his country as Ambassador to Belgium.

Mr. Wong is quite a fine gentleman and a very able representative of his country. I am sure Mr. Clausen will enjoy his meeting with him.

Sincerely,

Carroll Leggett
Vice President

1225 19th Street, N. W., Suite 750, Washington, D.C. 20036 • 202/659-5750
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1225 19th Street, N. W., Suite 750, Washington, D.C. 20036 • 202/659-5750
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THE WORLD BANK

Office of the President

1:05
July 31

?

Mr. Clausen,

Mr. Martin Wong, whom, apparently, you have met on several occasions, would like to have lunch with you at your convenience.

Mr. Wong, a Mainland Chinese from Taiwan, works for Hannaford Company, a public relations firm, on the economics of Taiwan. ?

Because of the recent differences between the Bank and Taiwan, he wanted to stress that this would be a purely social occasion.

Should I set up a date?

nina

THE ANSWER TO YOUR QUESTIONS ARE:

(1) I DON'T REMEMBER MR WONG.

(2) I SHOULD NOT HAVE LUNCH W/ MR. WONG UNDER ANY CIRCUMSTANCES. I'M TOO BUSY!

(3) ~~IF THE RACE, THINGS, THINGS, DOES NOT CHANGE~~ BUT I WOULD BE HAPPY TO SEE HIM FOR 15/20 MINUTES SOME DAY - CONVENIENT TO HIS SCHEDULE AND TO MINE!

B

6/30 To Mr. Husain I agree with you. Mr Chenery's letter, however, may be different. [illegible]

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
THROUGH: Mr. Ernest Stern
FROM: S. Shahid Husain

DATE: June 29, 1981

SUBJECT: Treatment of Taiwan in the World Bank Annual Report

I agree with Shahid. There is no reason why the Euromarket data should be treated differently from WDR data. Since this is the EDs report, if the US wishes to raise the issue they should do so at the Board
ES 6/29/81

1. Earlier this year you had asked me to coordinate the presentation of information on China, including Taiwan, in various World Bank publications. In February, I had met Messrs. Chenery, Golsong and Benjenk on the treatment of Taiwan in the Annual Report, World Bank Atlas and World Development Report. With the concurrence of Mr. Golsong and with the reservation of Messrs. Chenery and Benjenk, I had recommended that data on Taiwan be omitted from the Annual Report, World Bank Atlas and World Development Report. The only exception would have been Appendix D of the financial statements of Bank and IDA. My memorandum to you and your approval of my recommendations is attached. Once again, in June, on the recommendation of Mr. Stern, you agreed not to change the earlier position (please see Mr. Stern's memorandum to you dated June 1, 1981).

2. The issue has been raised once again and I met Messrs. Benjenk, Waide (representing Mr. Chenery), Goldberg (representing Mr. Golsong) and Wood to discuss it. The following are the conclusions:

a. The first question is whether the objective situation has changed since February 17. The answer is no. The United States has raised the issue with us and is likely to raise it again. However, United Nations organizations and the IMF continue to omit data on Taiwan, and China has not changed its position.

b. The second question is whether we are legally required to present data on Taiwan in the Annual Report. Here, a distinction should be made between Taiwan's debt to IDA and Bank and other financial transactions of Taiwan. Clearly, we are obliged to publish the first. However, there is no legal requirement that we publish data on Taiwan's external debt and international financial transactions.

c. The third question is whether non-publication of Taiwan's financial data will impair our relations with the financial market. Mr. Wood thinks no.

3. I am therefore of the view that little has happened since February which should warrant any change in your earlier decision. I recommend that while Taiwan's debt to Bank and IDA should be shown in Appendix D, data on Taiwan's external debt and borrowings be omitted from Tables 3, 4, 8 and 9. Mr. Benjenk does not agree with my recommendation. He feels that Taiwan's

.../

eurocurrency borrowings and international bond issues should continue to be shown in the Annual Report. Mr. Waide continues to support Mr. Chenery's earlier position that all data on Taiwan should be published.

Attachment

cc: Messrs. Stern
Benjenk
Golsong/Goldberg
Waide
Wood

SSHusain:bce

The World Bank / 1818 H Street, N.W., Washington, D.C. 20433, U.S.A. • Telephone: (202) 477-1234 • Cables: INTBAFRAD

February 4, 1981

2-10-81

Mr. A.W. Clausen
President
Bank of America
9 San Francisco
San Francisco, CA 94137

Dear Mr. Clausen:

On Mr. Husain's instruction, I am sending you the following documents on the development of the Bank's relationship with China over the past ten months:

a) Economic Brief - Development Performance and Issues; and Operations Strategy; both papers were prepared for Mr. McNamara's visit to China in April 1980.

b) Minutes of Mr. McNamara's meetings with Vice-Premiers Deng Xiaoping and Gu Mu in April 1980 in Beijing.

c) Minutes of Mr. Husain's meetings with Vice-Premiers Zhao Ziyang and Gu Mu in July 1980 in Beijing.

d) Mr. Husain's report to Mr. McNamara and his statement to the Board of Executive Directors on his July mission to China.

e) A paper on Lending to China, prepared for the Management Finance Committee in October 1980.

f) Mr. Husain's report (January 1981) to Mr. McNamara on the results of the first Economic Mission (October-December 1980) and recent developments in China.

g) A letter sent recently by Mr. Jaycox (Director, Programs, East Asia and Pacific Region) to Mr. Wang Bingqian, Minister of Finance, in preparation for a mission in March, during which the findings of the Economic Mission and the work program for the coming years will be discussed.

Mr. Husain will call you before you leave for China next week to discuss any other matters you may wish to raise.

Yours sincerely,

CKoch-Weser

Caio Koch-Weser
Chief, China Division
Country Programs Department
East Asia and Pacific Regional Office

Attachments

Record Removal Notice

The World Bank Group Archives & Records Management

File Title		Barcode No.
Country Files: China - Correspondence 02		1774658
Document Date	**Document Type**	
August 6, 1981	Board Record	

Correspondents / Participants

Subject / Title

IBRD/IDA Directors' Meeting - July 28, 1981 - Excerpts from Verbatim Transcript - Re: Remarks on China

Exception(s)

Additional Comments

Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Shiri Alon	17-Mar-17

July 13, 1981

Dear Mr. Sewell:

My apologies for not having responded sooner than this to you personally regarding your invitation to participate in your seminar on China, originally scheduled for this week. As Lynn Feintech will have told you, my first weeks here are too full to allow me the preparation time necessary to make a meaningful contribution. I understand that the seminar is now scheduled for mid-August and that the Bank will most proably be represented by our Division Chief for China, Mr. Caio Koch-Weser, unless he is, in fact, detained in China. He leaves on mission this week.

I, too, look forward to the continuing close association between ODC and the World Bank, which has been so successful in past years. I would be very pleased indeed if you and I, and perhaps one or two of our colleagues, could meet to discuss matters of mutual interest, possibly over lunch. I shall ask my secretary to be in touch with your office to see what would be the most convenient time within the next two or three weeks.

With kind regards,

Sincerely,

A. W. Clausen

Mr. John W. Sewell
President, Overseas Development Council
1717 Massachusetts Avenue, N. W.
Washington, D. C. 20036

bmm

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: February 17, 1981

FROM: S. Shahid Husain

SUBJECT: Treatment of Taiwan in Bank Documents

I agree fully with Shahid's recommendations. On the Atlas we must reprint, while it contains no data not elsewhere available to cancel it now is bound to lead to a lot of unwanted publicity.

1. You have asked me to make recommendations on the treatment of Taiwan in Bank documents. In this connection, I have met Messrs. Chenery, Golsong and Benjenk. We do not have agreed recommendations, but in the following paragraphs I shall present my recommendations as well as the reservations of Messrs. Benjenk and Chenery. Mr. Golsong agrees with my proposals.

2. The general position taken by the People's Republic of China is that Taiwan should not appear in any Bank document as a separate country. If data on Taiwan are to be shown, Taiwan should always appear immediately after China and be mentioned specifically as a province of China. In the present environment, the Chinese authorities are particularly concerned that the treatment of Taiwan in the publications of international organizations should not imply the existence of two Chinas. On the other hand, the procedure suggested by them would create awkwardness and touch on the sensitivities of other members of the Bank group. My view is that the only prudent course for us would be to omit the data on Taiwan in our publications. I recognize that Taiwan is an important trading entity and has significance in the world economy. Yet the publication of Taiwan figures without the qualifications suggested by the Chinese authorities would be construed as a political act at variance with the practice of the United Nations organizations as well as the International Monetary Fund. The International Monetary Fund no longer publishes separate data on Taiwan in their international statistics, although their aggregates do include these data. Messrs. Benjenk and Chenery do not accept my view. They feel that data on Taiwan should continue to be published. They feel that the Bank would be adequately safeguarded by including in our publications the general disclaimer that the reference to Taiwan should not be interpreted as having legal significance as to its status.

3. The following are my specific recommendations along with the reservations of Messrs. Benjenk and Chenery:

I. Annual Report

As far as Annex D is concerned, the issue is settled and there is no need for change. However, consistent with the approach I have mentioned above, in the next publication the reference to Taiwan in the statistical tables (p.134 of last year's report) should be omitted, particularly since next year's report should

include data on China. Mr. Chenery is of the view that, since this table presents definitive statements of external debt, Taiwan should not be omitted.

II. World Bank Atlas

The 1980 Atlas has four references to Taiwan as a separate country (pp. 4, 6, 8 and 14), although Taiwan is listed along with many other areas which are not independent states (e.g., Hong Kong, Puerto Rico, Greenland). Despite the disclaimer "The denominations used and the boundaries shown on these maps do not imply, on the part of the World Bank and its affiliates, any judgment on the legal status of any territory or any endorsement or acceptance of such boundaries" on page 1, this will create difficulties for us with the Chinese. On several occasions, most recently when the economic mission was in China, the Chinese have indicated their repugnance of such a practice. We have three alternatives:

(i) Not to publish the Atlas this year;

(ii) To reprint the Atlas without specific reference to Taiwan, although in the maps where Taiwan's statistics are different from those of China, Taiwan would appear in a color different from the Mainland;

agree

(iii) To publish the Atlas as now printed, with the following notation stamped on page 1. "The denominations and classifications used in the text and tables and the denominations used and the boundaries shown on these maps do not imply, on the part of the World Bank and its affiliates, any judgment on the legal status of any territory or any endorsement or acceptance of such boundaries. In particular, the words "country" and "countries" are used in a broad sense, and thus include not only countries but also territories, provinces and other areas."

It would be unfortunate if the Atlas is not published this year. It has become an important source of information and it will be missed. A decision not to publish

it will soon become known and the publicity may embarrass us. I would prefer the second alternative; I am told that the cost will be between $60,000 and $90,000. Messrs. Chenery and Benjenk would prefer the third alternative and would state to the Chinese that the design of the Atlas would be changed next year to make it clear that Taiwan is not considered a country. If this alternative is followed we should first explain the problem to the Chinese quite candidly.

III. World Development Report

I would recommend the omission of Taiwan from the World Development Indicators. Messrs. Chenery and Benjenk would wish to continue with last year's format. Mr. Chenery also suggests that the coverage of the World Development Indicators be expanded by increasing the number of nonindependent states. The Chinese authorities have also indicated that China should be treated as most of the developing countries, i.e., it should be shown within the income group rather than with centrally planned economies. This should be consistent with the treatment of countries such as Laos and Viet Nam, and I would see no objection to that.

agree - Moreover, I thought we had already settled this.

neither desirable nor necessary.

already agreed.

IV. Other Bank Publications

It is obvious that Taiwan will continue to feature in Bank publications whenever development issues are discussed. We should make sure that Taiwan is not referred to anywhere as Republic of China or as a country. Whenever statistics on Taiwan appear, there should be a general disclaimer that the mention of Taiwan or any other area in no way implies a judgment on its legal status.

cc: Messrs. Stern
Benjenk
Chenery
Golsong
Jaycox
Koch-Weser

SSHusain:bce

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

Office of the President

July 9, 1981

Edward Rubenstein, M.D.
Associate Dean of Postgraduate Medical Education
Stanford University School of Medicine
Stanford
California 94305

Dear Dr. Rubenstein:

Thank you for your letter of April 7, 1981, which I read with interest. I am sorry I was unable to reply sooner.

As you are probably aware, the Bank has just begun its work in China. It has already produced a comprehensive economic report, which includes annexes on both education and population, health and nutrition. The Bank has also recently approved its first project for China, a university development project. This project is the first phase of a government program to strengthen higher education, specifically in science and engineering fields, by helping to increase the output and improve the quality of education and research. This objective will be achieved through the provision of both technical assistance and equipment.

The Bank's lending program for the coming years has now been developed and will include projects in several key sectors, of which one is likely to be health. Given the Bank's particular expertise and experience, this project will probably not be in the field of high-level medical training and research, but rather in the area of strengthening lower- and intermediate-level health services and support services. To assist in the selection of this project we are planning to undertake additional sector work on the Chinese health system. We will also be doing further sector work on the education system, with a focus on higher and technical education; this should lead to further education projects.

The type of program you mention in your letter is clearly of great importance for China, and I am delighted that a school of such distinction as Stanford should be involved. Unfortunately, the Bank does not finance exchange programs of this kind. But if it would be helpful to you, relevant members of the Bank's staff would be most willing to share our knowledge of China's health sector with you, and to discuss your entire program and possible alternative sources of finance for it. Should you wish to arrange

a meeting with them, the best people to contact are Mr. Caio Koch-Weser, the Chief of the China Division, and Mr. John Evans, the Director of the Population, Health and Nutrition Department.

I regret not being able to give a more positive response to your request, but hope that any meeting between yourself and Bank staff will nonetheless prove useful.

Yours sincerely,

A. W. Clausen

STANFORD UNIVERSITY MEDICAL CENTER

STANFORD, CALIFORNIA 94305

Edward Rubenstein, M.D.
Associate Dean of Postgraduate Medical Education
Stanford University School of Medicine
Room TC129 • (415) 497-7188

April 7, 1981

Mr. A. W. Clausen
Bank of America National Trust and
Savings Association
555 California Street
San Francisco, CA 94104

Dear Mr. Clausen:

I would very much appreciate having the opportunity to meet with you regarding an educational program for the major medical schools in the People's Republic of China. The program is, I believe, of interest to the International Bank for Reconstruction and Development.

During the past year the Stanford University School of Medicine has been approached by the leaders of the Beijing Medical College, Shanghai First Medical College, and Zhongshan (Canton) Medical College with requests to establish a formal exchange program with the Stanford University School of Medicine. These schools, like the others in the People's Republic of China, face a crisis owing to the fact that they lack faculty needed for their teaching, patient-care, and research missions.

As you know, during the long years of repression in China, higher education came to a virtual halt and an entire generation of medical educators is now missing. For this reason, the leaders of the Chinese Academy of Medical Sciences and of the major medical schools in China have approached the Stanford University School of Medicine with proposals to develop exchange programs that would support the development of a new cadre of medical faculty in China. These exchange programs would include a number of one- to two-year visiting fellowships for promising young biomedical scientists from China. The fellows would work in various laboratories and clinical departments of the Stanford School of Medicine. In addition, the Chinese have requested a regular program of brief visits to their institutions by leading faculty persons from Stanford.

Unfortunately, the Chinese schools have no funds to support these programs. Because of the critically important nature of this effort to the health of the Chinese, the Stanford University School of Medicine is deeply interested in cooperating and is seeking to identify a source of support for this undertaking.

I have been asked to coordinate the development of these programs and therefore would greatly appreciate the opportunity to discuss this matter of vital importance to international health with you.

My secretary will be calling your office to make an appointment in the near future. I realize that you may not as yet have commenced your new duties, but hope that such a meeting would be convenient for you.

Sincerely yours,

Edward Rubenstein

Edward Rubenstein, M.D.
Associate Dean of Postgraduate Medical Education

ER/mla
cc: Vice President Lawrence G. Crowley, M.D.

China

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

Office of the President

July 9, 1981

Edward Rubenstein, M.D.
Associate Dean of Postgraduate Medical Education
Stanford University School of Medicine
Stanford
California 94305

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a meeting with them, the best people to contact are Mr. Caio Koch-Weser, the Chief of the China Division, and Mr. John Evans, the Director of the Population, Health and Nutrition Department.

I regret not being able to give a more positive reponse to your request, but hope that any meeting between yourself and Bank staff will nonetheless prove useful.

Yours sincerely,

A. W. Clausen

THE WORLD BANK

Office of the President

Mr. Clausen: July 8, 1981

Mr. Beryl Sprinkel called yesterday from Ottawa where he is attending a meeting of the Summit Preparatory Group. He asked me to convey to you his serious concern about the omission of Taiwan in the WDR IV (1981 World Development Report) which he says will create great difficulties for the Administration in its defense of Multilateral Development Banks and IDA on The Hill.

He asked that you call him in Ottawa today if you can (I have his phone number).

I did not want to comment on his message over the phone. I only told him that I would convey the message to you. If you decide to call him back, you may wish to inform him that good progress has been made on the Taiwan issue on your second day with the Bank, since a compromise has now been found in the case of the Annual Report. In addition, WDR was prepared under your predecessor's responsibility and was approved by the Board where the U.S. chair did not formally object. You may wish to tell Mr. Sprinkel of your intentions to find a compromise solution for next year's WDR.

Olivier

atlas

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Country Files: China - Correspondence 02	1774658

Document Date	Document Type
July 6, 1981	Memorandum

Correspondents / Participants

To: Mr. A.W. Clausen

From: Heribert Golsong

Subject / Title

Taiwan

Exception(s)

Attorney-Client Privilege

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Shiri Alon	17-Mar-17

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Country Files: China - Correspondence 02	1774658

Document Date	Document Type
June 12, 1981	Letter

Correspondents / Participants

To: Mr. Wang Bingqian, Minister of Finance

From: H. Golsong, Vice President and General Counsel

Subject / Title

Concerning the Bank's report entitled "China: Socialist Economic Development".

Exception(s)

Attorney-Client Privilege

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Shiri Alon	17-Mar-17

The Central Bank of China
TAIPEI, TAIWAN
REPUBLIC OF CHINA

KUO-HWA YU
GOVERNOR

June 5, 1981

Mr. A. W. Clausen
President
IBRD
1818 H Street, N. W.
Washington D. C. 20433
U. S. A.

Dear Mr. Clausen:

Now that I have returned from an extended trip abroad, I would like to convey to you my sincere pleasure in having had the opportunity of refreshing our friendship recently in San Francisco. It was an excellent occasion for exchanging viewpoints on areas of mutual interest.

May I also reiterate my congratulations and best wishes to you in your new and important function as President of the World Bank.

With best personal regards,

Sincerely,

Kuo-Hwa Yu

Rec'd 6-18-81

1155

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

TO: Mr. A. W. Clausen, President DATE: May 6, 1982
THROUGH: Mr. Warren C. Baum, Acting Senior Vice President, Operations
FROM: Syed Salar Kirmani, Acting Regional Vice President, AENVP

SUBJECT: CHINA: Your Meeting at Helsinki with Finance Minister Wang Bingqian

Taiwan CHINA

1. Minister Wang has requested the meeting and may raise three subjects: IDA, our lending program, and Taiwan.

IDA

2. IDA 6: When IDA allocations were rephased over four years in January 1982, China's allocation was reduced to $300 million. At the CPP Management Review on February 12, 1982, it was decided that the possibility of restoring it to $400 million would be discussed further between Mr. Stern and the Region. During Mr. Stern's visit to China, both the Finance Minister and Vice Premier Gu Mu said they hoped the Bank's agreement on the $400 million IDA (and total lending of $800 million) in FY81-83 would not be changed. Mr. Stern told them (and the Prime Minister) that total lending of $800 million was feasible and, from the Bank's point of view, was limited rather by the pace of project preparation and the 50/50 blend China had requested. It was not so clear whether the blend could be that originally agreed; he urged China to be flexible on this issue. IDA 6 was very likely to last four years not three, with a risk that it would have to be stretched over five years. If eventually $400 million could be provided, it would have to be over four years (FY81-84).

3. You should restate the position.

4. IDA 7: The Government has expressed to the U.S. Government (Secretary Regan) the importance it attaches to a large IDA 7. It asks that its needs be fully taken into account in IDA 7, and that it be treated equitably, which in its view means its share should be not lower (and perhaps slightly higher) than India's. The Chinese Executive Director was upset by a table prepared for the recent Board seminar on the FY83 work program and budget, which showed implicitly that China's share of IDA 7 was being set at 12%. This table was based on the tentative decision on the FY82-86 lending program which was taken at the CPP Review pending clarification of IDA 7 amounts and allocations. The figure has since been revised upward to 17.5%. The footnote to the table points to the notional status of these figures.

5. You should say that the Bank's management is committed to China's obtaining a fair share of IDA 7, although the needs of sub-Saharan Africa will have to receive priority. China's share will thus depend on the total size of IDA 7, and you should urge the Government to use its influence towards securing a large replenishment. It is too early to say what amount China will receive from IDA 7. However, you should say you hope the Government will be flexible on the blend issue given the justification and need for a very substantial total lending program. (If Minister Wang mentions the table discussed above, you should say this was a draft for an informal discussion, and did not accurately reflect senior management's expectations regarding IDA 7).

Lending Program

6. The lending program for the rest of FY82 and for FY83 is generally progressing well. The North China Plain Agriculture project (FY82, $60m IDA) and the Agricultural Education and Research project (FY83, $75m IDA) have both been negotiated, with the former scheduled for Board presentation in June. We have a problem on the Ports project (FY82, $124m Bank): negotiations were adjourned in early April without agreement on the project definition, and the Bank's information requirements, but technical discussions have resumed in China in early May. In FY83 our lending program consists of the Agricultural Education and Research, Daqing Petroleum, China Investment Bank I (Industry), Heilongjiang State Farms and Dongpu Petroleum projects. Work is underway on a large pipeline of projects for the outer years.

7. You should express your satisfaction at the development of the lending program; your confidence that the Ports Project negotiations can soon be successfully concluded; and your hope that an extensive pipeline of projects can be built up which will help justify a large lending program.

Taiwan

8. Minister Wang may use this opportunity to reiterate the Government's position that data regarding Taiwan should not be reported separately in Bank publications.

CKoch-Weser/DBerk:hk

RECEIVED

1982 MAY -7 PM 1:11

OFFICE OF THE PRESIDENT

January 19, 1981

His Excellency
Wang Bingqian
Minister of Finance
Sanlihe, Beijing
People's Republic of China

Dear Mr. Minister:

On behalf of the Bank's management and the many staff who were involved with the recent economic mission, I would like to thank you and the officials of your Ministry for their excellent cooperation and help in making the work of the mission most productive and enjoyable.

The first economic mission to China marks a particularly important point in the development of our relationship. Its findings provide the basis for initiating our dialogue on your Government's development priorities and plans, and on the role the Government would like the Bank to play in China's development over the next several years; the conclusions of the mission will also help determine the volume and terms of future Bank lending to China. The next steps in further developing our relationship are to agree with the Government on the specific objectives of our cooperation for the future, in the light of China's development needs and priorities; on the size of the program in the coming years and the sectors of Bank involvement; on the specific content of Bank lending operations; and on a program of sector studies and technical assistance to support such a lending program. These are the subjects I would like to explore during my visit with Mr. Wyss and Mr. Koch-Weser in March.

I realize, of course, that a number of uncertainties still prevail on both sides, which might make it difficult to reach firm conclusions on all these points in March. China's readjustment policies are presently under review and work on the Five-Year Plan has not yet been concluded; as you know, the additional demands on the Bank's resources imposed by future lending to China are under review by our member governments. However, I believe that during my visit in March we can explore meaningfully most of the subjects outlined, and we should be able to agree on a work program with the understanding that it would be reviewed and adjusted as your plans develop and the Bank's financial plans are clarified. In this letter I would like to outline several ideas that your Government might wish to consider in determining the role for the Bank to play in China's development efforts. Also, I would like to suggest a work program for our mission in March.

Objectives of Cooperation

From the outset of China's relationship with the Bank, senior officials of your Government have indicated that in the process of modernizing and opening China's economy, they would like the Bank to assist the Government in selecting and absorbing available technology from the wide range of Bank member countries; in improving investment planning and management in key sectors of the economy; and in gaining access to concessionary development

capital, including the World Bank Group's own resources. Based on the work of the economic mission and the views expressed by you and your colleagues about the immediate needs of readjustment and reform, as well as China's longer term development goals, I would suggest the following general objectives for the Bank's cooperation with China, which we should bear in mind in determining the specific content of a program of operations over the next five years:

- The Bank should contribute to the Government's efforts to improve sector planning and investment criteria.

- The Bank should support the Government's efforts in institution building, i.e., in improving the managerial and financial performance of existing institutions under the present readjustment policies and in creating new institutions needed for reform of the system.

- Bank assistance should help achieve better utilization of existing productive capacity and human resources, and quick production increases, which are required for readjustment of the economy.

- Bank lending should contribute to the removal of critical constraints to development, e.g., in energy, education and transportation.

- The Bank should help facilitate the availability and transfer of an appropriate level of external concessionary funds to China, both from its own resources and from other sources, e.g. through cofinancing.

It is, of course, for your Government to determine the relative weight to be given to each of these objectives. Their relative importance will also change as our relationship develops over time; but I would hope that we can base our dialogue concerning a program of operations on a clear understanding of the general objectives of our cooperation.

Size of Lending Program

Let me turn briefly to the question of the size of the Bank's lending program in the coming years. It will be difficult, of course, to determine the sectors to be covered by our program and the number of operations in each sector without an indication of the approximate volume of Bank lending to China. But the future size of the Bank's program might turn out to be difficult to establish in March: China's longer term needs for external capital can be determined only in the context of the Five-Year Plan, which is still being elaborated, and the amounts of IDA and IBRD resources available to China in the coming years might not be determined by that time. Under these circumstances, I suggest that we base our discussion of the development of the lending program on a tentatively assumed volume of Bank lending, which at the present stage of your Government's planning work you consider would best meet China's longer term needs for external resources and which would be within the preliminary estimates of potential IBRD/IDA commitments to China contained in the Bank management's paper to the Board of Executive Directors of December 18, 1980.

Content of Lending Program

I would now like to address questions regarding the selection of sectors and subsectors for future Bank operations and the various types of project lending we should consider. The findings of the sector teams of the economic mission and the more immediate needs of readjustment indicate that the following sectors (not necessarily presented in order of priority) should be selected. I suggest that we explore these possibilities in March.

- Agriculture. In this sector, Bank assistance could contribute to the above objectives of achieving quick production increases and building institutions, particularly in agricultural credit but possibly also in agricultural research, and of improving investment criteria, especially for irrigation and drainage projects. The communes appear to be an effective system of rural development, and indirect support through rural credit could lead to improvements in agriculture, rural industries, transport, etc. The Agriculture Bank is an increasingly important institution with financial discipline; its capability could be further developed and long- and medium-term credit programs introduced. The Bank has vast experience in this sector and could help through projects prepared and supported by a program of studies.

- Industry. Priority in the near future should be given to modernizing existing productive capacity, introducing energy conservation, and improving management. These needs can probably best be met by a policy of delegating authority for investment decisions to lower level organizations; one approach would be to develop units in the Construction Bank or the People's Bank, or to create a new institution with the responsibility for appraising and making decisions on a large number of smaller investments. The Bank has provided assistance to such development finance companies in many countries. However, lending would have to be preceded by careful studies of the financial system and various industrial subsectors.

- Transport. In this complex sector, a series of studies of bottlenecks in the railways, ports and highways is required in order to establish priorities and identify investment projects. The Bank could help through its program of sector studies and by including studies under the first ports project. Limiting such investigations to regions or subsystems (e.g. roads or ports) might be desirable.

- Energy. In electric power, the Bank could help overcome the present serious shortages through new projects and improvements in the system, e.g. in transmission, and in planning and management. But first, studies need to be undertaken to establish priorities and select the projects that typically require large investments and long construction periods. Again, such studies could be undertaken under a first loan. Studies might also be carried out by the Bank on the coal sector, including its transport requirements, leading to later project lending. In the petroleum sector, a possible area of Bank involvement could be the upgrading of existing on-shore fields.

- Education. This sector imposes a severe constraint on China's development. There is in particular a need for sector-related training in industry and agriculture, higher technical education, improvements in teacher training, production of teaching materials, and adult education. In these areas the Bank has considerable expertise and may be helpful. It is proposed that under our first education project, a number of studies be undertaken to prepare future investments in these areas. Also, in the field of human resources, health and nutrition might be a sector for future co-operation, although further study of these sectors would be necessary.

I would hope that in the course of our forthcoming meetings we can reach an initial agreement - based on your Government's readjustment priorities and longer term development goals and the objectives of our cooperation - on the sectors and subsectors to be included in the Bank's work program of the next few years.

Finally, I propose that we explore together during my visit how best to translate the general objectives and sector priorities of our cooperation into a program of lending and a pipeline of individual projects, and into a series of sector studies to support those lending operations. While the identification of individual projects should be left to the ensuing visits of sector and project specialists, I suggest we discuss, as proposed by officials of your Government, the various general types of lending operations possible under Bank policies and procedures. Specifically, I understand several Government officials raised with the recent economic mission the possibility of the Bank adopting a flexible approach in its project lending in order to meet the immediate needs of readjustment. In this connection, it might be useful to distinguish between three broad themes for Bank project lending: indirect lending through financial intermediaries; completion of ongoing projects; and new project investments.

First, indirect project lending through industrial development finance institutions and agricultural credit banks would establish a general line of credit in these two sectors against which such an institution could draw funds to finance many smaller loans. An objective of this type of project would be to strengthen the capability of the Chinese institution to do investment selection and appraisal; the institution should have adequate managerial and financial independence to function efficiently. These are objectives we emphasize as part of the project lending process, and this type of lending seems to be particularly appropriate in the circumstances of China today.

Second, as to the Government's request for lending to complete ongoing projects, we have no objection in principle to such an approach, but the projects selected should meet the normal criteria for Bank financing, i.e., they would need to be economically sound, be cost effective, and have appropriate design and technical attributes. I hope that in March your colleagues can discuss in detail with us the type of projects you wish to complete, indicating clearly why such projects have priority, their cost and benefits, and their technical appropriateness.

Finally, although near-term problems of adjustment might seem overwhelming, the main objective of Bank lending in the longer term would be to assist the Government's effort in creating new productive capacity and improving human resource capabilities. The identification of a variety of specific projects for this purpose, which the Government and the Bank could consider for financing, should be the result of a program of studies on the agreed sectors and subsectors. Therefore, it is important in terms of future resource transfer to initiate sector studies as soon as possible. This we expect should result in large-scale savings in China's future investment programs, particularly those that are highly capital intensive and have long gestation periods (e.g., in the power sector).

Sector Analysis

In order to support your Government's readjustment and development efforts and the preparation of a Bank lending program, I suggest that we agree during my visit on a program of economic and sector studies for 1981 and early 1982. Our tentative thinking on this question suggests that this program should cover subsectors or specific topics in the following sectors: human resource development (education, training and health), agriculture, industry, transportation, and a financial sector review (Construction Bank, Agriculture Bank and People's Bank).

Work Program for Mission

In sum, let me emphasize again that the above is only a summary outline of possible objectives, sector priorities, types of lending and program of sector studies. We would, of course, welcome any further suggestions your Government might have. My hope is to have a frank exchange of ideas on the future role of the Bank in China's development, and to reach agreement on overall objectives, scope and areas of cooperation, and the outlines of an initial program of lending and supporting studies.

Regarding a general schedule of our meetings, I would like to suggest that we first meet with you and your senior colleagues in the State Capital Construction Commission and the State Planning Commission, so that I can inform you of the broad conclusions of the economic mission and elaborate further on the proposals contained in this letter. The most important aim, however, would be for us to learn about your development priorities, the problems you foresee, your policy targets, and the role you propose for the Bank in order to help meet them.

After this initial exchange, we would like to meet separately with each of the ministries responsible for high priority sectors where the Bank might provide technical assistance and finance specific projects. Based on our knowledge at this time, these would be the ministries responsible for electric power, coal, and petroleum; communications and railways; industries; agriculture, water conservation and possibly state farms; and education.

Finally, I would like to meet again with you and the senior officials of the central agencies, to explore the results of the discussions with the technical ministries and to try to reach broad agreement on an outline for the Bank's work and lending program over the next few years. These ideas could then be elaborated by our staff in Washington and discussed with you further during Mr. Husain's visit in May. We would also hope that by that time the three panels on the development of procedures for Bank program implementation (in the areas of design, civil works and procurement of equipment) would have formulated their proposals, so that we can reach agreement on the procedures to be followed.

I am aware that you have constituted a small and informal liaison group of staff from the Ministry of Finance, the State Capital Construction Commission and the State Planning Commission, who are considering in more detail the program of cooperation your Government might wish to ask the Bank to undertake. I hope this letter will assist this group in its work. Mr. Koch-Weser is planning to arrive in China a few days ahead of me, and he will be able to help your colleagues with any questions they might have. As agreed in December, he will also send the liaison group further documentation on Bank sector studies, types of projects and lending procedures (e.g., sector reports and reports on lending to development finance companies).

I hope that these proposals will meet with your approval and that you will find the process helpful. Once we have your agreement to my proposed mission, I will suggest specific dates for our arrival.

Yours sincerely,

Edward V.K. Jaycox
Director
Country Programs Department
East Asia and Pacific Regional Office

cc: Messrs. Wang Liansheng (Executive Director) and Chen Hui (Alternate ED)

Cleared with and cc: Mr. Wyss
cc: Messrs. Husain, Hasan (AEN); Kirmani (AEP); Lim, Koch-Weser (AEA)

CKoch-Weser/hk

CKW

OFFICE MEMORANDUM

TO: Robert S. McNamara, through Mr. W. Baum, Acting Senior Vice President Operations

DATE. January 9, 1981

FROM: S. Shahid Husain

SUBJECT: CHINA - Recent Developments

1. The Economic Mission has completed its fieldwork and returned from China. In recent weeks important changes have taken place in Chinese economic policy. I believe it appropriate to review for you the broad conclusions of the Economic Mission, the changes presently occurring in China and their likely implications for the Bank's role and program. (For your reference a copy of the final statement of the Economic Mission is attached.)

Findings of the Economic Mission

2. A core team and five sector teams undertook fieldwork and discussions with Government from mid-October to mid-December. The teams received excellent cooperation from their Chinese counterparts, travelled widely, and were allowed reasonably good access to data (the quality and availability of which had, however, suffered during the Cultural Revolution). As expected, the Mission was more successful in analyzing China's past development performance and in understanding how the Chinese system works, than in assessing the future development plans of the Government. The absence of data, trust and initiative within the bureaucracy is part of the problem, but more importantly the Government's own assessment of the economic situation and its future plans are much more in flux than we observed in July.

3. An IMF mission was in the field during part of the Bank's Mission to carry out a routine Article IV consultation and to discuss China's request for a loan from the Trust Fund and a 12 months' stand by arrangement in the first credit tranche, equivalent to SDR 450 million. Management's recommendation is expected to go before the Fund's board in mid-February.

4. The Economic Mission has confirmed that China's economic achievements during the last 30 years are impressive - a relatively high growth rate, a highly developed industrial structure for a poor country, relatively egalitarian distribution of incomes, and marked progress in meeting basic needs. On average, however, living standards are low; there are shortages of cloth and urban housing; the income disparity between urban and rural areas has grown; and over the past 20 years in some regions absolute incomes have probably fallen.

5. GNP per capita is estimated to be in the range of $260 to $270 at the official exchange rate. The GNP growth rate in 1957-1979 averaged about 4.5% p.a., which is less than commonly believed but still higher than in India (4% p.a.). The average per capita growth rate in the same period is estimated at 2.5-2.7% p.a., compared to India's 1.7% p.a. The growth of gross

agricultural output in 1952-79 was 2.4% p.a., as compared with 2.5% in India. The accumulation rate (investment as a ratio of national income) in constant prices has gone up from 15% to 33% during 1957-1979. (About 25-30% of accumulation represents a massive build-up in inventories.) Consumption growth per capita in 1957-79 was about 2% p.a., compared with the average of 1.3-1.4% for low income countries. Most of the growth in consumption in 1977 was in non-food items, and the growth in rural consumption was substantially below that in urban areas. Overall, China has done better than most low income countries, but less well than is generally believed.

6. Energy, oil and coal investments in recent years have lagged badly. We believe oil output will drop between 1980 and 1990; coal output may increase by 3-5% p.a. during 1980-85, while electricity output may increase by 5-6% p.a. over the period, but even this is unlikely to meet unfilled demands (as reflected in severe rationing to industries) and will require substantial new investments. Energy production and its efficient use have emerged as a major issue for China.

7. Agriculture is relatively highly developed. The cultivated area per capita is certainly small and even in total may have decreased over the past 20 years; fertilizer use is high; yields are respectable; the commune structure is potentially conducive to rural development, for providing credits, inputs, marketing and agricultural extension, but the system has not been allowed to work well. The lack of financial support for agriculture and insufficient material incentives are problems that new policies are now meant to address. Investments in water conservation, agricultural research and agricultural credit have also been neglected.

8. Light industry will have to be emphasized to provide employment opportunities, especially in rural areas. Transport, while not a serious constraint at present levels of production and energy use, will soon become a bottleneck.

9. China compares well with other countries in some but not all areas of education. Primary enrollment is universal, but many teachers are unqualified, as in all other developing countries. The secondary education enrollment ratio is 45% compared to India's 28%, but the share of technical education is extremely low, with less than 10% in vocational schools and only 1% in agricultural schools. In higher education, the effects of the Cultural Revolution were disastrous, and skilled and managerial manpower shortages will be a major development problem for years to come.

10. The solution to the problem of low income in rural areas lies partly in reducing the pressures of population on land. The success of population control policies and the sharp drop in the fertility rate over the last few years are encouraging. We believe that the target for limiting the population to 1,200 million by the year 2000, implying an annual growth rate of 1% p.a. for the next 20 years, is feasible.

11. The allocation of scarce funds for agriculture, light industry and education, while also giving high priority to energy and transport investment, will be a real test of the Government's willingness to cut down on new construction in heavy industry and the very sizable annual increment in inventories. At the same time modernization and improved efficiency in the heavy industry sector will be important to future performance, since its weight in GNP is high, and it consumes 60% of total energy and more than 60% of capital construction funds. Further, there are substantial linkages of heavy industry to other sectors of the economy through petrochemicals, fertilizers, and construction materials. The preliminary judgment of the mission is that the modernization of industry does not need massive imports of equipment, but rather a selective use of foreign exchange to balance, to adjust, to modernize and to expand.

12. China's clearly defined priorities are increasing the efficiency of investment, restructuring output to meet the needs of consumption, and reducing waste and making better use of existing plants. The mission found strengthened planning and management reform to be critically needed. To a much greater extent than expected, we concluded that the statistical system had to be not only revitalized but also reformed; that little systems planning and evaluation of investment were conducted - even less than in many so-called market economies; that there is little analysis of benefits and costs at any level; that a long-term perspective is lacking (preparation of the Sixth Five Year Plan has been delayed further); that system reform without some price reforms may be impossible; and that many of the institutions (especially financial intermediaries) needed to operate a decentralized economy are weak or nonexistent.

Recent Changes in Economic Policy

13. At the time of the mission's wrap-up discussions in early December, it became clear that a major debate was taking place in the State Council, reviewing the initial results of the economic readjustment measures introduced in 1979. This debate culminated in a major policy editorial in the People's Daily, which was highly critical of the degree of progress made. Further adjustment of the economy is given priority over reform of the system, and the adjustment period will be extended beyond the three years envisaged originally.

14. The editorial was particularly critical of overextension in capital construction and unbalanced development, and of the failure to analyze economic results and the feasibility of investment proposals, particularly in projects involving large imports. It stressed the need for better control of investments of localities and enterprises and greater scrutiny of imports. Officials have also voiced serious concern that greater than expected budget deficits in 1979 and 1980 may result in inflationary pressures, which in turn might lead to social tensions (because of the population's extreme fear of inflation, originating from the Kuomintang days). There is also

worry about uncertain export prospects, partly because of a likely decline in oil production. (Contracted oil deliveries to Japan will be cut back sharply this year and halved in 1982.) And there is concern about future debt service capacity. On these points the example of Poland is frequently invoked. In the absence of an adequate planning framework, these criticisms and fears are leading to an increasingly conservative economic policy. In August, the Government believed that the budget deficit would be eliminated not later than 1982 (mainly by cutting capital construction and defense expenditures). There may now be doubts that this can be achieved. A large number of investment projects are being dropped or postponed and the Government is cancelling contracts signed with foreign investors. It has expressed its intention of closing hundreds of uneconomic factories and reviewing hundreds of ongoing projects to determine which should be deferred or curtailed.

15. The economic pressures are reflected in political developments. Leaders associated with the ambitious investment program of 1977 and 1978, including efforts to secure large commitments of financing from abroad and who encouraged massive new plant and equipment orders since the downfall of the Gang of Four are being criticized. Earlier last year Yu Qiuli was replaced by Yao Yilin as head of the State Planning Commission; Vice Premier Gu Mu, a key figure in pressing for a rapid development of Bank-China relations and a key contact for us in his responsibilities for the Capital Construction Commission, the Foreign Investment Commission and the Import-Export Control Commission, has just been relieved of his Chairmanship of the Capital Construction Commission. It was Gu Mu who was the main architect of China's economic agreements with Japan, including large financial commitments in return for raw material and oil supply contracts. Gu Mu also played an important role in arranging for Japan's financing of the Baoshan Steel Complex, which has suffered huge cost overruns and is now the subject of intense criticism. (A second stage has just been postponed.)

16. The fierce debate in China over the direction and pace of the country's development seems to be resolving itself in favor of financial conservatism and a determination to move more slowly with the investment program while studying projects more carefully. Those who are confronted with choosing short-term adjustment priorities and determining longer term goals have only a vague notion of how to undertake these tasks, as the Economic Mission discovered; they are vulnerable to the pressures of the moment and are thus likely to overreact. It is clear that the Government will issue only a one year plan during 1981 and that preparation of the Five Year Plan will take much longer than expected. This protracted appraisal is not necessarily bad; it could result in a healthier atmosphere for China's long-term development and provide a better setting for investment planning and analysis.

The Bank's Role

17. During the seven months since the change of China's representation in the Bank, the relationship between the Chinese Government and the Bank has developed rapidly and on a broad front. More than a dozen missions have been to China; they have worked with most of the commissions and ministries in the economic area, established contacts with many economic bureaus and research institutions, and visited about 17 provincial governments and a large number of localities, communes, enterprises and projects. At this stage, the Bank's general dialogue with the senior officials of our main counterpart ministries (Ministry of Finance, Ministry of Foreign Affairs) and commissions (State Capital Construction Commission, State Planning Commission) is characterized by openness and a spirit of shared objectives and close cooperation. As is to be expected, the various relationships are still not sufficiently institutionalized. Expectations with regard to the early benefits of cooperation have become more realistic as both sides became increasingly aware of each other's strengths and limitations. The Government appears cautious yet deeply interested in the assistance we can offer in terms of economic, sectoral and project work, especially as this relates to improved planning and project evaluation.

18. Recent events in China have affected the Government's attitude with regard to the development and content of the Bank's lending program in the coming years. They now seem to have realized that we can lend for smaller, less capital-intensive projects which fit their present needs better. The Government has requested that we help with their current financial constraints by, for example, lending through intermediaries for projects to renovate and improve the efficiency of existing industrial capacity, and for the completion of selected high-priority projects that would not otherwise be affordable and that have a quick productive potential. We will be exploring their thoughts on this type of lending in more detail during the next few months.

19. The recent changes in economic policy might also have implications for our Initial Operations Program. As you will recall, we had agreed last July that, as an exception and pending completion of the economic report, we would begin work on preparing and appraising an initial group of six projects for lending during FY82 and 83. Of the six, the Education Project (for tertiary level science and engineering) has been appraised. It should be ready for Board consideration this fiscal year. The Government indicated that some of the other five projects under consideration might require further careful study with regard to their economic justification and financial feasibility in light of the constraints imposed by the present readjustment policies. We will work with the Government on these issues.

20. The implications of all these factors for our program are not clear yet. During the wrap-up discussions, government officials indicated their interest in an intensive program of sector work to be carried out by the Bank. We may find that we are asked to play a much stronger role than expected in sector work and technical assistance, and that the depth and closeness of our country dialogue will mature more quickly than expected.

21. On the other hand, the build-up of the lending program may be slower than anticipated. We are proceeding with our work program as outlined earlier to you. In particular, we are planning initial lending program and economic report discussions with the Government in March and final economic consultations in May, so that the economic report can be distributed to the Board in June before presentation of the first project.

cc: Jaycox, Kirmani, Hasan, Wyss, Koch-Weser

Attachment

JRB/CKW/vla

Economic Mission to China

General Wrap-up Meeting
12/11/80

Mr. Li Peng, Vice Minister of Finance

The World Bank Economic Mission has stayed in China for two months as of today. All members have worked hard and done a lot research work on China's economy. We are very much interested in listening to your findings. Today also present are Mr. Gan Ziyu, from State Planning Commission, the largest comprehensive economic institution; Mrs. He Liliang from Ministry of Foreign Affairs, who is in close cooperation with the Mission; also colleagues from State Statistical Bureau and State Economic Commission, etc.

Mr. Hasan, Mission Leader

We are deeply grateful to Government for its assistance to us, for countless hours of discussion and for outstanding arrangements of extensive field trips. Thanks for everyone's assistance and continued interest. For 2 months we have had about 30 counterparts from many ministries working with us and among 25 mission members, we have visited 15-17 provinces. It has been a memorable experience for all of us and the hospitality has been most generous.

The purpose of this economic mission is to assess the economic situation in China as a basis for dialogue with the government as the foundation for the Bank's lending work. All the questions we have asked are as economists, not lenders. Bank is not just a financial institution; we are a development agency. We believe that the economic and sector work provides the intellectural basis for Bank's lending work and the economic dialogue. The volume, pattern, and terms of lending are influenced very much by the economic findings of Bank missions. In a sense, our task of reflecting on what we have learnt and discussed and analyzing the information we have received has just begun. But it would be inappropriate and perhaps ungracious to leave here without sharing with you our very preliminary views, reactions,thoughts and ideas and perhaps posing some of the more difficult questions again in order to complete our task. We are conscious of our limitations as newcomers to a great and ancient country. Much of what we will say is well-known to you. The purpose of this occasion is to have meeting of the minds as to where the Chinese economy is. In the process, we may provide a somewhat different perspective. I stress again what we say is preliminary; we hope to have greater analysis and support for our conclusions when the draft Economic Report is sent to the Government by end-March.

I will start with the overview of China's economic performance and problems as seen by us; Mr. Edwin Lim will then speak mainly on issues of system performance and reform. Economic and system performance are related matters but we will be sharing responsibility in presenting our main findings as we have in the past few months in managing the Economic Mission.

It is impossible not to be impressed China's economic achievements in the past 30 years. I say this sincerely and from the view point of a development economist, and not as a polite international civil servant. You have had a relatively high growth rate; your industrial structure is more developed than

that of any low income country and most middle income countries. You have a more equalitarian income distribution than most developing countries and thus you have been very successful in meeting the basic needs of the large majority of the population. The incidence of poverty is much lower in China than, say in India, Indonesia, and the Philippines. You have also made impressive headway in human resource development, e.g., in health, education, and population control. Still China is a poor country; the average living standard is low; there is shortage of cloth, nonstaple food, and housing. The incidence of poverty though much lower than most other developing countries, still seems to be around 20%. The disparity between urban and rural incomes has grown since 1957; in some regions the average absolute income levels have probably fallen over the past 20 years.

The Government is quite candid about the major economic failures. The mission's analysis has confirmed the picture of very uneven economic advance during 1957-77. Even though rapid advance has taken place in the last two years, overall improvement in living standards for the period 1957-79 has been only moderate and distributed unevenly among large segments of the population. Development has been lopsided. There is imbalance between agriculture and industry; between heavy industry and light industry; between investment and consumption; and between urban and rural areas.

We have worked on Chinese statistics for sometime and have tried to refine and convert them so that international comparisons are possible. My summary of macroeconomic performance is largely based on Government data, but includes elements of Bank's own estimates. I present them to you to ensure that they don't violate reality as, seen by the Government.

GNP growth rate in 1957-79 averaged about 4.5% p.a. (rather than 5-5.5% p.a. figure used in outside literature). In the same period, India's GNP growth was 4% p.a. Average per capita growth rate in same period is estimated at 2.5-2.7% p.a., compared to India's 1.7% p.a. The growth of gross agricultural output in 1957-79 was 2.6% p.a., but the growth in value-added in agriculture was 2% because the cost of inputs have grown much faster than output. The long-term agricultural growth in China during 1952-79 was 2.4% p.a., while that for India was 2.5% p.a. As for consumption growth, which is the most important goal of development, per capita growth in 1957-77 was 1.6% p.a.; combining the last two good years, the rate rises to 2 percent per annum, compared with the average of 1.3-1.4% for low income countries. Therefore, you have clearly done better than most low income countries, but less well as is generally believed. Between 1957 and 1977 most of the growth in per capita consumption was in non-food items. During this period the growth in rural incomes was substantially below that in urban incomes.

The overall growth rate of industry at 9% p.a. during 1957-79 is very impressive. Only Korea, Thailand and possibly Brazil have exceeded this. For India for the same period, the growth was 5% per annum. One surprise is that China's gross output in light industry has increased four fold. But within light industry there are major imbalances. Cotton cloth production increased by only 50-60% from about 8 metres per capita in 1957 to 12.5 metres per capita in 1979. China is about 19-15% below India in per capita cotton cloth consumption.

But in other consumer products, e.g. bicycles, sewing machines, TVs, radios and wristwatches, etc., China's output and consumption per head is much higher than India's and other low income developing countries. We are less sure about the quality and prices of these industrial consumer goods.

Accumulation rate also shows imbalance between saving and investment. The accumulation rate was about 33% of National Product in the 1970s, compared to 24% in 1957. However, investment good prices have fallen over this period. If today's prices were used, the accumulation rate in 1957 was only 15%; therefore, the accumulation rate in constant prices has gone up from 15% to 33%. 25-30% of accumulation is for massive buildup in inventories; each 7-8% of net material product takes the form of increase in stocks (inventories). This is a big puzzle to us, because we do not know where these resources go, and how they are ultimately used. If we exclude the building up of stocks, the ratio of fixed investments to GNP in China is probably around 24-25%; it is high but again not excessively so. In most of the middle income countries, the ratio of fixed investment to GNP is also around 25%.

Within the large investment program there have clearly been imbalances. Energy, oil and coal investments in recent years have lagged. The preliminary conclusion of the energy team is that China's oil output is likely to drop between 1980 and 1990; coal output will increase by 3-5% p.a. during 1980-85, while electricity increases by 5-6% p.a. over this period. There are clearly rough estimates, but it seems that energy has emerged as a major constraint on development.

In agriculture, in retrospect, investments in water conservancy, agricultural research and agricultural credit have been neglected though some of this was due to political reasons rather than the failure of planning. Within agriculture, investment in mechanization has perhaps been excessive.

In the transport sector, ports, railways and roads have not received sufficient allocations. Surprisingly, the transport team has found that the railways were not a serious bottleneck at present. This partly because railways are extremely well-run; tracks are well maintained; turnaround time of wagons is good and capacity use is generally high. But railways may not be a bottleneck only because coal and steel output have slowed down below expectations. If coal output was expanding at a desirable rate, then railway transport will be a bottleneck. Motor vehicles have been underutilized, because incentives exist for enterprises, communes, municipalities to operate their own vehicles. Examples of large excess capacity in heavy industries are numerous. Every branch of industry, but especially machinery industry has over production capacity. Against this, investment in human resource development also lagged.

China has considerable achievements to its credit in the education field. Closer comparison, however, shows that China compares well with other countries only in selected areas of education. Primary education enrollment is universal, but the quality is low, with many unqualified teachers. For secondary education the enrollment ratio is 45% compared to India's 28%. For a typical mid-income country the ratio is 40%. Still the relative size of the secondary education sector in China is large. But again the share of technical education is low.

Less than 10% of the secondary school enrollments are in vocational schools. Only 1% of upper secondary school enrollments are in agricultural schools - a low percentage for a country where 75% of population is still in agriculture. In higher education the enrollment ratio is less than 2%; compared to 4% for India and 11% for mid-income countries. Admittedly in India there are many university students who should not be there. In any case, the rate for China is surprisingly low. We have been stressing imbalances and weaknesses rather than tremendous institutional and organizational achievements and strengthens. This is because we believe the focus on weaknesses is more relevant for improving future economic performance.

The causes of the present economic problems are complex. The political turmoil during the decade of the cultural revolution and the economic policies of political extreme left have had major adverse consequences, but in our judgment this is not the whole story. The disappointing economic performance has also been related to (a) question of development strategy that emphasized heavy industry, (b) a highly centralized system of economic controls and administration which increasingly has not been able to provide effective economic coordination and efficient use of resources. There are obvious links among the above factors. The political problems of the past did lead to weakening of planning institutions. But the fact remains that this highly centralized system is not working too well. Mr. Lim will speak later on the issues of system reform and re-adjustment.

In our view the emphasis on heavy industry was influenced by (a) historical reasons - following of the Soviet economic model; (b) defense considerations; (c) the need for a large country -- where foreign trade is a small part of GNP -- to be self-sufficient in capital goods. This strategy has elements of good economic sense, it seems to have been overdone and perhaps not implemented very well. The result of following a closed model and the emphasis on heavy industry is that the ratio of China's exports to GNP is 5%, one of the lowest in the world. On the other hand, China needs to import less than 10% of capital goods from abroad. But the price of economic isolation has been high -- in terms of getting away from the mainstream of international technological developments and technological transfer. Also, the export of manufactured goods has proven an important source of development in developing countries, especially your neighbors in East Asia have used this strategy very well.

Two factors have further complicated economic difficulties and have led to limited economic growth in incomes: (a) population growth rate remained high till 1970s; (b) the base of agriculture is relatively highly developed; cultivated area per capita is small and has fallen over the past 10 years. Irrigation is well developed; fertilizer use is high; and yields are respectable. It is more difficult to increase yields once the base levels are high. However, commune structure is conducive to rural development -- as help for mechanization, for providing credits, inputs, marketing and agricultural extension. But the problem is that the system has not been allowed to work very well because of too much political and administrative interference. Other factors have been the lack of financial support for agriculture and insufficient material incentives. Decisions of the Chinese Communist Party in September 1979, on rural development policy have attempted to correct all these imbalances.

Higher support prices for agriculture introduced last year, the loosening of direct control on acreage, providing of encouragement to private plots, no longer considering grain as the key in agriculture and promoting diversification of exports are key elements of new policy. All these hold promises for accelerating growth in agriculture. But the past growth rate was only 2%; even after acceleration, we are not sure how high this rate can go up.

The pattern of growth that I have outlined is no doubt very familiar to you. I am also sure you have a much more actual sense of problems that you face. However, I am confident that the Mission now better understands the nature of some of these problems. My last coment regarding the assessment of past concerns the apparent preoccupation in China with capital accumulation as a source of growth. Future growth must come from increased efficiency in the use of capital and from technological change and investment in human capital. Western studies of the decomposition of the sources of growth indicate only a part of the increase in output comes from labor and physical inputs of capital. Technical innovations, economies of scale, and improvements in the quality of human and physical capital all play an important role.

As for the future, we fully understand and support the government's efforts to develop agriculture, light industry and exports. We have a better appreciation of the constraints the economy faces in energy, transport, high-grade manpower and managerial skills. We see the underlining threat of growing disparities among regions and between rural urban areas.

The ultimate solution to the problem of low income in rural areas - must lie in reducing the pressures of the population on land. We are encouraged by the success of population control policies, and the sharp drop in fertility rate in the last few years. The mission believes that the target for limiting the population to 1200 million by year 2000, implying an annual growth rate of 1% p.a. for the next 20 years, is feasible. However we are not quite sure with regard to the effective relaxation on the age of marriage, and the impact it may have on future population growth.

But the fact that population is now growing at only little over 1% less than half of the rate of a decade ago is a major source of economic strength and will help to bring about a better balance between food supplies and population even if foodgrain output at 2% p.a. grows at somewhat slower rate than the past trend. In the long run foodgrain self-sufficiency for China is necessary goal because China's requirements are too large to be met to any substantial extent by reliance on the international market. But at the same time potential for crop diversification and livestock development should be fully exploited.

Allocation of additional funds for agriculture, light industry and education while giving high priority to energy and transport and education will be a real test of the government's willingness to cut down investment in heavy industry and very sizeable annual increment in inventories. Modernization and improved efficiency in the heavy industry sector is of great importance to future performance of Chinese economy. The reasons are obvious. The sheer weight of this sector in GNP is rather high. Also, this sector is a key user of energy, materials, and investment funds. Heavy industry in China includes coal, oil and electricity, so energy cannot be separated from the heavy industry. Heavy industry

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consumption is 60% of total energy use in the country and absorbs more than 60% of capital construction funds. Share of light industry is only around 6%. Unless conservation efforts in heavy industry are successful, unless the wastage of materials can be reduced, and unless claims of this sector on capital construction funds are reduced (through utilization of substantial excess capacity) the programme of readjustment and restructuring cannot be successful. Further, there are substnatial linkages of heavy industry to other sectors of economy through petrochemicals, fertilizers, and construction material. It requires a mixture of direct (central) planning and reforms to make the heavy industry to contribute significantly to the lessening of constraints especially in the energy sector and investment funds while maintaining a reasonable rate of growth. Adjustment through growth will not only help to maintain overall economic activity but also make the efficiency increases and economies at the plant level feasible.

The preliminary judgment of the mission is that the process of modernization in industry does not need massive imports of large sets of equipment, but rather a selective use of foreign exchange to balance, to adjust, to modernize and to expand.

As Mr. Chenery emphasized the other day, China should aim at increasing the ratio of imports and exports to GNP, both to relieve the foreign exchange constraint and to increase technological transfer. As mentioned earlier, manufactured exports have played an import role in development in a number of countries. This can also be true for China, though perhaps not to the same extent. Manufactured exports will provide opportunities to improve design, product quality and product differentiations, which are important for the home market. Manufactured goods exports from China have been growing and constitute 45% of total exports but constitute only a very small fraction of the value of gross manufacturing output. They can continue to grow at about 12% p.a. in real terms if present emphasis and policy improvements continue. This is about the same rate of growth of manufactured goods as projected for all developing countries. Therefore, China's share among developing countries will not be increasing. According to our estimates there will be no increase in oil exports, and may even be a decline in the near future. Overall exports in the next five years may grow at 8% p.a. but still faster than GNP. For longer term, say 20 years, 10% real growth in exports is quite feasible, because of great natural resources and low wage costs. If export growth is around 10% per annum -- just as an example -- over the next 15 years, while the economy grows at 5.5-6.0%, then the ratio of export to GNP will improve from 5% to 10%, which is very desirable.

We also believe that a country at China's stage of development should be a net foreign borrower of capital to permit a growth in imports faster than exports, starting from the present rough balance in foreign exchange transactions. China's low per capita income will definitely entitle her to consideration for concessionary assistance. But provided exports are growing steadily, as we expect they will, there will be every reason for China to utilize her repayment capacity with the limits of prudent debt management, to borrow on conventional terms.

In mission's preliminary judgment, China's per capita GNP, after suitable adjustments, will be in range of $260-$270, converted at the official exchange rate. This compares to India's GNP per capita of $183 for 1978-1979 and over

$200 from 1979-1980 (India's fiscal year is from April - March). But international comparisons of living standard and purchasing power are notoriously difficult and there is the question as to whether the difference between India and China as reflected in official estimates is a representative difference. At least our preliminary impression is that it is representative difference. The structure of output between India and China is greatly different. But precise comparisons are impossible because of methodological differences. Roughly speaking, industrial product per capita was $115 for China in 1979 compared to India's $45 in 1978/79; so the difference between India's and Chinese per capita GNP appeared to be mostly in industry. For agriculture, product per capita was $87 for China, compared to $70 for India. Foodgrain output per capita in China is currently 25% higher than India's and so the agriculture sector comparison seems plausible. In the service sector, China per capita product ($61) was somewhat lower than India ($68). This for three possible reasons: i) some service sectors are covered in production under communes, enterprises, etc. in China; ii) wages are low in China, and income differentials in the service sectors as in the rest of the economy are small compared to India's; iii) the personal service sector is less developed in China (domestic services, private doctors, barbers, etc.)

Mission will be attempting, at least roughly, to compare the relative purchasing power per capita GNP of India with China. The final results will depend greatly on relative prices of industrial products in the two countries. Broadly speaking, agricultural prices are roughly comparable at the present foreign exchange rate. More information on the prices of final products will be very helpful in this regard -- industrial products, especially, means of production -- say, about 50-100 items, for example, construction material, cement, fertilizer, etc. These prices will be used to evaluate the gross value of industrial output.

Finally, a few words about the economic mission's scope of work. The mission's objectives were many: i) to analyze the level of development in China; ii) to study the level and pattern of growth in the recent past; iii) to pinpoint the constraints on economic growth; iv) to understand the economic system in China; v) to assess the likely impact of reforms and new economic policies; vi) to assess future plans and prospects; and vii) to assess future capital requirements, foreign exchange requirements, and the Bank's role.

Our overall efforts have been largely successful. We were perhaps more successful in understanding the level and trend of development in China, and the nature of the economic problems that have emerged; and we have obtained a better idea of how the system works. It was not possible to meet our all statistical requests, but we had unlimited opportunities for discussion. We were less successful in objectives v) to vii). We understand that at present the plan (Sixth Five Year Plan) has not yet been formulated, and therefore we are less able to assess developments in the 1980s. China's success in economic planning will depend to a large extent on the system performance and progress of reform, and I will turn over to Mr. Lim to speak on this difficult subject.

Mr. Edwin Lim

First, let me say that our estimate of China's GNP per capita is very preliminary. It is based largely on data supplied by the State Statistical Bureau (SSB). The difference is partly due to conceptual difference, e.g. World Bank uses mid-year population figure; SSB uses end of the year figure, but we will explain the methodology in the Report.

I would like to say something about the problems related to the economic system in China and the implications of the findings of the economic mission for Bank lending; specifically, on the general criteria that should be used in deciding how to make use of Bank resources in light of China's economic situation.

Concerning the Chinese economic system, I think there is a need to sum up the experience of the past objectively and scientifically. It is important to analyze the economic system, to identify its advantages and disadvantages, and not to be over-critical and ignore the advantages of the system. Many aspects of the system have benefitted the people a great deal and are now emulated by other countries, especially the ability of the system to provide basic needs, to obtain a high rate of saving, and to develop the country without foreign assistance. Many of the imbalances in the economy have been caused by the isolation of economy, but this was due to reasons not entirely the choice of China, but was dictated by the international situation of the 1950s and 60s. Evaluation of the system must be made by the Chinese people themselves. As outside observers, we see a tendency in China to go from one extreme to another, and there is need for more balanced and objective evaluation.

Nonetheless, there seems general agreement that there are very serious problems in the economy today, and many of these problems are attributable to the economic system. The symptoms are well known and discussed frequently by Chinese economists and in the Chinese press, e.g. over investment in capital stocks and over staffing; mismatch between output and the need of the people and what is often called "Production for production's sake".

Let me comment first on the relation between reform and adjustment; these are key factors in current economic policy. The line of thought at present seems to be that reform and adjustment are two different things, and reform may have to wait until adjustment is completed. But the objective of adjustment is to restructure the economy to meet the current and future needs of the people. This is the objective of reducing the rate of accumulation, improving the balance between heavy and light industries and agriculture, and in adjusting the structure within the industrial sector. The objective of reform is to strengthen planning so that it will be less detailed, longer-term oriented, and implemented by economic levers rather than by administrative means. Reforms should therefore make it easier to achieve adjustment. There is a tendency, however, for planners to think that they have the solutions to all economic problems and solutions can be achieved by the administrative system, thus reform can come later.

There seems to be some opinion now that China is facing economic difficulty, so reform must wait. As economists, we would think that at a time of economic difficulty, it is even more important to strengthen planning and improve management. The basic aims of adjustment are: i) to increase the efficiency and effectiveness of investment, ii) to restructure output to meet the needs of consumption; iii) to reduce waste and make better use of existing equipment. Surely strengthened planning and management through reform will help to achieve these objectives.

Turning now to the planning and management system, our first observation is on the statistical system. Planners can only be as good as the information they receive. The statistical system suffered severe disruptions during the two decades following the Great Leap Forward. While restoration of the system is now underway, some reforms may also be necessary: First, there is a need to rely less on comprehensive administrative reporting and more on sample surveys. With administrative data there is a great risk of false and incorrect reporting. Only with sample surveys can the statistician evaluate the quality of the data they are receiving from the lower levels. The history in China over the past 30 years shows many examples of errors in planning made because of false and inaccurate statistics. Second, there is a need to improve the collection and compilation of statistics. Statistics for planning purposes should be compiled in a form useful to planners, in a form which can be used for analytical purpose, not simply by administrative units as they are now. Moreover, the system of collecting data should be changed to meet the needs of the economy in the 1980s rather than the 1950s. Statistical reforms are necessary if the planners are to learn what is going on in the economy. Statistical changes are especially important as the economic system evolves towards the greater use of the market. It will be necessary to monitor the changes outside the planned economy. Finally, wider dissemination of statistics seems necessary. A decentralized planning system can not function well unless the mass of population and the enterprises know what is going on in the economy. There is also need to revive economic science, which have been much neglected for many decades. Unless statistics are no longer kept secret, economic research by Chinese economists can hardly be possible. In addition, the publication of statistics will allow a better monitoring of the economic performance.

Our second observation is on the need to improve investment planning. It is the impression of the mission that there is little systematic planning and evaluation of investment in China, perhaps even less than in many so-called market economies. There is a lack of scientific analysis of the economic benefits and costs of investment projects. There is a lack of consideration of alternative ways to meeting economic objectives. For example, an investment project may appear to be justifiable when considered by itself, but may not be when compared to an alternative way of meeting of the same objectives. There is clearly a need to improve investment planning and economic evaluation of projects. This is especially important when investment funds are scarce and must be used effectively and efficiently.

Our third observation on management is the lack of long-term perspective in planning. Since the completion of the first five-year plan, no other 5 year plan has been completed. The current problems of imbalances, and the shortages in energy and transport must be due to a large extent to the lack of long-term planning. Even now there seems to be no long-term perspective to planning and management. It is difficult to see how some of the current issues of development can be resolved without a long term perspectives.

Our fourth point re management concerns prices. Chinese economists now seem to agree that prices today reflect neither cost nor demand/supply condition. There seems to be general agreement that price reforms must be the core of system reform. Indeed it is questionable whether other reforms are possible without price reform. In fact because of the lack of price reform, some contradictions are already emerging. This is a difficult issue in China, where most goods are in shortage and any large-scale price reform will probably lead to higher prices rather than lower. But at least the planners should begin to calculate what prices should be and use these immediately as the basis for evaluation of investment, while gradually introducing them into the economy.

Our fifth point re management is the need to create new institutions to manage a decentralized economy. One type of institutions needed is to handle distribution -- wholesaling, retailing, i.e. distribution to help the movement of goods. With the introduction of market into the economy, some parts of China seem to have reverted to a barter economy rather than using a distribution system which would be much more efficient to the movement of goods. Another kind of institutions needed is financial intermediaries, especially banks. There is a need for such institutions to facilitate and regulate the flow of capital under the new economic system. Local governments and enterprises now have a great deal of funds but there are no institutions to put the funds to use in the economy. During our travels in China, we learned that some enterprises have set up their own investment companies to invest in other companies; some are investing in communes. It would be more efficient to allow those capital to flow through financial intermediaries; it would also allow the planners to regulate these flows.

Our sixth comment is on the need to separate economic and administrative units. At present, local government in counties and provinces act like businessmen because they own and receive profits from enterprises. This seems neither good for the economy nor for administration. Local governments may not be interested in education, health, and agriculture because they yield low or no profits, and therefore they may prefer to put money in industries which now yield high profits. At the same time, such a system is not good for administrative purposes because there is no incentive for local governments to invest in health and education though these must be their responsibility. Mr. Hasan has pointed to the low level of expenditures on education and health; this may be one of the reasons.

Our final comment is on the need for management development in course of system reform. Many of the managers of enterprises, communes and provinces were old revolutionary cadres. Now the government's objective is to replace managers with "younger, more educated, and professionally more competent" people. There is also recognition of the need to reduce bureaucratism and to increase the participation of the mass of the population in decision making. These are related to political questions, and have been covered in Chairman Hua's report to the National People's Congress. As stated in that report these are necessary conditions for economic reform.

In any event, there is a need to have a complete blueprint of reform; reform of an economic system is difficult to pursue piece by piece. It may be done gradually and with caution, but on all fronts. Many of the current problems of reform in China today may be caused by moving too fast in some areas and not at all in other areas - in other words, by what have not been done rather than what have been done - e.g. price reforms, institutions for manging the new economic system and strengthening planning work itself may be necessary before those reforms that have already been introduced can work.

Now, I would like to make a few remarks on how China might make use of World Bank resources in this period of adjustment and reform. I believe you should always bear in mind that the World Bank's operational program must meet the need of development at the moment and will not be rigid. On the basis of the preliminary findings of the economic mission, the following criteria seem especially important for the use of World Bank resources in the coming years:

1) World Bank resource should be used to help China make better use of existing capacity and personnel;

2) Priority should be given to investments that yield quick and good results;

3) World Bank operations should help China develop better investment planning and project analysis and techniques.

4) Bank operations should assist in building institutions needed for the new economic system; and

5) Help remove the immediate constraints of development, e.g. energy.

The following are some suggestions for the Government in the course of preparing a program to propose to the World Bank for cooperation. These are not proposals of the Bank, but suggestions by some of us who have been studying the economy over the past two months on what might be best use of Bank resources in the coming years:

1) High priority should be given to human resource development programs, building on the strengths of the system and trying to overcome some of the deficiencies as mentioned by Mr. Hasan. There is especially urgent need for sector-related training, including of existing staff, in industry and agriculture -- because of the demand on management in

the course of system reforms. There is also a need to improve the training of teachers, -- including teachers on the job. Adult education is especially important, and more use of TV universities and similar facilities. In these areas, the World Bank has much experience in other countries, and may be halpful.

We have little knowledge of the health system, but there seems to be a need to improve a system which is always good. Health is an area where evaluation of the past seems now to be overcritical and there is a danger now of neglecting to build upon the strength of the past. For example, in Gansu we learned that many cooperative health programs of brigades are being dismantled, and some counties are trying to make the health system completely self-financing. Even in advanced countries in Europe and in the U.S., there are few health systems that are self-financing.

2) In agriculture, support should be indirect. We have often learned from experience that peasants know better than the Government what they need and the Government should not try to tell them in detail what to do. The commune system is a potentially efficient system. It has many of the advantages of small farms and as well as some of large-scale farms. Credit to agriculture therefore seems one of the best ways to support agriculture. Credit to the communes could lead to improvements in agriculture, transport, and rural industries, etc. Credit allows the Government to help agriculture without directing the communes and peasants exactly what to do with the credit. Building up the capability of the Agricultural Banks seems important in the present circumstances of China. In this regard also, the World Bank has much experience. Generally, agricultural credit need not be tied to foreign exchange requirements; this often gives greater flexibility to the borrower.

3) In industry, priority should be given to making better use of existing capacity and reducing the use of energy. The tentative conclusion of the industry team is that in many areas there is no need to import complete sets of equipment. Balancing equipment and simple renovation could improve the work of many plants. This type of investment cannot be planned from the top, but must be determined by lower level organizations that can appraise and evaluate the detailed needs of enterprise.

In the circumstances there is a need for an investment bank of some sort that would act as an agent of the government in making the financial needs of the enterprises. The central planners can regulate the work of the institution to make sure that actual investments meet macro-economic objectives. It may be possible, for instance, to create a unit in the Construction Bank or the People's Bank or to create a new bank altogether to evaluate, appraise, and make investment decisions on a large number of small investment. Such a system can complement the central government's efforts to modernize and overcome bottlenecks through large projects. The World Bank has provided assistance to such development

finance companies in many countries and such assistance often offers the government a great deal of flexibility.

4) New project investments are of course still necessary in many cases. But our impression is that a large number of studies are necessary before investment decisions can be taken -- studies both on sectoral priorities can on individual projects. Our sector teams did not have the impression that there has been much planning or that investment projects are being evaluated carefully. Such evaluation is especially important for projects in transport, power and irrigation, which need large investment and have long construction periods. Also, our sector teams believe that through improvements in the system and in management, some problems can be overcome without large investments. Therefore, before undertaking major investment, careful studies should be undertaken. For example, studies might be made on (a) the coal sector, including its transport requirements, which may lead to some solutions of both the energy as well as the transport problems; (b) large-scale irrigation and water development; (c) transport bottlenecks in specific areas; (d) creation of a super grid in the electricity system, which again, may lead to overcoming some of the power shortages without investment in new generating capacity.

In sum, our suggestion is to concentrate the use of Bank resources where (1) the World Bank can help in the absorption of foreign technology; (2) World Bank involvement can contribute to your efforts to improve project evaluation, analysis and formulation.

As we are now finishing the World Bank's first study of the Chinese economy, I would like to say just a few words about some areas for further study. During the next fiscal year (from July 1981), the World Bank's economic and sector work on China might include the following components, aimed mainly at identifying areas of future cooperation:

1) Agriculture - special study of a specific area, e.g. agricultural credit or irrigation;

2) Industry -- special study e.g. of industrial financing of energy conservation or in-depth study of one or two sub-sector;

3) Human Resource Development, including health and training;

4) Transport - as mentioned earlier, coal study, or of a specific geographical areas;

5) Because China's Five-Year Plan is still under preparation, we have very limited understanding of the Government's programs and plans for the long term. When China has completed the preparation of the next Five-Year Plan, say by early 1982. We would hope to send another general economic team here to study that plan and how the Bank might best support that Plan.

(Final words of thanks and appreciation, etc.)

Economic Mission to China

General Wrap-up Meeting
12/11/80

Mr. Li Peng, Vice Minister of Finance

The World Bank Economic Mission has stayed in China for two months as of today. All members have worked hard and done a lot research work on China's economy. We are very much interested in listening to your findings. Today also present are Mr. Gan Ziyu, from State Planning Commission, the largest comprehensive economic institution; Mrs. He Liliang from Ministry of Foreign Affairs, who is in close cooperation with the Mission; also colleagues from State Statistical Bureau and State Economic Commission, etc.

Mr. Hasan, Mission Leader

We are deeply grateful to Government for its assistance to us, for countless hours of discussion and for outstanding arrangements of extensive field trips. Thanks for everyone's assistance and continued interest. For 2 months we have had about 30 counterparts from many ministries working with us and among 25 mission members, we have visited 15-17 provinces. It has been a memorable experience for all of us and the hospitality has been most generous.

The purpose of this economic mission is to assess the economic situation in China as a basis for dialogue with the government as the foundation for the Bank's lending work. All the questions we have asked are as economists, not lenders. Bank is not just a financial institution; we are a development agency. We believe that the economic and sector work provides the intellectural basis for Bank's lending work and the economic dialogue. The volume, pattern, and terms of lending are influenced very much by the economic findings of Bank missions. In a sense, our task of reflecting on what we have learnt and discussed and analyzing the information we have received has just begun. But it would be inappropriate and perhaps ungracious to leave here without sharing with you our very preliminary views, reactions,thoughts and ideas and perhaps posing some of the more difficult questions again in order to complete our task. We are conscious of our limitations as newcomers to a great and ancient country. Much of what we will say is well-known to you. The purpose of this occasion is to have meeting of the minds as to where the Chinese economy is. In the process, we may provide a somewhat different perspective. I stress again what we say is preliminary; we hope to have greater analysis and support for our conclusions when the draft Economic Report is sent to the Government by end-March.

I will start with the overview of China's economic performance and problems as seen by us; Mr. Edwin Lim will then speak mainly on issues of system performance and reform. Economic and system performance are related matters but we will be sharing responsibility in presenting our main findings as we have in the past few months in managing the Economic Mission.

It is impossible not to be impressed China's economic achievements in the past 30 years. I say this sincerely and from the view point of a development economist, and not as a polite international civil servant. You have had a relatively high growth rate; your industrial structure is more developed than

that of any low income country and most middle income countries. You have a more equalitarian income distribution than most developing countries and thus you have been very successful in meeting the basic needs of the large majority of the population. The incidence of poverty is much lower in China than, say in India, Indonesia, and the Philippines. You have also made impressive headway in human resource development, e.g., in health, education, and population control. Still China is a poor country; the average living standard is low; there is shortage of cloth, nonstaple food, and housing. The incidence of poverty though much lower than most other developing countries, still seems to be around 20%. The disparity between urban and rural incomes has grown since 1957; in some regions the average absolute income levels have probably fallen over the past 20 years.

The Government is quite candid about the major economic failures. The mission's analysis has confirmed the picture of very uneven economic advance during 1957-77. Even though rapid advance has taken place in the last two years, overall improvement in living standards for the period 1957-79 has been only moderate and distributed unevenly among large segments of the population. Development has been lopsided. There is imbalance between agriculture and industry, between heavy industry and light industry, between investment and consumption; and between urban and rural areas.

We have worked on Chinese statistics for sometime and have tried to refine and convert them so that international comparisons are possible. My summary of macroeconomic performance is largely based on Government data, but includes elements of Bank's own estimates. I present them to you to ensure that they don't violate reality as, seen by the Government.

GNP growth rate in 1957-79 averaged about 4.5% p.a. (rather than 5-5.5% p.a. figure used in outside literature). In the same period, India's GNP growth was 4% p.a. Average per capita growth rate in same period is estimated at 2.5-2.7% p.a., compared to India's 1.7% p.a. The growth of gross agricultural output in 1957-79 was 2.6% p.a., but the growth in value-added in agriculture was 2% because the cost of inputs have grown much faster than output. The long-term agricultural growth in China during 1952-79 was 2.4% p.a., while that for India was 2.5% p.a. As for consumption growth, which is the most important goal of development, per capita growth in 1957-77 was 1.6% p.a.; combining the last two good years, the rate rises to 2 percent per annum, compared with the average of 1.3-1.4% for low income countries. Therefore, you have clearly done better than most low income countries, but less well as is generally believed. Between 1957 and 1977 most of the growth in per capita consumption was in non-food items. During this period the growth in rural incomes was substantially below that in urban incomes.

The overall growth rate of industry at 9% p.a. during 1957-79 is very impressive. Only Korea, Thailand and possibly Brazil have exceeded this. For India for the same period, the growth was 5% per annum. One surprise is that China's gross output in light industry has increased four fold. But within light industry there are major imbalances. Cotton cloth production increased by only 50-60% from about 8 metres per capita in 1957 to 12.5 metres per capita in 1979. China is about 19-15% below India in per capita cotton cloth consumption.

But in other consumer products, e.g. bicycles, sewing machines, TVs, radios and wristwatches, etc., China's output and consumption per head is much higher than India's and other low income developing countries. We are less sure about the quality and prices of these industrial consumer goods.

Accumulation rate also shows imbalance between saving and investment. The accumulation rate was about 33% of National Product in the 1970s, compared to 24% in 1957. However, investment good prices have fallen over this period. If today's prices were used, the accumulation rate in 1957 was only 15%; therefore, the accumulation rate in constant prices has gone up from 15% to 33%. 25-30% of accumulation is for massive buildup in inventories; each 7-8% of net material product takes the form of increase in stocks (inventories). This is a big puzzle to us, because we do not know where these resources go, and how they are ultimately used. If we exclude the building up of stocks, the ratio of fixed investments to GNP in China is probably around 24-25%; it is high but again not excessively so. In most of the middle income countries, the ratio of fixed investment to GNP is also around 25%.

Within the large investment program there have clearly been imbalances. Energy, oil and coal investments in recent years have lagged. The preliminary conclusion of the energy team is that China's oil output is likely to drop between 1980 and 1990; coal output will increase by 3-5% p.a. during 1980-85, while electricity increases by 5-6% p.a. over this period. There are clearly rough estimates, but it seems that energy has emerged as a major constraint on development.

In agriculture, in retrospect, investments in water conservancy, agricultural research and agricultural credit have been neglected though some of this was due to political reasons rather than the failure of planning. Within agriculture, investment in mechanization has perhaps been excessive.

In the transport sector, ports, railways and roads have not received sufficient allocations. Surprisingly, the transport team has found that the railways were not a serious bottleneck at present. This partly because railways are extremely well-run; tracks are well maintained; turnaround time of wagons is good and capacity use is generally high. But railways may not be a bottleneck only because coal and steel output have slowed down below expectations. If coal output was expanding at a desirable rate, then railway transport will be a bottleneck. Motor vehicles have been underutilized, because incentives exist for enterprises, communes, municipalities to operate their own vehicles. Examples of large excess capacity in heavy industries are numerous. Every branch of industry, but especially machinery industry has over production capacity. Against this, investment in human resource development also lagged.

China has considerable achievements to its credit in the education field. Closer comparison, however, shows that China compares well with other countries only in selected areas of education. Primary education enrollment is universal, but the quality is low, with many unqualified teachers. For secondary education the enrollment ratio is 45% compared to India's 28%. For a typical mid-income country the ratio is 40%. Still the relative size of the secondary education sector in China is large. But again the share of technical education is low.

Less than 10% of the secondary school enrollments are in vocational schools. Only 1% of upper secondary school enrollments are in agricultural schools - a low percentage for a country where 75% of population is still in agriculture. In higher education the enrollment ratio is less than 2%; compared to 4% for India and 11% for mid-income countries. Admittedly in India there are many university students who should not be there. In any case, the rate for China is surprisingly low. We have been stressing imbalances and weaknesses rather than tremendous institutional and organizational achievements and strengthens. This is because we believe the focus on weaknesses is more relevant for improving future economic performance.

The causes of the present economic problems are complex. The political turmoil during the decade of the cultural revolution and the economic policies of political extreme left have had major adverse consequences, but in our judgment this is not the whole story. The disappointing economic performance has also been related to (a) question of development strategy that emphasized heavy industry, (b) a highly centralized system of economic controls and administration which increasingly has not been able to provide effective economic coordination and efficient use of resources. There are obvious links among the above factors. The political problems of the past did lead to weakening of planning institutions. But the fact remains that this highly centralized system is not working too well. Mr. Lim will speak later on the issues of system reform and re-adjustment.

In our view the emphasis on heavy industry was influenced by (a) historical reasons - following of the Soviet economic model; (b) defense considerations; (c) the need for a large country -- where foreign trade is a small part of GNP -- to be self-sufficient in capital goods. This strategy has elements of good economic sense, it seems to have been overdone and perhaps not implemented very well. The result of following a closed model and the emphasis on heavy industry is that the ratio of China's exports to GNP is 5%, one of the lowest in the world. On the other hand, China needs to import less than 10% of capital goods from abroad. But the price of economic isolation has been high -- in terms of getting away from the mainstream of international technological developments and technological transfer. Also, the export of manufactured goods has proven an important source of development in developing countries, especially your neighbors in East Asia have used this strategy very well.

Two factors have further complicated economic difficulties and have led to limited economic growth in incomes: (a) population growth rate remained high till 1970s; (b) the base of agriculture is relatively highly developed; cultivated area per capita is small and has fallen over the past 10 years. Irrigation is well developed; fertilizer use is high; and yields are respectable. It is more difficult to increase yields once the base levels are high. However, commune structure is conducive to rural development -- as help for mechanization, for providing credits, inputs, marketing and agricultural extension. But the problem is that the system has not been allowed to work very well because of too much political and administrative interference. Other factors have been the lack of financial support for agriculture and insufficient material incentives. Decisions of the Chinese Communist Party in September 1979, on rural development policy have attempted to correct all these imbalances.

Higher support prices for agriculture introduced last year, the loosening of direct control on acreage, providing of encouragement to private plots, no longer considering grain as the key in agriculture and promoting diversification of exports are key elements of new policy. All these hold promises for accelerating growth in agriculture. But the past growth rate was only 2%; even after acceleration, we are not sure how high this rate can go up.

The pattern of growth that I have outlined is no doubt very familiar to you. I am also sure you have a much more actual sense of problems that you face. However, I am confident that the Mission now better understands the nature of some of these problems. My last coment regarding the assessment of past concerns the apparent preoccupation in China with capital accumulation as a source of growth. Future growth must come from increased efficiency in the use of capital and from technological change and investment in human capital. Western studies of the decomposition of the sources of growth indicate only a part of the increase in output comes from labor and physical inputs of capital. Technical innovations, economies of scale, and improvements in the quality of human and physical capital all play an important role.

As for the future, we fully understand and support the government's efforts to develop agriculture, light industry and exports. We have a better appreciation of the constraints the economy faces in energy, transport, high-grade manpower and managerial skills. We see the underlining threat of growing disparities among regions and between rural urban areas.

The ultimate solution to the problem of low income in rural areas - must lie in reducing the pressures of the population on land. We are encouraged by the success of population control policies, and the sharp drop in fertility rate in the last few years. The mission believes that the target for limiting the population to 1200 million by year 2000, implying an annual growth rate of 1% p.a. for the next 20 years, is feasible. However we are not quite sure with regard to the effective relaxation on the age of marriage, and the impact it may have on future population growth.

But the fact that population is now growing at only little over 1% less than half of the rate of a decade ago is a major source of economic strength and will help to bring about a better balance between food supplies and population even if foodgrain output at 2% p.a. grows at somewhat slower rate than the past trend. In the long run foodgrain self-sufficiency for China is necessary goal because China's requirements are too large to be met to any substantial extent by reliance on the international market. But at the same time potential for crop diversification and livestock development should be fully exploited.

Allocation of additional funds for agriculture, light industry and education while giving high priority to energy and transport and education will be a real test of the government's willingness to cut down investment in heavy industry and very sizeable annual increment in inventories. Modernization and improved efficiency in the heavy industry sector is of great importance to future performance of Chinese economy. The reasons are obvious. The sheer weight of this sector in GNP is rather high. Also, this sector is a key user of energy, materials, and investment funds. Heavy industry in China includes coal, oil and electricity, so energy cannot be separated from the heavy industry. Heavy industry

consumption is 60% of total energy use in the country and absorbs more than 60% of capital construction funds. Share of light industry is only around 6%. Unless conservation efforts in heavy industry are successful, unless the wastage of materials can be reduced, and unless claims of this sector on capital construction funds are reduced (through utilization of substantial excess capacity) the programme of readjustment and restructuring cannot be successful. Further, there are substnatial linkages of heavy industry to other sectors of economy through petrochemicals, fertilizers, and construction material. It requires a mixture of direct (central) planning and reforms to make the heavy industry to contribute significantly to the lessening of constraints especially in the energy sector and investment funds while maintaining a reasonable rate of growth. Adjustment through growth will not only help to maintain overall economic activity but also make the efficiency increases and economies at the plant level feasible.

The preliminary judgment of the mission is that the process of modernization in industry does not need massive imports of large sets of equipment, but rather a selective use of foreign exchange to balance, to adjust, to modernize and to expand.

As Mr. Chenery emphasized the other day, China should aim at increasing the ratio of imports and exports to GNP, both to relieve the foreign exchange constraint and to increase technological transfer. As mentioned earlier, manufactured exports have played an import role in development in a number of countries. This can also be true for China, though perhaps not to the same extent. Manufactured exports will provide opportunities to improve design, product quality and product differentiations, which are important for the home market. Manufactured goods exports from China have been growing and constitute 45% of total exports but constitute only a very small fraction of the value of gross manufacturing output. They can continue to grow at about 12% p.a. in real terms if present emphasis and policy improvements continue. This is about the same rate of growth of manufactured goods as projected for all developing countries. Therefore, China's share among developing countries will not be increasing. According to our estimates there will be no increase in oil exports, and may even be a decline in the near future. Overall exports in the next five years may grow at 8% p.a. but still faster than GNP. For longer term, say 20 years, 10% real growth in exports is quite feasible, because of great natural resources and low wage costs. If export growth is around 10% per annum -- just as an example -- over the next 15 years, while the economy grows at 5.5-6.0%, then the ratio of export to GNP will improve from 5% to 10%, which is very desirable.

We also believe that a country at China's stage of development should be a net foreign borrower of capital to permit a growth in imports faster than exports, starting from the present rough balance in foreign exchange transactions. China's low per capita income will definitely entitle her to consideration for concessionary assistance. But provided exports are growing steadily, as we expect they will, there will be every reason for China to utilize her repayment capacity with the limits of prudent debt management, to borrow on conventional terms.

In mission's preliminary judgment, China's per capita GNP, after suitable adjustments, will be in range of $260-$270, converted at the official exchange rate. This compares to India's GNP per capita of $183 for 1978-1979 and over

$200 from 1979-1980 (India's fiscal year is from April - March). But international comparisons of living standard and purchasing power are notoriously difficult and there is the question as to whether the difference between India and China as reflected in official estimates is a representative difference. At least our preliminary impression is that it is representative difference. The structure of output between India and China is greatly different. But precise comparisons are impossible because of methodological differences. Roughly speaking, industrial product per capita was $115 for China in 1979 compared to India's $45 in 1978/79; so the difference between India's and Chinese per capita GNP appeared to be mostly in industry. For agriculture, product per capita was $87 for China, compared to $70 for India. Foodgrain output per capita in China is currently 25% higher than India's and so the agriculture sector comparison seems plausible. In the service sector, China per capita product ($61) was somewhat lower than India ($68). This for three possible reasons: i) some service sectors are covered in production under communes, enterprises, etc. in China; ii) wages are low in China, and income differentials in the service sectors as in the rest of the economy are small compared to India's; iii) the personal service sector is less developed in China (domestic services, private doctors, barbers, etc.)

Mission will be attempting, at least roughly, to compare the relative purchasing power per capita GNP of India with China. The final results will depend greatly on relative prices of industrial products in the two countries. Broadly speaking, agricultural prices are roughly comparable at the present foreign exchange rate. More information on the prices of final products will be very helpful in this regard -- industrial products, especially, means of production -- say, about 50-100 items, for example, construction material, cement, fertilizer, etc. These prices will be used to evaluate the gross value of industrial output.

Finally, a few words about the economic mission's scope of work. The mission's objectives were many: i) to analyze the level of development in China; ii) to study the level and pattern of growth in the recent past; iii) to pinpoint the constraints on economic growth; iv) to understand the economic system in China; v) to assess the likely impact of reforms and new economic policies; vi) to assess future plans and prospects; and vii) to assess future capital requirements, foreign exchange requirements, and the Bank's role.

Our overall efforts have been largely successful. We were perhaps more successful in understanding the level and trend of development in China, and the nature of the economic problems that have emerged; and we have obtained a better idea of how the system works. It was not possible to meet our all statistical requests, but we had unlimited opportunities for discussion. We were less successful in objectives v) to vii). We understand that at present the plan (Sixth Five Year Plan) has not yet been formulated, and therefore we are less able to assess developments in the 1980s. China's success in economic planning will depend to a large extent on the system performance and progress of reform, and I will turn over to Mr. Lim to speak on this difficult subject.

Mr. Edwin Lim

First, let me say that our estimate of China's GNP per capita is very preliminary. It is based largely on data supplied by the State Statistical Bureau (SSB). The difference is partly due to conceptual difference, e.g. World Bank uses mid-year population figure; SSB uses end of the year figure, but we will explain the methodology in the Report.

I would like to say something about the problems related to the economic system in China and the implications of the findings of the economic mission for Bank lending; specifically, on the general criteria that should be used in deciding how to make use of Bank resources in light of China's economic situation.

Concerning the Chinese economic system, I think there is a need to sum up the experience of the past objectively and scientifically. It is important to analyze the economic system, to identify its advantages and disadvantages, and not to be over-critical and ignore the advantages of the system. Many aspects of the system have benefitted the people a great deal and are now emulated by other countries, especially the ability of the system to provide basic needs, to obtain a high rate of saving, and to develop the country without foreign assistance. Many of the imbalances in the economy have been caused by the isolation of economy, but this was due to reasons not entirely the choice of China, but was dictated by the international situation of the 1950s and 60s. Evaluation of the system must be made by the Chinese people themselves. As outside observers, we see a tendency in China to go from one extreme to another, and there is need for more balanced and objective evaluation.

Nonetheless, there seems general agreement that there are very serious problems in the economy today, and many of these problems are attributable to the economic system. The symptoms are well known and discussed frequently by Chinese economists and in the Chinese press, e.g. over investment in capital stocks and over staffing; mismatch between output and the need of the people and what is often called "Production for production's sake".

Let me comment first on the relation between reform and adjustment: these are key factors in current economic policy. The line of thought at present seems to be that reform and adjustment are two different things, and reform may have to wait until adjustment is completed. But the objective of adjustment is to restructure the economy to meet the current and future needs of the people. This is the objective of reducing the rate of accumulation, improving the balance between heavy and light industries and agriculture, and in adjusting the structure within the industrial sector. The objective of reform is to strengthen planning so that it will be less detailed, longer-term oriented, and implemented by economic levers rather than by administrative means. Reforms should therefore make it easier to achieve adjustment. There is a tendency, however, for planners to think that they have the solutions to all economic problems and solutions can be achieved by the administrative system, thus reform can come later.

There seems to be some opinion now that China is facing economic difficulty, so reform must wait. As economists, we would think that at a time of economic difficulty, it is even more important to strengthen planning and improve management. The basic aims of adjustment are: i) to increase the efficiency and effectiveness of investment, ii) to restructure output to meet the needs of consumption; iii) to reduce waste and make better use of existing equipment. Surely strengthened planning and management through reform will help to achieve these objectives.

Turning now to the planning and management system, our first observation is on the statistical system. Planners can only be as good as the information they receive. The statistical system suffered severe disruptions during the two decades following the Great Leap Forward. While restoration of the system is now underway, some reforms may also be necessary: First, there is a need to rely less on comprehensive administrative reporting and more on sample surveys. With administrative data there is a great risk of false and incorrect reporting. Only with sample surveys can the statistician evaluate the quality of the data they are receiving from the lower levels. The history in China over the past 30 years shows many examples of errors in planning made because of false and inaccurate statistics. Second, there is a need to improve the collection and compilation of statistics. Statistics for planning purposes should be compiled in a form useful to planners, in a form which can be used for analytical purpose, not simply by administrative units as they are now. Moreover, the system of collecting data should be changed to meet the needs of the economy in the 1980s rather than the 1950s. Statistical reforms are necessary if the planners are to learn what is going on in the economy. Statistical changes are especially important as the economic system evolves towards the greater use of the market. It will be necessary to monitor the changes outside the planned economy. Finally, wider dissemination of statistics seems necessary. A decentralized planning system can not function well unless the mass of population and the enterprises know what is going on in the economy. There is also need to revive economic science, which have been much neglected for many decades. Unless statistics are no longer kept secret, economic research by Chinese economists can hardly be possible. In addition, the publication of statistics will allow a better monitoring of the economic performance.

Our second observation is on the need to improve investment planning. It is the impression of the mission that there is little systematic planning and evaluation of investment in China, perhaps even less than in many so-called market economies. There is a lack of scientific analysis of the economic benefits and costs of investment projects. There is a lack of consideration of alternative ways to meeting economic objectives. For example, an investment project may appear to be justifiable when considered by itself, but may not be when compared to an alternative way of meeting of the same objectives. There is clearly a need to improve investment planning and economic evaluation of projects. This is especially important when investment funds are scarce and must be used effectively and efficiently.

Our third observation on management is the lack of long-term perspective in planning. Since the completion of the first five-year plan, no other 5 year plan has been completed. The current problems of imbalances, and the shortages in energy and transport must be due to a large extent to the lack of long-term planning. Even now there seems to be no long-term perspective to planning and management. It is difficult to see how some of the current issues of development can be resolved without a long term perspectives.

Our fourth point re management concerns prices. Chinese economists now seem to agree that prices today reflect neither cost nor demand/supply condition. There seems to be general agreement that price reforms must be the core of system reform. Indeed it is questionable whether other reforms are possible without price reform. In fact because of the lack of price reform, some contradictions are already emerging. This is a difficult issue in China, where most goods are in shortage and any large-scale price reform will probably lead to higher prices rather than lower. But at least the planners should begin to calculate what prices should be and use these immediately as the basis for evaluation of investment, while gradually introducing them into the economy.

Our fifth point re management is the need to create new institutions to manage a decentralized economy. One type of institutions needed is to handle distribution -- wholesaling, retailing, i.e. distribution to help the movement of goods. With the introduction of market into the economy, some parts of China seem to have reverted to a barter economy rather than using a distribution system which would be much more efficient to the movement of goods. Another kind of institutions needed is financial intermediaries, especially banks. There is a need for such institutions to facilitate and regulate the flow of capital under the new economic system. Local governments and enterprises now have a great deal of funds but there are no institutions to put the funds to use in the economy. During our travels in China, we learned that some enterprises have set up their own investment companies to invest in other companies; some are investing in communes. It would be more efficient to allow those capital to flow through financial intermediaries; it would also allow the planners to regulate these flows.

Our sixth comment is on the need to separate economic and administrative units. At present, local government in counties and provinces act like businessmen because they own and receive profits from enterprises. This seems neither good for the economy nor for administration. Local governments may not be interested in education, health, and agriculture because they yield low or no profits, and therefore they may prefer to put money in industries which now yield high profits. At the same time, such a system is not good for administrative purposes because there is no incentive for local governments to invest in health and education though these must be their responsibility. Mr. Hasan has pointed to the low level of expenditures on education and health; this may be one of the reasons.

Our final comment is on the need for management development in course of system reform. Many of the managers of enterprises, communes and provinces were old revolutionary cadres. Now the government's objective is to replace managers with "younger, more educated, and professionally more competent" people. There is also recognition of the need to reduce bureaucratism and to increase the participation of the mass of the population in decision making. These are related to political questions, and have been covered in Chairman Hua's report to the National People's Congress. As stated in that report these are necessary conditions for economic reform.

In any event, there is a need to have a complete blueprint of reform; reform of an economic system is difficult to pursue piece by piece. It may be done gradually and with caution, but on all fronts. Many of the current problems of reform in China today may be caused by moving too fast in some areas and not at all in other areas - in other words, by what have not been done rather than what have been done - e.g. price reforms, institutions for manging the new economic system and strengthening planning work itself may be necessary before those reforms that have already been introduced can work.

Prepared in October 1980
for Management
Finance Committee

LENDING TO CHINA

Introduction

1. Judgment of China's eligibility for Bank and IDA borrowing and formulation of a lending program have to be based on staff analysis of the country's development performance and prospects and a comprehensive policy dialogue with the Government. The Bank's first economic mission is presently in the field; this paper should not prejudge its conclusions, which are expected to be presented to the Government by end-March 1981. The first CPP on China is planned to be reviewed before the end of the fiscal year. Therefore, in the following, only a highly tentative assessment is made of China's eligibility for Bank and IDA borrowing. Based on this assessment, a possible progression of lending is presented for FY82-86. The overall amounts of lending and particularly the proportions of IDA/IBRD financing have to be considered as indicating only rough orders of magnitude.

2. The paper first reviews China's past development performance; second, it deals with the country's capital needs and creditworthiness; and finally, it presents an indicative program of lending.

Development Performance

3. Country Size and Per Capita Income. Among developing countries, China is by far the largest in terms of both population and GNP. It had a population of 952 million and GNP of $219 billion in 1978, compared to India's population of 644 million and GNP of almost $113 billion. China's official figure for GNP per capita in 1978 is $230, though other estimates are as high as $400 (the official estimate is based on official exchange rate conversion and probably understates the income's real purchasing power). Thus China's per capita income probably places it among the group of low-income countries with per capita incomes below $360 in 1978, which for IDA-6 have been allocated 90% of total available funds, and certainly well below the upper limit of IDA eligibility of $625 (at 1978 prices). The per capita income of major IDA borrowers ranged from $90 (for Bangladesh) to $400 (for Egypt) in 1978.

4. Economic and Social Performance. A firm assessment of China's economic and social performance cannot be made until a full analysis has been completed by the economic mission. Over a 30-year perspective, there is little doubt that China's performance by these two criteria is much better than that of India, Indonesia, Pakistan and Bangladesh - the only countries with which a meaningful comparison can be made. Growth has averaged about 5% a year. Income distribution improved significantly between 1950 and 1958 (as a result of land reform and other institutional changes) and has remained roughly unchanged despite rapid growth, although urban-rural income disparity may have widened somewhat in the 1970s. Access to social services is also more equitably distributed than in any of the countries mentioned above. An active population planning program has reduced the population growth rate from over 2% in 1970 to the current rate of 1.2%. Over the past year, even stronger incentives have been introduced in an effort to reduce the growth rate to 0.5% by 1985. During the 1970s, growth in China has been somewhat slower than in the past because of the political disruptions of the Cultural Revolution.

Nonetheless, China's performance in the 1970s probably still compares favorably with that of larger low-income countries, though perhaps not with that of the market economies of East Asia.

5. Mobilization of Resources and Efficient Use of Capital. China's performance by this criterion has been uneven. The country seems to share with most socialist countries a remarkable ability to mobilize resources for development but an apparent inability to use them efficiently (during most of the 1970s, an investment rate of 30% resulted in a growth rate of less than 5%). The latter, however, is attributable partly to the country's economic isolation since 1960, though inadequate planning and management have been contributing factors. Between the late 1950s and the late 1970s practically all the resources used for development were domestic.

Capital Needs and Creditworthiness

6. Current Account Deficit. Little can be said with any degree of certainty about China's future current account position. The future volume of trade is likely to be much larger than in the past and past balance of payments trends provide little guidance to future development. The main objective of imports during the 1960s and 1970s was to relieve domestic supply shortages, especially in food grains and industrial supplies. Since about the mid-1970s, the Government has begun to use external trade as a development instrument, and the volume of trade has expanded. Since 1976, borrowing from abroad was allowed, in order to finance imports required for the country's modernization program. The most recent trade statistics are given below:

	1976	1977	1978	1979	Annual average growth 1976-79 (%)
	($ billions)				
Exports	7.3	7.7	10.1	13.7	24
Imports	5.4	7.3	11.3	15.8	43
Total balance	1.8	0.4	-1.2	-2.1	

7. In the short and medium term, the country's import demands are likely to grow considerably faster than its export capacity, and China is likely to incur a large and growing trade deficit as it moves towards a more open economic structure. The transition to a level of imports appropriate for the size of the economy implies a rapid growth of imports for some years, and the amount of "pent-up" demand is very large, especially to modernize plants using the more efficient equipment or more advanced technology available from abroad. For the longer term, the transition to a more open economy implies rapid growth of exports as well as imports.

8. The rapid growth rate of exports and imports of the recent past can probably not be sustained for any length of time. In the following, some alternative projections of future growth rates are presented, though at this point, these are of necessity purely arithmetical exercises. As a "worst possible outcome" projection, exports in current prices might grow by 15% a year over the next six years, while imports grow by 25% a year, i.e. at substantially lower rates than those experienced over the past four years. Under these assumptions,

China's trade deficit would rise to $29 billion by 1985, while total deficits for 1980-85 would amount to $85 billion. Clearly such a level of deficits would be very difficult to manage. On the other hand, under a "best possible outcome" projection (both exports and imports growing by 20% a year in nominal terms), the trade deficit would rise to $6 billion by 1985, while accumulated deficits over 1980-85 would total $25 billion. However, it appears unlikely that the high rates of export growth assumed under this scenario can be achieved. Finally, a "most likely outcome" projection would assume that exports grow by 15% a year while imports grow by 20% a year. This implies that the trade deficit would rise to $15 billion by 1985 and accumulated deficits for the next 6 years total $50 billion.

9. In 1978, China enjoyed a service account surplus of $1.2 billion, comprising $0.5 billion of tourist income and a slightly larger amount of remittances from abroad. Net service income could amount to about $2 billion a year during the 1980s. Accordingly, under the "most likely scenario," the current account deficit in the mid-1980s in current prices could be around $13 billion a year, while cumulative deficits over 1980-85 would be about $38 billion. The accumulated current account deficits of this scenario appear to be manageable if China can obtain longer term and concessionary financing. During his meeting with Mr. McNamara in April, Vice-Premier Gu Mu had stated that in the future, the country's current account deficit might reach $10 billion per year.

10. Debt Service Capacity. China will be embarking on its modernization program with a relatively small external debt, but its debt service capacity and balance of payments prospects remain to be analyzed. However, it appears that in the early years of the modernization program, the country can afford to contract a fair amount of conventional loans. Estimates by US and Japanese sources indicate that, before 1974, China's external debt consisted almost entirely of short-term supplier credits. Since then, medium-term debt has been used to finance plant imports. By the end of 1978, total short- and medium-term debt was estimated at $1.6 billion, about 16% of export value in that year. Because of the short-term and commercial nature of these debts, debt service payments have been quite significant at about 10% of exports in recent years, or even more in terms of hard currency exports.

11. In 1978, the Government began a major effort to seek external credit for financing its modernization program. By February 1980, a total commitment of $26 billion had been obtained, of which $16 billion were Exim Bank credits carrying interest rates between 7.25% and 7.50% and about $10 billion were commercial bank credits carrying interest rates about 0.5% above LIBOR (currently 14.75%). During the Government's reassessment of the development program in 1979, doubts were apparently raised as to the economic justification and feasibility of the projects to be financed by these external credits. Most of the projects were in heavy industry. The Government has since reordered its priorities. Doubts were apparently also raised about the country's ability to service such an amount of external debt. As a result, only a very small amount of the debt commitment has been drawn upon. Instead, the Government attempted to obtain longer term concessionary credits.

12. Level of International Reserves. China apparently has a low level of international reserves. No official estimates of China's international reserves have ever been given, but available information indicates a total of $2.7 billion in gold and foreign exchange./1

13. In conclusion, China at present has no external debt problem. So far, the country also seems to have no difficulty in obtaining a large amount of funds on Exim Bank and commercial bank terms. However, because of the huge backlog of import requirements and the Government's intention to accelerate the pace of modernization, the country faces very large foreign capital requirements over the coming years. Clearly China will have to obtain longer term and concessionary financing if debt service payments are to be kept at a reasonable level. There are virtually no historical data on which to judge China's ability to obtain and use external development assistance.

14. Economic Management. China will probably soon need to obtain and manage a sizeable foreign debt in order to implement its modernization program. In the circumstances, the crucial factor in an assessment of China's creditworthiness must be the country's economic management. Despite the country's achievements, the present Chinese leadership is very critical of development management in the past, especially since the mid-1960s, and they are frank about the inefficiencies of the Chinese economic system, which has remained largely unchanged since the late 1950s. The Chinese feel that these inefficiencies arise from excessive centralized control and planning, inadequate use of prices as an instrument and insulation of production from demand, isolation from foreign technology, and an excessive concentration on heavy industry.

15. The Government is presently introducing a series of economic management reforms. Steps are being taken to delegate significant production and investment decisions to industrial and agricultural units, to create a free market for some consumer and producer goods, and to introduce new monetary incentives for productivity. Many industrial enterprises are being transformed from direct state-managed units to substantially independent entitities, with full accountability of managers for their performance. An expansion of financial and technological links with the outside world is seen as an integral part of the effort to modernize and restructure the economy, to improve consumption standards, and to deepen the technological base of the economy.

16. There are fundamental risks in the new course the Government is following, and an evaluation of the new policies and programs will only be possible after some time. In addition, China's near-isolation in recent years makes it difficult to assess the economy's ability to adjust to unexpected adverse external circumstances and internal factors, though in the past, the country has coped well, for instance, with the sudden withdrawal of Soviet assistance, and with political turmoil or experimentation with radical social and economic policies.

/1 With gold valued at SDR 35 per fine ounce.

17. Availability of Projects and Implementation Capability. China's annual investment program amounts to more than $75 billion. The country seems to have the capacity to absorb large amounts of lending and has a large number of projects at various stages of preparation for which it is seeking external financing. Because of the size of the Chinese economy, most of these are very large projects by Bank standards. Earlier this year, the Chinese presented to Bank mission members an initial list of 19 projects (with a total cost of $10.6 billion and a foreign exchange component of $6.0 billion) for possible Bank financing over the next five years. The size of the hydro and thermal power projects is indicated by their estimated cost, which ranged from $670 million to $2,370 million, with a foreign exchange cost of $400 million to $1,400 million. The estimated cost of most transport projects ranged from $200 million to $445 million, with a foreign exchange cost of between $100 million and $300 million. The education and agriculture projects subsequently presented have an estimated cost of $390 million and $440 million respectively, and a foreign exchange cost of $160 million and $190 million.

18. To implement the projects, the Chinese have a well organized system. Each ministry is equipped with its own bureaus of construction, maintenance and operation, and often also with its own production bureaus or factories for manufacturing the equipment required for its projects. However, the division of responsibility among the various bureaus and their accountability are so clearly defined and enforced that they virtually operate as contractors. Bank mission members were convinced that China has the competence and capacity to plan, design and implement such large and complex projects as those suggested for Bank financing, but that the country is weak in such areas as technology, innovation and know-how. This calls for a "higher quality input" by the Bank in project formulation and design to introduce technology and practices presently missing in China. In project implementation, China has a tremendous advantage through the central coordinating and review role of the State Capital Construction Commission. The Bank has not yet been able to fully assess the Chinese system of project implementation or to establish how the Chinese system can be meshed with Bank guidelines and procedures, particularly with regard to procurement. However, the Chinese have now agreed to set up a World Bank Projects Coordination Unit under the Capital Construction Commission to further expedite the processing of Bank projects, particularly the preparation of contract documents.

Proposed Work Program

19. Objectives and Initial Country Dialogue. The objective of initial Bank operations in China must be to (a) facilitate China's re-entry into the world development community; (b) assist Chinese officials in selecting and absorbing available technology from the wide range of Bank member countries; (c) provide technical assistance in investment planning and management in key infrastructure and other sectors; and (d) assist China to gain access to concessionary development capital, including the Bank Group's own resources. Our initial dialogue with the Chinese confirms their interest in these areas. The Chinese attach great importance to their relationship with the Bank and expect the institution to be a major source of both capital and technical assistance. They consider the country eligible for large amounts of IDA

funds, but recognize that only over the longer term will they be able to receive financing to the full extent of their IDA eligibility. They have also accepted that the Bank conducts its operations within a broader context of economic and sector work; their past discussions with the Bank have been candid, and they have agreed to allow the economic mission full access to the available data.

20. It is still too early to address the sector composition of lending. The Chinese initially expressed an interest in financing in the energy, and transport and communications sectors; the education, agriculture and industry sectors were subsequently mentioned as possible areas for financing. However, since the inadequate development of economic infrastructure seriously constrains economic growth, the initial emphasis of Bank operations will most likely be in electric power and transport. Of the 19 projects presented to Bank mission members for possible Bank financing over the next five years, the Bank has selected six projects (one project each in the agriculture and education sectors and two each in transport and energy) for presentation to the Board in FY82/83. One project might be moved forward to FY81, most likely that in the education sector.

21. The average size of Bank projects in China is expected to be large, given the size of the government's investment program and the size of most projects presently under implementation in China. This applies also to early lending operations: the estimated total cost of the six selected projects ranges from $360 million to $1,500 million. The following lending program tentatively assumes that the average loan size will be $200 million and that cofinancing of projects will frequently be possible.

22. Possible FY82-86 Lending Program. Based on the preceding evaluation of China's development record, capital needs and absorptive capacity, and taking into account the current volume of lending to other large, populous countries, a level of lending to China of at least $3-4 billion per year would be justified. Achievement of this level of lending depends both on the time needed to develop and initiate a full program of operations, as well as on the Bank's capacity to accommodate this additional financial commitment to China within its overall lending program. Based on these two criteria, we do not anticipate that this level of lending can be reached before FY86.

23. The proposed progression of lending assumes an initial build-up of operations from three projects in FY82 to five projects in FY83 and ten projects in FY84. An initial review of the projects for which the Government is seeking external financing, together with a comparison with the expansion of Bank operations in Indonesia after 1968, indicates that such a build-up is possible. In the case of that country, the number of lending operations jumped from zero in FY68 to four in FY69 and eight in FY70. Mission members also agreed that Chinese ministries are much better organized than the Indonesian Government was in 1968.

24. An immediate issue is whether China should receive any significant amount of IDA funds, since, at least during the IDA-6 replenishment period, it would be withdrawing resources from other countries, whose creditworthiness for Bank lending might be more limited than China's, or even nonexistent. The Bank's strategy should be to maximize China's borrowing from IBRD (and minimize borrowing from IDA) within prudent credit limits. At this point, only a notional proportionality can be presented. The proposed progression of lending over FY82-86 envisages a blend of one-half IDA and one-half IBRD funds, except during IDA-6 when a blend of one-third IDA and two-thirds IBRD is assumed.

	FY 82	FY 83	FY 84	FY 85	FY 86
	($ million)				
Bank	400	650	900	1,250	1,750
IDA	200	350	850	1,250	1,750
Total	600	1,000	1,750	2,500	3,500
No. of Projects	3	5	10	12	16

To further reduce demands on IDA, particularly in the initial years, a blend of one-quarter IDA and three-quarters IBRD funds during IDA-6, and of one-third IDA and two-thirds IBRD for the other years, could be considered, but this proposal might not be acceptable to the Chinese Government. These overall amounts, as well as the proportions of IDA/IBRD financing, should, of course, be amended in light of the conclusions of the economic mission and the results of a comprehensive policy dialogue with the Government over the next eight months.