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CHINA - LOAN 2967/CREDIT 1932-CHA

VOL. 5

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4161

R1991-101 Other #: 13

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Rural Sector Adjustment Loan [RSAL] Project - China - Credit 1932 - Loan 2967 - P003514 - Correspondence - Volume 5

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CHINA - Rural Sector Adjustment
Loan - RSAL

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CLOSE - OUT SHEET

This file is closed as of January 31, 1989

For further correspondence, please see Vol. VI

INFORMATION CENTERS SECTION

This file contains material from: 12/1/88 to 1/2/89

OFFICE MEMORANDUM

DATE January 19, 1989

TO Mr. Joseph R. Goldberg, Chief, AS3AG

FROM *R Burcroff II*
R. Burcroff II, AS3AG

EXTENSION 72443

SUBJECT CHINA: Supervision Report
Ln. 2967-CHA/Cr. 1932-CHA
Rural Sector Adjustment Loan

See Spn. report 1-4-89

1. Attached for your review are copies of Annexes 1-9 to the RSAL supervision report (the supervision report was distributed separately on January 4, 1989):

<u>Annex</u>	<u>Title</u>
1	Progress With Implementating The Land Mgt. Reforms
2	Reform of the Grain System
3	Reform of Urban Ration Grain System
4	Marketing Systems for Perishable Food Products in China With Emphasis on Fruits and Vegetables
5	Fresh Vegetable Marketing: Review and Assessment of Beijing Municipality and Guangdong Province
6	Rural Enterprise Reforms
7	Rural Investment and Finance
8	Progress With Implementing Marketing System Reforms
9	RSAL Monitoring and Evaluation Arrangements

2. By this memo, the annexes also will be placed in Section III of the Project Implementation Index File.

Attachments

Distribution:

Messrs. Karaosmanoglu, Yenal (ASIVP); Burki, Ahmad, Tidrick (AS3DR);
Deshpande, Bi, Piazza (AS3AG); Grimshaw, Mudahar (ASTAG);
Goering (RMC); Knudsen (AGRAP); AS3AG Staff (circulating copy); M.C. Evans, N. Mahoney (C)

Asia Files
Black Book

LN 2967/cr 1932-CHA

Jan 4/89

PIIF

Asia Files

OFFICE MEMORANDUM

Ln 2967/cr1932-dtt

DATE: January 4, 1989

TO: Mr. Joseph R. Goldberg, Chief, AS3AG

FROM: R. Burcroff II, AS3AG

EXT: 72443

SUBJ: CHINA: Supervision Report
Ln. 2967-CHA/Cr. 1932-CHA
Rural Sector Adjustment Loan (RSAL)

Phased missions, staffed by myself, R. Deshpande, M. Mudahar, and A. Piazza (Bank); M.C. Evans, N. Mahoney, L. Duboff and H. Riley (C) visited China from September 12-November 16, 1988 to initiate supervision of the RSAL. We were assisted in the field by Messrs. T.J. Goering, Bi Mingjian and Zhou Weigou (RMC). Attached please find a copy of the supervision report.

The following mission reports will be entered in the Project Implementation Files, forwarded to the Asia Regional Information Center, and will be available upon request.

<u>Title of Report</u>	<u>Date Issued</u>	<u>Project Implementation Index File Ref.</u>
Status of Implementation (Form 590)	01/04/1989	Section I
Project Execution		} <u>dtt</u> Section II
Aide-Memoire	12/16/1988	
Post-mission Telex	12/29/1988	
Compliance With Covenants	01/03/1989	
Draft Paragraph for President's Status Report	01/03/1989	
Progress With Implementing The Land Mgt. Reforms	10/24/1988	} <u>Att</u> Section III
Reform of the Grain System	01/10/1989	
Reform of Urban Ration Grain System	11/28/1988	

Marketing Systems for Perishable Food Products in China With Emphasis on Fruits and Vegetables	11/01/1988
Fresh Vegetable Marketing: Review and Assessment of Beijing Municipality and Guangdong Province	10/13/1988
Rural Enterprise Reforms	10/20/1988
Rural Investment and Finance	11/15/1988
Reform of Marketing Organizations and Institutions	10/24/1988
RSAL Monitoring and Evaluation Arrangements	12/15/1988

AA

Attachments

Distribution: Full Report

Messrs. Karaosmanoglu, Yenal (ASIVP); Burki, Ahmad, Tidrick (AS3DR); Deshpande, Piazza (AS3AG); Grimshaw, Mudahar (ASTAG); Goering (RMC); Knudsen (AGRAP); AS3AG Staff (circulating copy); Asia Files; AS3AG Files

Distribution: Form 590 & Cover Memo

M/M Dubey (EAS); Golan (ASTDR); Pearce (AS3CO); Stern (AS3IF); Lim (RMC); Le Moigne (AGRPS); Braverman (AGRAP); Donaldson (OEDD1); Tanaka (LEGAS); Hwang (LOAAS); Szapary (IMF)

RBurcroffII/ms

FOR DETAILED INSTRUCTIONS ON COMPLETION OF THIS FORM,
PLEASE SEE ANNEX C OF OMS 3.50

() THE INITIAL SUMMARY
THIS SUMMARY IS (X) PART OF A MISSION REPORT
() AN ANNUAL UPDATE

REGIONAL OFFICE: VP - ASIA | PROJECT NAME: RURAL SECTOR ADJ. LN | PROJECT CODE: 4CHAPA107 | LOAN (X) CREDIT (X) NO: C19320 L29670 | L.C. AMT (\$XX.XM/SDR): 200.0/72.2

COUNTRY: CHINA | BORROWER/BENEFICIARY: PEOPLE'S REPUBLIC OF CHINA | BOARD DATE/FY: 06/23/88 - 88 | SIGNING DATE: 07/15/88 | EFFECTIVE DATE: 09/19/88

MANAGING DEPT./DIV. NAME: AGRICULTURE OPERATIONS DIVISION | DRG CODE NO.: 25520 | PROJECTS OFFICER: R. BURCROFF | LOAN OFFICER: | MISSION END DATE: 11/18/88

	SECTION 1: PROJECT DATE AND PERFORMANCE RATINGS		PROJ. COSTS	DISBURSEMENT	NO/YR	RATINGS	THIS SUM	LAST SUM
	CLOSING DATE	COMPL. DATE						
	(MO/YR)	(MO/YR)	(\$/LOCAL (XX.XM))		(\$XX.XM) (% OF LC)			
SAR/PR:	07/31/90	01/31/90	300.0/1,116.0	SAR/PR:\$	150 (50%)	AVAIL. FUNCS	1	
REVISED:			/	ACTUAL:\$	236 (81%)	PROJECT MGMT.	1	
LAST IS:			/	PROFILE:\$		DEV. IMPACT	1	
EXPECTED:	07/31/90	01/31/90	300.0/1,116.0	COMMT.:\$		OVERALL STAT.	1	
		COMPL. DELAYS	COST OVERRUN	DISB. LAG				
RATINGS - THIS SUMMARY:		(.0 %)	(.0 % .00 %)	(-57%)				
RATINGS - LAST SUMMARY:		(.0 %)	(.0 %)	(.0 %)				

SECTION 2: SUMMARY PROJECT DESCRIPTION: TYPE OF LENDING INSTRUMENT: SECTOR ADJUSTMENT LOAN

The RSAL supports national and regional initiatives to reform China's agricultural land management system, grain system, rural enterprise system, rural financial markets, & cooperatives' marketing system. Nationwide reforms to be prepared during 1988, for implementation during 1989 & 1990. Regional reforms, in the form of 12 experimental programs, to be initiated during 1988, or move into a second phase. Monitoring systems to be developed for regional reform programs.

SECTION 3: PROJECT STATUS. SUMMARIZE CURRENT STATUS OF IMPLEMENTATION. IDENTIFY MAJOR PROBLEMS.

The RSAL became effective on Sept. 19, 1988. Most regional reforms (RRPs) were successfully initiated in 1988 or moved into second phase. Exceptions are two land consolidation RRP, which require redesign. 1988 national reforms partially implemented with promulgation Private Enterprise Regulations. Nationwide grain pricing reform delayed due macroeconomic situation. Preparation 1989-1990 program being carried out on schedule. Very rapid disbursement, with counterpart funds allocated to slice of State Investment program. Credit closed on 12/19/88. In late Dec. 1988, serial ICB tenders issued for 500,000 mt fertilizers, of which at least \$50 million to be financed from loan balance.

SECTION 4: ACTION TAKEN. SUMMARIZE CURRENT ACTIONS TAKEN OR AGREED TO BE TAKEN WITH BORROWER TO ADDRESS MAJOR PROBLEMS.

State Council to reaffirm commitment to experimental program. Grain system review to be initiated by Bank, for discussion late 1989. Formal agreement "at least \$50 million" to be procured using serial ICB. Format semiannual progress reports agreed.

SECTION 5: ACTION PROPOSED. SUMMARIZE FURTHER ACTIONS REQUIRED. INCLUDE AGENDA FOR NEXT MISSION (MO/YR) (06/89)

General: augment budgets for most RRP in 1989. Grain System: Evaluate Bank review prior to setting national policies for 1990. Augment production inputs, technical support for grain RRP, reduce ration coupon "overhang". Land Management System: Devise national regulations on basis Zhunyi Conference framework. In Southern Jiangsu, eliminate contract grain requirement in one county and monitor. Redesign Nanhai, Guangdong RRP. Rural Enterprise System: Reveal national controls on investment and credit. Initiate testing under Fuyang RRP of non-State owned enterprise and trial insolvency regulations. Rural Financial Markets: Initiate review rural financial market policies. Within Fuyang RRP, develop trial rules & regulations for informal intermediaries. For Guanghan, Sichuan RRP (formal sector), increase unit autonomy during 1989 for setting interest rates, carry out unit performance review. M & E: Give local M&E units increased organizational autonomy. In Fuyang--relocate responsibility to prefectural level.

NAME OF PREPARING OFFICER: RICHARD BURCROFF | DATE: 01/04/89 | REVIEWED BY: (DIVISIONAL MANAGER) JOSEPH GOLDBERG, CHIEF | PIR REVIEW: (ASST. DIR/DIV/VP) J. Hordley

SUPPLEMENTAL SHEET FOR FORM 590

Project Name: Rural Sector Adjustment Project ID: 4CHAPA107
Mission Sequence No: first

Date of Last Mission: -na- Reporting Period: 09/88-11/88

1. COMPLIANCE WITH LOAN COVENANTS

List action due on any loan covenants during reporting period:

-nil-

List all loan covenants on which action is overdue:

-nil-

2. AUDITS

Last Audit Report received for FY: On: -na-

Due date of next Audit Report: June 30, 1989 (first report)

Action taken by Task Manager on Audit Report received and/or due:

none required

3. PROGRESS REPORTS

Last Progress Report received for period: On: -na-

Due date of next Progress Report: Jan. 31, 1989 (first report)

4. PROCUREMENT

List procurement activities/problems during reporting period:

With exception US\$ 57 million from Loan Account (Credit was closed on 12/19/88) all procurement has been completed. Of remainder, Govt. agreed to procure "at least" US\$ 50 million using serial ICB. Tenders issued late Dec. 88. Bid evaluation expected by end-Jan. 89.

5. TECHNICAL ASSISTANCE/TRAINING ACTIVITIES

-na-

EXECUTIVE SUMMARY

China RSAL: Findings of Post-Effectiveness Supervision

1. The Statement of Rural Reform Policies indicated that national reforms would be prepared during 1988, for implementation during 1989 and 1990. The regional reforms, in the form of "experimental" programs (RRPs), would either be initiated in 1988 or move into a second phase. It was agreed that monitoring systems would be developed along lines suggested by staff. The 1988 program was generally implemented on schedule. As a result of the stabilization policies, however, setbacks may occur during 1989. Main findings are summarized below.

2. Land Management System (LMS): The mission was invited to attend a high-level "rural work" conference, organized to establish a policy framework for LMS reform. The conference concluded that the difficult trade off between efficiency and employment objectives should be addressed through regionally tailored LMS policies that feature a much larger role for market forces. The mission endorsed this approach. Implementation of the LMS RRP was unbalanced during 1988. Progress with the leasehold market experiment (Meitan, Guizhou) has been noteworthy, including establishment of China's first land banking institution. In 1989, the Meitan design will be extended province-wide. However, the land consolidation experiments have either fallen behind schedule (Southern Jiangsu) or failed completely (Nanhai, Guangdong), a result of inappropriate design. The mission reiterated previous recommendations that agricultural marketing be freed-up completely in one of the three counties in Jiangsu and that grain imports be permitted. We also recommended that the Nanhai RRP be redesigned to test production and marketing arrangements for high valued crops.

3. Grain System. To help "counter inflation", a six part program is being adopted for 1989 to stimulate grain production through traditional administrative means. The mission advised that the program may destabilize the rural economy rather than achieve intended results and thus aggravate China's macroeconomic problems. The Bank offered to do a quick review of grain issues before China's guidelines for 1990 have been finalized. Implementation of the two grain system RRP (Xinxiang, Henan and Yulin, Guangxi) was very successful in 1988. Second stage plans are now being finalized. However, both RRP experienced budgetary shortfalls during 1988, a result of unanticipated inflation, and some erosion of staff morale. The mission recommended that adequate budget be assigned for 1989. To counter the morale problem, the State Council intends to reaffirm its commitment to the regional reforms in the near future.

4. Rural Enterprise System. TVE reform will likely become hostage to current restraints on off-Plan investment. Since the burden will be shouldered mainly by collectively- and privately-

owned enterprises, indiscriminate cutbacks could force stronger TVEs into liquidation alongside the less viable ones, thus imperilling China's off-farm employment objectives. National Private Enterprise Regulations were issued by the State Council in July, 1988. RCRD has drafted trial regulations for all non-State owned enterprises, which are broader and appear to be an improvement on the July 1988 proclamation. Together with trial insolvency regulations, these are scheduled for testing under the Fuyang, Anhui RRP once approval is received from provincial and local authorities. The mission believes that these trial regulations may demonstrate means for China to create a politically viable business environment, and therefore encouraged RCRD to initiate testing as soon as possible. Meanwhile, the Fuyang RRP's 20-odd components progressed at a rapid pace during 1988, supplemented by RCRD programs in four coastal regions to encourage TVE exports.

5. Rural Financial Markets. Though uncertainty is pervasive in China's rural financial markets, substantial progress was made during 1988 in the Guanghan, Sichuan RRP (for formal sector institutions) to increase unit autonomy, link staff remuneration with unit performance, establish interbank markets, and streamline settlement procedures. For the 1989 program, the mission recommended more autonomy in the setting of interest rates, and a review of unit performance in early 1989. Under the Fuyang RRP, however, worrying developments underscore the need for sound standards and broader financial policy guidelines for informal sector intermediaries. The mission offered Bank assistance for the preparation of trial rules and regulations. RCRD intends to respond shortly to this proposal.

6. Monitoring Systems. Good progress has been made to set up monitoring systems for the RRP's. Criteria have been determined, training initiated, and the requisite surveys have been designed. However, all M&E activities lack budget, while most have not been placed in functionally independent units. Within the Fuyang RRP, executive authority has been transferred from the prefectural office to the 8 participating counties. While these arrangements have eased implementation, effective M&E is nearly impossible. The mission urged RCRD to give the M&E units organizational autonomy, measurably augment their budgets, and--for Fuyang--to reassign responsibility for M&E to the prefectural level.

7. Withdrawals and Procurement. As of November 21, 1988, the equivalent of US\$ 243 million had been withdrawn from RSAL proceeds. The Credit has fully disbursed and was closed on December 19, 1988. The mission noted that this represents an extremely rapid draw down, though perhaps understandable given the financial stringency which China believes it faces. No ICB tendering has been utilized thus far. The MOF has confirmed via telex that at least US\$ 50 million of the remaining procurements would be carried out using serial ICB tendering procedures.

World Bank Mission to China
for 1st Supervision of the
Rural Sector Adjustment Loan

A. INTRODUCTION

1. A World Bank mission visited China from September 12-29 and October 16-November 16, 1988 to initiate supervision of the Rural Sector Adjustment Loan (RSAL). Our main tasks were to (a) assist as necessary with arrangements for loan effectiveness, (b) review the status of the overall reforms, as detailed in Part III of the Statement of Rural Reform Policies, (c) update our understanding of developments in the regional reform programs (RRPs) being implemented under State Council guidance, and (d) advise on matters arising concerning the utilization of loan proceeds, procurement procedures and disbursements.

2. In Beijing, the mission was briefed on the pace of overall reform and progress in the experimental zones by senior officials of the Research Center for Rural Development (RCRD) and the China Agribusiness Trust & Investment Corporation (CATIC). Details of the nine new RRP's under the purview of the RCRD were also discussed. Subsequent meetings were held with the Ministries of Finance, Commerce, Agriculture and Water Resources to review the overall reforms; and with the State Planning Commission's Department of Rural Economy, the People's Bank and the Agricultural Bank of China to discuss reorganization of the State Investment Program and developments in China's rural financial markets.

3. After initial briefings, the mission travelled to various experimental zones to review progress with the grain system reform (Xinxiang Prefecture, Henan and Yulin City, Guangxi); land management reform (Meitan County, Guizhou and Shunyi County, Beijing); rural enterprise reform (Fuyang Prefecture, Anhui Province); and reform of rural financial markets (Guanghan, Sichuan, Fuyang Prefecture and Meitan). During these visits, our staff exchanged views with RCRD and local officials about design, implementation, initial impact, staffing, budgeting and plans. We also reviewed the monitoring systems and indicators being set-up to track progress. While in Guizhou, the mission was invited to attend the Conference on Land System Reform, held in Zunyi City between September 20-21, where we presented our views on the design and financing of the land-lease market and land consolidation programs. Also, two experts in the field of perishable products marketing, who joined the mission in response to a request from RCRD, reviewed product acquisition and distribution systems for fresh vegetables in Beijing and Guangzhou.

4. The mission was well received. We wish to express our appreciation for the warm hospitality, many courtesies extended, and arrangements made. In particular, we wish to thank Messrs. Wang Qishan and Wang Gang, President and Vice President of the CATIC; Lu Mai, Director of RCRD's Experimental Programs Office; Chen Xiwen, Acting Director of RCRD's Development Institute; Qian Fagen, Acting Director of the RSAL/World Bank Loan Implementation Office; and their staffs and colleagues at the provincial and local levels. The mission has agreed to provide RCRD with detailed summaries of our findings and recommendations by end-December, 1988.

B. GENERAL

5. This initial supervision took place during a period of reassessment in China. The need for China to address the difficult issues of inflation, monetary and credit expansion, and ultimately, the need to add substance to enterprise reform is appreciated. We realize (and agree) that the pace of rural policy reform must be articulated with, and will be somewhat contingent upon decisions made in regard to the non-rural reforms, especially Government's macroeconomic stabilization policies.

6. Having said this: there is a danger that the more fundamental of the rural reforms--viz. the land management and grain system reforms, and the restructuring of the TVEs' policy and business environment, if implemented too slowly, may increasingly become hostage to an overreaction to the current macroeconomic situation and the slow-moving reform of State-owned enterprises. There is an equally important concern that resources of both the informal financial service cooperatives in China and local branches of the specialized banks, as well as of China's ubiquitous Rural Credit Cooperatives are becoming tied-up in dubious loans to State-owned and collectively-owned entities. These loans generally are long term in nature, having--of late--somewhat doubtful profitability, and a risky expectation of timely repayment.

C. THE MISSION'S WORK PROGRAM

7. The mission's review of the overall program aimed mainly to (a) record recent developments in the realm of national policies, (b) understand Government's current thinking about the pace of rural reform in light of recent developments, and (c) assess the likelihood that Government would be able to implement the program of rural reforms referred to in the Statement of Rural Reform Policies (the "Policy Letter") within time frames indicated. Our

detailed review therefore emphasized the more immediate undertakings, i.e. "Price Reform" (paras. 14-18 of the Policy Letter), "Establishment of a Land Use System" (paras. 19-22), "Rationalization of the Rural Enterprise System" (paras. 26-29), and "Rural Investment System Reform" (paras. 30-33). The mission was also briefed on "Rural Marketing System Reform & Establishment of Rural Cooperative Organization" (paras. 23-25), but was not staffed to carry-out a detailed review of this topic. Our understandings are recorded below:

D. GRAIN SYSTEM & AGRICULTURAL PRICE REFORMS

-Program of General Reforms.

8. In the past few months, inflation has emerged as a major national issue and the Government has introduced steps to control it. We understand that the "counter-inflationary" program for agriculture in 1989 will entail new measures to stabilize markets by expanding supply and reducing demand for key commodities. In the grain sector, which is considered the key to regaining balance in the agricultural sector, the Government appears fully committed to accelerate grain production. A six-part program is being adopted, which--in broad outline--aims to (a) stimulate grain production, (b) constrain growth in urban food subsidies, (c) ration fertilizers and other modern inputs, (d) ration foreign exchange expenditures for agricultural operations, (e) establish new investment programs dedicated to grain production and (f) develop new, earmarked, taxation to finance these programs. If the Government is able to identify viable means for implementing these guidelines, the result would be a major step away from efficiency pricing and its institutional handmaiden: the liberalization of China's internal marketing and distribution systems. In addition, a tight national control of grain and agricultural input prices will inhibit the Grain System RRP from implementing planned further price reforms, thereby denying the possibility of learning appropriate lessons from these pilot reforms for wider application at the national level.

9. Clearly, the Government's ability to stabilize agricultural pricing will influence the transition towards macroeconomic balance and affect its pace, but the mission feels strongly that this must continue to be accompanied by strong incentives to encourage production, rationalize consumer subsidies, and render more transparent, buoyant and effective, the resource mobilization required to finance adjustments in the grain system. Indeed, the initial experience in the Xinxiang and Yulin experimental zones anticipates the kinds of gains which are possible and the rapidity by which these may be realized, even in the face of a worrisome inflation.

-Progress in the Experimental Zones.

10. The RRPs covenanted in the RSAL for grain system reform deal specifically with reform of the grain procurement and marketing system, and the financing of related subsidies. The mission focussed on decisions made and measures taken to implement the first phase of the Xinxiang, Henan and Yulin, Guangxi RRPs, and plans/preparations for the next phase. In this context, we reviewed (a) reforms to producer pricing policies in the experimental areas and the treatment of contract grain purchases; (b) the pricing and availability of production inputs--thus, also, inputs subsidies; (c) consumer pricing, ration sales and the monetization of ration coupons; (d) agricultural tax reform; and (e) monitoring systems for the RRPs. Our main findings are summarized here (though the discussion of monitoring arrangements is presented below in Section H), with details available in the mission reports that will be furnished presently.

11. Implementation of the Xinxiang RRP's first phase has been smooth and the initial impact was positive. Producer prices were increased, inputs subsidies reduced, and agricultural tax rates revised upwards. Grain production responded to increased producer incentives (in spite of the drought), the local grain stations were able to procure quota grains ahead of schedule and without problems, and the government was able to accelerate the collection of agricultural taxes. However, problems in three vital areas emerged during the second half of 1988 which--unless rectified soon--could seriously undermine the initial success at Xinxiang and make it difficult to introduce the crucial second phase. These problems include finance, availability of rationed inputs and a wavering of political will by local authorities.

12. Since the RRP was designed to be financially self-sustaining, the Xinxiang City and Henan Provincial governments did not budget additional financial resources to cover reform related expenditures. But now the RRP appears to be experiencing severe financial shortfalls due to the fact that about half of the 1988 fertilizer and diesel were sold before implementation began, at the old plan prices, whereas the bulk of the summer harvest was procured at the higher contract prices featured in Phase I of this RRP. Furthermore, Xinxiang did not receive its assigned allocation of urea and diesel due to various problems including transportation bottlenecks, which will likely constrain farmer response to Phase I incentives during Winter and Spring plantings. Further, since the gaps between market prices on the one hand, and contract grain and ration sales prices on the other, have widened far more than anticipated, the financial resource requirement for Phase II will likely be even higher than expected since this phase entails both a further increase of grain procurement prices and an increase in consumer prices.

13. The Xinxiang authorities are understandably nervous, fearing that the reform may be blamed for instabilities in production, consumption and finance that in fact derive from China's macroeconomic problems and rigidities in inputs supply. Morale is said to be a problem, and the mission was asked to convey a request for some kind of assurance from national-level authorities that the reform should progress as planned, and that necessary financial resources and production inputs will be made available to facilitate unhindered implementation. The mission strongly endorses these requests, and was advised that the State Council intends to confirm its endorsement of all of the experimental reforms being implemented under the purview of the RCRD in the not-too-distant future.

14. The pricing and marketing components of Yulin City's first phase RRP is more comprehensive than Xinxiang's and was not intended to be financially self-sustaining. The prices of contract grain (rice) procurement, of rationed sales to urban consumers and rural resales were raised to prevailing market levels; consumers were given fixed income supplements; prices of production inputs were substantially increased; and measures were introduced to make the remaining subsidies more transparent. Unlike Xinxiang, however, the Yulin City and Guangxi Zhuang Provincial governments agreed to share part of the remaining subsidies.

15. Implementation of the first phase was smooth and the initial impact has been quite positive. Rice production responded well to higher procurement prices, and perhaps most importantly, the plantings of input intensive hybrid rice increased dramatically. Indeed, Yulin now faces a shortage of hybrid rice seeds, much to the credit of the reform. Yulin's grain quota was fulfilled well ahead of schedule, accompanied by a rapid increase in the share of private operators in the local grain trade. As a result of these reforms, the market is reported to be very stable in spite of persistent inflationary pressure. The mission understands that Yulin plans to go ahead with the second phase, which will consist of further increase in grain purchase prices and increased reliance on the market, further reduction of quota sales, and the introduction of agricultural tax reform.

16. Similar to Xinxiang, the Yulin authorities face three problems that should be sorted out before the second phase begins. The first one concerns financing, the second relates to an overhang of unused ration coupons--which have become monetized and could place tremendous pressure on City finances were ever these "cashed-in", and the third (again) involves morale. The financial difficulties are known and will not be repeated here, except to underscore the mission's recommendations that

- (i) the Guangxi Zhuang Financial Bureau should be encouraged to release the central and provincial funds

already allocated to the Yulin RRP as soon as possible, and

- (ii) that earmarked exemptions to Yulin's credit ceilings should be granted to enable the City to finance the RRP's working capital requirements.

17. The overhang of ration coupons from previous years could present an equally serious problem. These coupons have been effectively monetized, and represent a store of unearned wealth beyond official control under present arrangements, and ready to be unleashed if consumer confidence erodes. Recognizing this problem, we understand that an expiry date is now assigned to newly issued ration coupons. Although the Yulin authorities have decided otherwise on "equity" grounds, the mission strongly recommends that those ration coupons being retained by consumers from before the reform was implemented also be given an expiry date, say on June 30, 1989, else simply be declared invalid. To protect low income consumers, a more dedicated targeting than that represented by the broadside distribution of ration coupons could be easily set-up within the framework of existing administration--and perhaps should be experimented with under Yulin's RRP.

18. The morale problem is similar to Xinxiang's: a result of uncertainties regarding State endorsement of the reforms being introduced. The State Council's intended reaffirmation (para. 13) should allay current concerns, though additional visits to Yulin by RCRD's officials would also help, since the absence of routine visits has made experimental zone authorities feel somewhat like orphans while trying to implement this far-reaching experiment without visible high-level support. Technical support, especially, will be required from RCRD when the Yulin authorities finalize designs and implementation details for the second phase reform, and is so recommended.

E. REFORM OF THE LAND MANAGEMENT SYSTEM

-Program of General Reforms

19. Amendments to Article 10 of China's Constitution by the National People's Congress on April 12, 1988 provided sanction for an expanded experimentation with the rural land management system (LMS). In addition to the RRP's reviewed while the RSAL was being formulated (at Meitan, Guizhou, in Southern Jiangsu and in Guangdong's Nanhai County), the State Council subsequently endorsed RRP's for Pingdu County, Shandong and Beijing Municipality's Shunyi County. The need for diversity, both regional and in recognition of agroeconomic and off-farm opportunities, is implicit in the differing features of the land

system RRP's. The mission feels these have been selected wisely, and that an evaluation of program results will lend well to a formulation of national laws and regulations intended during 1990.

20. The mission was invited to attend (and make presentations at) a Conference on Land System Reform in Zhunyi, Guizhou, which was held to debate the shape and form that national policies might ultimately assume. This provided extremely valuable insights into the nature of the current debate in China, and the variety of approaches being considered. There is clearly widespread acceptance at all levels of the need to replace the present administrative procedures for allocating land use rights by a system which allows for a much greater role for market forces. The seminar also recognized that room for manoeuvre in LMS reform is presently constrained by agricultural pricing and marketing policies and by food security strategy and that, conversely, the range of options available for reforming these policies is itself partly determined by the potential impact which LMS reform will have on agricultural productivity.

-Progress in The Experimental Zones

21. The Meitan RRP is progressing steadily. The formal establishment in September 1988 of a land bank (The Meitan Land Finance Company) to finance land use transfers and agricultural development schemes was a major milestone in supportive institution building. The recently introduced land contracts (formalizing the leasing of land by households from the collective) will serve as collateral for the borrowings. We understand that a group from the Guizhou Provincial Land Management Bureau will visit Meitan shortly to supervise the issuing of land certificates to cover all land in the County. These will, in effect, serve the purpose of "title deeds" and facilitate the transfer of land between collectives and compensation for individual households concerned.

22. Revenue raising and financing of local level activities has been streamlined in the Meitan RRP by formally making villages administrative subunits of townships. Crop quotas and contract purchases have been reduced in amount, thus effectively raising farm prices in an effort to encourage greater use of agricultural inputs. Subsidized grain resales to rural consumers have also been reduced. The recently introduced land use fee appears to have been generally accepted by farmers.

23. The Meitan "model" has been endorsed by the Provincial Government, which is urging other counties in Guizhou to introduce similar reforms. Diffusion of this RRP within Guizhou will be closely monitored. The main question about the Meitan RRP concerns the rate at which land transfers will take place, with

the corresponding emergence of consolidated and/or specialized farms operating at high levels of efficiency. Much will depend on the schemes to bring into production the uncultivated uplands and the amount of surplus agricultural labor, made available through land consolidation in the lowlands, which can be productively employed on the uplands. This in turn will depend on the amount of good quality upland per capita, market opportunities and the type of upland production system (e.g. mini-estate, smallholding or a combination) which is instituted.

24. The Southern Jiangsu, Nanhai, Pingdu and Shunyi RRP's are all attempts to deal with problems caused by the high opportunity cost of land under grain crops and of labor needed to work the land, in an environment of rapidly growing demand for non-agricultural workers and for high value agricultural products. Production gains under the specialized household systems have been good this year in both Southern Jiangsu and Shunyi, but it is clear that these RRP's present expensive solutions to land fragmentation and the problem of low agricultural productivity, both in terms of the capital financing and the income support required from the non-agricultural sectors. Under present conditions, there is some question whether the Southern Jiangsu experiment can be sustained, since its diffusion to nearby towns and counties has fallen well behind schedule. With both of these experiments, replicability remains very much at issue--even in the labor deficit coastal zones and environs of major cities for which these RRP's are designed and where they are presently located.

25. In Guangzhou's Nanhai County, the RRP simply is not working. Only a tiny fraction of households have opted to become specialized producers of quota crops operating consolidated holdings. The lure of off-farm employment and the gains from producing vegetables and other high-valued crops (where gains from reduced fragmentation could be expected to be negligible) have eliminated any enthusiasm for the RRP that may originally have been present in Nanhai. There is a need for experimenting with land use rights transfers and/or other forms of land management within the context of a dynamic and highly commercialized agricultural environment, however, and the Nanhai RRP--if appropriately reformulated--presents an opportunity to begin this kind of reform. The mission so recommends, rather than pursue the current official thinking in Nanhai that stronger, even punitive measures, should be introduced to force farmers to participate in the RRP.

26. By way of contrast, the Pingdu RRP--in which all farmland is divided into food plots and responsibility plots--and use rights on the latter are auctioned off to competing bidders for a fixed term, appears to have been highly successful. It has fostered a reduction in fragmentation, and offers a semi-market based method for establishing land "rental" values. The biggest stage of

recruitment of villages has just been completed, bringing the proportion of villages in the county using the system to more than 90%. The features of this RRP may well provide a model for other labor deficit zones where reliance on quota grain production (rather than imports) will continue to prevail for the foreseeable future, and also--with local refinements--a general method for establishing the rental value of use rights (owed to the collective) and the value of compensation for improvements made by previous operators who have chosen to relinquish their responsibility lands.

F. REFORM OF THE RURAL ENTERPRISE SYSTEM

-Program of General Reforms

27. After China's Constitution was amended on April 12, 1988 to sanction private and other enterprise forms, a National Private Enterprise Law was promulgated in July 1988 which reconfirmed the legitimacy of enterprises operating outside of the state-owned sector and provided for their right to operate with a significant degree of freedom from local government control. This Law lays out the basic requirements for sole proprietorships and partnerships, as well as for private companies limited by shares. However, some provisions of the law are discriminatory, in that higher tax rates and stricter payment obligations apply to private enterprises than required of State- and collectively-owned firms.

28. Under the Fuyang, Anhui RRP (cf. below), a trial Non-governmental Enterprise Law has been drafted to apply both to private enterprises owned by individual citizens and to township or community-owned enterprises--the aim being to give all non-state enterprises equal status in law. This draft is expected to be implemented when approved by the provincial and local People's Congresses. The trial Insolvency ("Bankruptcy") Regulations for non-State enterprises also remains in draft form pending approval. Although both trial enactments will need to be tested in a controlled environment before national laws can be issued, the potential national significance is so great in terms of stabilizing the TVEs and establishing financial discipline in the non-State sector, that the mission strongly urges RCRD to bring as much pressure to bear as possible to have these enacted in Fuyang and to initiate testing.

-Progress in the Experimental Zones

29. The overall experimental frame appears to be spreading as RCRD now refers to four distinct models of TVE development: the Wushi (Jiangsu), Fuyang (Anhui), Wenzhou (Zhejiang) and Shishi

(Fujian) models respectively. The current concern with macroeconomic issues may not yet have had discernable impact on the growth of TVEs but the credit squeeze will undoubtedly do so. Some readjustment of policy priorities is under consideration, away from the less developed rural areas (such as Fuyang) where adjustments to the rural economic structure and the creation of off-farm jobs have been stressed, and towards the coastal regions which are better placed to develop exports and hard currency earnings. In this connection, the mission was advised that RCRD has been undertaking work with TVEs for the last two years to encourage the increased production of export commodities. This work has been concentrated in the coastal provinces of Fujian, Zhejiang, Jiangsu and Shandong. In some locales, TVEs have been given greater freedom to retain earnings and other receipts in foreign currency. The mission was gratified to learn that the formally endorsed RRP's, which essentially focus on institutional issues, are being supplemented by assistance from the RCRD through less structured (but certainly no less important) means that focus more narrowly on TVE activities in promising economic subsectors. However, because of difficulties with arranging appointments with RCRD's "Rural Enterprise" staff in Beijing, the mission was unable to complete an in-depth review of these important developments, nor of the overall rural enterprise policy framework, and requests that during the next RSAL supervision appropriate arrangements be made.

30. Formal RRP's for the development of TVEs and non-state enterprises have now been established in three areas: Fuyang Prefecture in Anhui Province, Wenzhou City in Zhejiang, and a new one in Zhebu City's Zhoucun County in Shandong Province. The emphasis in this newly introduced RRP will be on enterprise shareholding (joint stock) systems--systems designed in particular for enterprises currently owned or controlled by local governments.

31. During its visit to the Fuyang experimental zone, the mission noted that the majority of the 20 subprojects in this RRP are being implemented according to schedule. The industrial zones with their preferential policies to encourage new rural enterprises have undergone remarkable development in the last seven months. The subprojects to remove artificial restrictions in rural markets have been successful in the pilot counties and these reforms are now spreading rapidly within Anhui.

32. There are early indications that the number of enterprises, their output and profits have continued to increase at a significant rate in spite of the macroeconomic instability which also has affected Fuyang Prefecture. New enterprises are continuing to be set up to exploit new market opportunities, although there are signs that some of the markets into which TVEs first entered are reaching maturity. Fuyang's experimental zone office has introduced two new enterprise models--both for joint

ventures with foreign companies--but the enterprise structure subproject as a whole seems to be some way off from completion. Some of the RCRD staff involved in the enterprise reform subprojects have general reservations about the feasibility of a rapid introduction of "modern contractual" relationships into rural society, although China's reform growth targets would suggest that such relationships, embodied in enterprise charters and contracts, and protected by law and local courts, are both imperative and inevitable.

33. Two aspects of the Fuyang RRP give rise to concern. The first is the continued operation of the non-governmental financial service associations without a secure asset base and with potentially destabilizing lending policies. The danger of collapse and erosion of confidence is great. This is discussed in the next Section. The second is that the monitoring system is not being implemented as planned. This is discussed in Section H below.

G. INVESTMENT SYSTEM & RURAL FINANCIAL MARKETS

-Program of General Reforms

34. The mission exchanged views with RCRD staff and the State Planning Commission about the newly organized State Investment Corporations, and with RCRD on the current status and issues in China's financial system. The latter discussions focussed on rural financial markets and trial rules and regulations for the non-governmental financial service associations (NGFAs) that have proliferated of late. We also discussed concepts and issues in land banking with participants at the Zhunyi seminar on LMS reform.

35. China's rural investment system and financial markets are currently going through a difficult period in the wake of severe credit curbs imposed to constrain inflationary pressures, and recent changes in the interest rate structure which were initiated mainly to restrict the rapid draw down in deposits and to depress overall credit demand. These measures also are having an effect on the performance of the financial sector RRP's.

36. A key element of the general program for reform of the rural investment system is the formal review of rural financial market policies and preparation of trial rules and regulations for the NGFA indicated in paras. 32 and 33 of the Policy Letter. Since RCRD does not appear to have sufficient in-house resources, the mission indicated that it would recommend to Bank management that these tasks be carried out either through its economic and sector work program for China, or under future lending for agricultural credit such as the proposed Fourth Rural Credit Project. In

either event, the mission conveyed its views that involvement of the People's Bank and other major financial institutions would be required. RCRD agreed to inform the Bank of its proposals shortly.

-Progress in the Experimental Zones

37. As a result of economic uncertainty, the pace and impact of the Guanghan, Sichuan and Fuyang, Anhui RRP in rural finance have noticeably slowed down. However, in Guanghan, much progress has been made towards introducing the contract responsibility system for management of local, governmental financial institutions. The result has been a genuinely increased autonomy in decision-making and business operations, and a linking of wages/remuneration with unit performance. There are, however, several areas in which the experimental design could be strengthened, including (a) methods for determining salary and wage incentives, (b) more flexibility in the interest rate structure, (c) interbank settlement procedures and (d) the internal organization of State-owned banks. To accommodate current uncertainties, the mission recommended that contractual targets for deposits, loans and profits for individual units within the Guanghan RRP should be subjected to frequent review and adjustment, since any rigidities in this regard could quickly prove counterproductive. This is an important consideration, since the Agricultural Bank of China has already adopted the contract responsibility system nationwide, and subsequent refinements will no doubt be influenced by staff performance within its Guanghan branches. The mission also recommended that a more detailed review be undertaken early in 1989, after operational performance data for financial institutions participating in this RRP become available for the three consecutive years (1986-1988) that elapsed since implementation began.

38. The Fuyang, Anhui experiment with NGFAs still represents the main experiment under State Council guidance for broadening rural financial markets and improving their dynamism and flexibility. However, the mission noted several worrying developments which underscores the urgent need to establish sound financial standards for these institutions and delineate the broader financial sector policy issues that will have to be addressed during future expansion of the NGFA system.

39. The management, technical and financial standards of the NGFAs in Fuyang require urgent attention. These entities appear to be operating more or less without informed advice from the experimental office, and limited regulation by provincial and central banking authorities. The latter, in any event, should be positioned to encourage NGFA development without imposing undue restrictions, while at the same time monitoring the NGFA's

decisions and performance to insure that these operate according to sound financial principles. The mission found that several of Fuyang's NGFAs have been concentrating their loan portfolios on politically-mandated investments having doubtful viability, and have a financial resource structure that is nearly risk free as far as the "shareholders" are concerned. If these fail (and some of the 7 NGFAs in Fuyang are approaching insolvency), the impact on investor confidence and the reaction from the already beleaguered State banks could sweep away this important institutional innovation. The result would be a loss of a benchmark experiment in the provision of informal financial services, which could lead to an untimely postponement of benefits from the inherent flexibility which the NGFAs--if managed intelligently--can provide.

40. The establishment of the Land Financing Company (MLFC) in Meitan, Guizhou is a remarkable development since contracts for land use rights will be used for the first time to secure loans for purchasing use-rights and to support agricultural development. This is the first institution of its kind in China of which we are aware, and its evolution and performance should be monitored with interest since it could serve as a model for the future development of land banking throughout China. The MLFC's conceptual framework is sound, though additional thought needs to be given to evolving financial instruments for raising longer term capital, reducing reliance on budgetary allocations for medium- and long-term loans, and to the MLFC's lending policies per se'. The mission offered to assist with this endeavor during future RSAL supervisions and other missions to review/prepare Bank operations in China's rural financial sector.

H. MONITORING ARRANGEMENTS

41. In this subject matter area, the mission concentrated on developments within the experimental reform programs. We were given an opportunity to discuss in detail the progress being made in establishing monitoring and evaluation (M&E) systems for the Xinxiang, Yulin, Meitan, Fuyang and Guanghan RRPs, and also received some information pertaining to the Southern Jiangsu RRP. It was decided to defer extensive discussion of M&E arrangements for tracking the diffusion of reforms at the national level and for reviewing other RRPs' M&E efforts until the next supervision mission. By that time, RCRD will have prepared the first semi-annual progress report based, in part, on the M&E reports from the various experimental reform offices.

General Issues

42. There are two general issues concerning M&E arrangements for the RRP, which the mission recommends RCRD should address on fairly short order, since these arrangements are still being established and placed into effect.

- (i) It is not clear whether the need for clearly separating the M&E function from the general management function in the experimental reform offices is adequately appreciated. There is some danger that the RRP management and M&E roles of staff will become indistinguishable with a resulting lack of focus and objectivity, both needed for objective reporting and a continuity of performance on the M&E side. The issue (in all of the RRP) is really one of recognizing the need for attaching a permanent M&E unit to each of the experimental offices, having the primary purpose of ensuring that the data-gathering agencies are reporting on time with the needed information, and each provided with desktop computers and necessary budget. The mission strongly urges RCRD to give these recommendations serious consideration.
- (ii) While it is perhaps too early for definitive judgement, there are grounds for believing that M&E training for the RRP may need to include a wider audience and have greater technical content. Leaders below the county level may need to be better briefed in the objectives and methodological principles of M&E so that they in turn can ensure appropriate actions/responses by cadres and farmers. It is particularly important that the difference between M&E's information needs and the statistical agencies routine reporting formats be clearly understood and appropriate modifications be embedded in the M&E reporting formats. Greater technical ability among M&E staff to design and conduct surveys is also likely to be needed in order to cope with the (necessary) complexity of the RRP's indicator systems.

The Grain System RRP

42. In Xinxiang, good progress has been made to organize a system of monitoring indicators, but the organization for monitoring still lacks coherent organization, needed staff and financial resources, and data processing equipment to carry out M&E in a scientific and satisfactory way. Similarly, in Yulin City a monitoring system has been established, but it is not well organized and equipped. In particular, the system lacks the needed manpower and financial resources to monitor the impact of the reform, particularly on grain consumption patterns among

different income groups (there is no Urban Economic Sample Survey Team operating in Yulin City and its environs).

The Land Management RRPs

43. The effort which has gone into the design of M&E for the Meitan RRP is impressive. A land system "building, monitoring and population" research group has been set up under the auspices of Meitan's Leading Group for rural reform, and organized by Guizhou's Provincial Bureau of Statistics. This group has produced a document listing over 200 monitoring indicators in six main categories (general situation, changes in land use, attitudes/behavior/responses, economic benefits, social impacts and ecological effects). Many of these indicators require the collection of data which is not normally collected by the existing information channels. Staff recruitment is in hand to establish a network of statistical personnel at the grassroots level as well as an early warning system to detect LMS problems before they become too widespread. Some training of local leaders in M&E principles has already been undertaken and more has been programmed. Another county in Guizhou Province--Fenyang--has been selected as a control for the Meitan RRP and will provide comparative data. There is no doubt that M&E of the Meitan RRP is being taken very seriously by the authorities at both the provincial and county levels.

44. In the Southern Jiangsu RRP, leaders from 30 villages and five townships responsible for rural economic management have attended a training session on data collection, having particular reference to the monitoring of performance indicators during the 1988 Autumn harvest. It appears that a format for M&E reporting has been developed, but the mission was not able to review a copy at the time of the briefing.

The Rural Enterprise RRPs

45. The mission was only able to review M&E arrangements for the Fuyang RRP, which are much less satisfactory than those reported above. The decision to place responsibility for subproject coordination and monitoring with the various counties concerned, and staff shortages in the experimental office have led to the abandonment of plans to carry out some important enterprise surveys. There also appears to have been no systematic effort made (yet) to monitor the effectiveness of prefecture-wide changes in certain key policies or administrative actions taken as part of the reform program. For example, the impact of new regulations and procedures to reduce interference by local cadres in the operation of free markets has not been systematically checked, nor has anyone followed-up applications for model enterprise charters to see the extent to which the new charters

are actually being used. This failure/inability to monitor RRP "inputs" is potentially quite serious and should be urgently rectified.

The Financial Market Experiments

46. Monitoring systems for the two financial sector experiments (i.e. Guanghan, and Fuyang) are presently being set-up with RCRD's assistance. Detailed reporting formats are being finalized by the local experimental offices, which RCRD intends to append to the first semi-annual progress report to the Bank next January.

47. The mission was informed that M&E in the Guanghan RRP will focus both on quantitative and qualitative assessments of the financial performance of the involved intermediaries and staff productivity improvements. M&E will be based on semi-annual reports from the specialized banks and annual reports from nonbanking financial service companies. The socioeconomic impact of the RRP and exogenous macro- effects on the performance of participating institutions will be assessed annually based on statistical information compiled by the local statistical office, supplemented by special surveys. The M&E indicators will fall under three broad headings:

- (i) overall monetary indicators,
- (ii) financial performance indicators, and
- (iii) miscellaneous quantitative indicators.

The analytical (and reporting) frames would be by type of participating institution. In this connection, the mission recommended that the current four-category format be revised as follows to better reflect the nature of the participating institutions, viz. state-owned specialized banks, nonbanking state-owned financial institutions, collective institutions, and credit organizations which do not provide services to the general public (e.g. cooperative funds). The mission also urged that a systematic attempt be made to isolate the effects of inflation and macro-level policy directives from effects deriving from the design of the RRP, when monitoring unit performance and staff incentive systems.

48. Monitoring arrangements for Fuyang's NGFAs are still being devised. The mission was informed that the experimental office at Fuyang (which needs to be strengthened) plans to monitor the three initial NGFAs set up under the RRP, using financial indicators such as increases in deposits, loans and profits, and miscellaneous quantitative indicators. The experimental office also would review progress made in refining "stocks and

ownership" concepts, and the introduction of financial standards for the NGFAs banking operations.

I. DISBURSEMENTS

49. As of November 21, 1988, the equivalent of about US\$ 243.0 million have been disbursed from the loan and credit, leaving respective balances of about US\$ 57.0 million in the loan account and a zero balance in the credit account. This represents an extremely rapid draw down of loan and credit proceeds, which were expected to disburse over a 12 to 18 month period. On the other hand, the urgency for rapid draw down is appreciated in view of the pressures being placed on China's foreign accounts and domestic budgetary resources. (The possibility that part of the counterpart proceeds may be allocated to specific and scheduled budgetary expenditures for agriculture development is endorsed.)

50. Thus far, a total of ten withdrawal applications have been received, of which the first nine have been accepted and disbursed against, save for payments made before the loan was signed (cf. below), and a few items where inconsistencies showed in the withdrawal applications. The Ministry of Finance has been notified of details. Further, the proceeds of Category 3 in the loan and credit agreements have been reallocated to Category 1 as per MOF's telexed request of September 19, 1988. However, disbursements against Application No.10 are being withheld to retain undisbursed amounts sufficient to reimburse ICB procurement of an amount "at least not less than US\$ 50 million" as indicated in MOF's telex to the Bank's Director of China Operations dated October 7, 1988.

51. We regret that some confusion was caused by the Bank's disbursement letter for this operation, which stated that payments made after May 18, 1988 would be eligible for reimbursement. As with investment project agreements, however, the Bank's General Conditions are the legal referent--as indicated in Section 1.01 of the RSAL's Loan and Credit Agreements. (These stipulate that only payments after the date of Loan/Credit signing (July 15, 1988) are eligible for reimbursement unless retroactive financing has been authorized. Retroactive financing was neither applied for nor authorized for the China-RSAL.) The mistake occurred because of end-fiscal year pressures...we apologize for the inconvenience this may have caused.

J. PROCUREMENT

52. During appraisal and loan negotiations for the RSAL, it was generally understood that procurements in the amount of US\$ 125-150 million would be carried out under the loan/credit using serial international tendering ("serial ICB") procedures. It was further anticipated that these tendering procedures would be used mainly for fertilizer procurements by China's Chemical Industries Import-Export Corporation, known as SINOCHEM. This seemed an appropriate arrangement, given SINOCHEM's preeminent position in China's fertilizer imports vis-a-vis other importers such as the International Tendering Corporation.

53. Further, we appreciate that a genuine attempt was made by the RCRD and CATIC to implement these procedures: first, through advertisement in the Development Business section of "Development Forum", and second, through notifications to foreign embassies in Beijing. But we were advised that only 9 requests for registration applications were received, and only two had been returned by end-September. This is puzzling, since fully two and one-half months had elapsed since the advertisements and notifications were issued.

54. The mission was advised that SINOCHEM is reluctant to attempt serial ICB in the face of rising fertilizer prices. The mission emphasized that this argument is somewhat specious, and referred to the recent Indian fertilizer procurement experience under its Emergency Drought Relief Loan. (Like China, India is a major fertilizer importer--capable of influencing prices if careless procurement is practiced.)

55. However, we were gratified to learn that Government intends to procure at least US\$ 50 million under the RSAL using serial ICB procedures, though it is unfortunate that more will not be attempted in view of the savings that normally are associated with ICB procurements. We also are concerned with SINOCHEM's ability to continue to operate as a trading company under the current stringent financial conditions, rather than behave more responsibly as one of the Government's most important procurement agencies.

K. SEMIANNUAL REPORTS

56. It was understood during loan negotiations that semiannual reports for the RSAL would be furnished commencing January 1989. A format was presented by RCRD during the mission's visit, which will be more than adequate. The mission suggested, however, that additional sections be added to encompass the monitoring arrangements being set up for the RRP's, including a summary of

procurement and disbursement activity under the loan and credit agreements.

L. NEXT SUPERVISION

57. The scope of the next supervision must necessarily be more comprehensive than the present one was. Originally scheduled to visit China in February 1989, we propose to postpone the next mission to May or June of 1989, to give sufficient time to RCRD and authorities in the experimental zones to implement changes and improvements currently being considered. Mandated by a need to review the impact of macroeconomic adjustment measures being adopted by the State Council, and with the benefit of more elapsed time for implementing the RRP's, the next mission would also carry out the formal program review scheduled during Loan Negotiations for May/June 1989. It thus will be expected to review progress with the overall reforms in greater detail, as well as visit RRP's not reviewed during this first supervision. A corollary responsibility would be to discuss a format and design for the proposed Second RSAL.

58. In spite of current setbacks, China's rural reform endeavors have global importance. We in the Bank are convinced that RCRD's programs will succeed, that the momentum for rural reform can not be reversed, and feel privileged to assist with this historically significant undertaking. We only hope that the current instability will be viewed in China as presenting an opportunity: one which can be used to set in place previously unpalatable reforms to enable China to move more squarely towards indirect macro-management and control of rural economic activities. The reverse, a wholesale retreat to traditional administrative measures, would merely destabilize the rural economy. It would impede the operation of forces already unleashed without being able to bring these under some form of indirect regulation, and thus would likely aggravate current macroeconomic problems. Worse, such measures would most definitely postpone progress towards meeting the needs of a Socialist Market Economy.

Richard Burcroff II
 Richard Burcroff II
 World Bank Mission Leader
 December 16, 1988

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-SUBJECT: RURAL SECTOR ADJUSTMENT LOAN (LOAN 2967-CHA,
-CREDIT-1932-CHA): SEPTEMBER-NOVEMBER 1988 SUPERVISION.
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REF RURAL SECTOR ADJUSTMENT LOAN (LOAN 2967-CHA, CREDIT 1932-CHA): SEPTEMBER-NOVEMBER 1988 SUPERVISION.

AAA EYE AM SENDING THIS TELEX TO CONFIRM POINTS MADE BY THE SUPERVISION MISSION DURING WRAP-UP MEETINGS WITH SENIOR OFFICIALS FROM THE RCRD, CATIC AND REPRESENTATIVES OF THE MOF. OUR MAIN RECOMMENDATIONS HAVE BEEN CONVEYED IN GREATER DETAIL BY THE MISSION'S AIDE-MEMOIRE, AND IN A SEPARATE LETTER TO FOLLOW.

BBB THE MISSION WAS VERY WELL RECEIVED AND WISHES TO THANK RCRD AND CATIC FOR ARRANGEMENTS MADE AND FOR AN EXTREMELY VALUABLE EXCHANGE OF VIEWS. THE MISSION'S PRINCIPAL TASKS WERE TO

(1) REVIEW THE STATUS OF THE OVERALL PROGRAM OF RURAL REFORM, AS DETAILED IN PART III OF THE STATEMENT OF RURAL REFORM POLICIES,

(2) UPDATE THE BANK'S KNOWLEDGE OF DEVELOPMENTS IN THE EXPERIMENTAL REFORM AREAS, AND

(3) ADVISE ON MATTERS ARISING CONCERNING THE UTILIZATION OF LOAN AND CREDIT PROCEEDS, PROCUREMENT PROCEDURES AND DISBURSEMENTS.

CCC THE SUPERVISION TOOK PLACE DURING A PERIOD OF ECONOMIC REASSESSMENT IN CHINA, BUT THE MISSION WAS GRATIFIED TO LEARN THAT THE MOMENTUM FOR RURAL REFORM IS CONTINUING AND THAT NINE ADDITIONAL (AND TIMELY) EXPERIMENTAL PROJECTS HAVE BEEN ENDORSED FOR IMPLEMENTATION UNDER RCRD'S GUIDANCE.

DDD PERHAPS THE MOST IMPORTANT DEVELOPMENT HAS BEEN THE EXCELLENT PROGRESS MADE TO IMPLEMENT THE EXPERIMENTAL REFORMS REVIEWED WHILE THE RSAL WAS BEING PREPARED. THIS UNDERSCORES A POINT OF VIEW CONSISTENTLY MAINTAINED BY THE RCRD--THAT THE DESIRE FOR REFORM HAS BEEN FIRMLY IMPLANTED AT THE GRASSROOTS LEVEL AND CAN NO LONGER BE REVERSED. ON THE OTHER HAND, IMPLEMENTATION OF THE OVERALL PROGRAM HAS BEEN A BIT DISAPPOINTING, ESPECIALLY IN THE AREAS OF GRAIN PROCUREMENT AND MARKETING, AND OF INCENTIVES FOR RURAL INDUSTRIALIZATION. HOWEVER, WE APPRECIATE THAT THE SLOWDOWN STEMS DIRECTLY FROM A PERCEIVED CRISIS IN THE GRAIN SECTOR, AND FOR THE TVES, FROM A CONCERN THAT THE FREEZE ON OFF-PLAN INVESTMENTS MAY BE DIFFICULT TO ENFORCE. WE WOULD WELCOME AN OPPORTUNITY TO DISCUSS THESE SUBJECTS WITH YOU AT YOUR CONVENIENCE.

EEE WITH REFERENCE TO FIVE AREAS OF RURAL REFORM RECORDED IN PART III OF THE STATEMENT OF RURAL REFORM POLICIES, THE MISSION REVIEWED THE MORE IMMEDIATE GENERAL UNDERTAKINGS RECORDED THEREIN AND ON PROGRESS IN THE EXPERIMENTAL ZONES. ITS REVIEW ENCOMPASSED FOUR OF THE OF THE FIVE MAIN AREAS OF REFORM (PRICE REFORM, LAND MANAGEMENT SYSTEM, RURAL ENTERPRISE REFORM AND RURAL INVESTMENT SYSTEM), BUT THE MISSION WAS NOT STAFFED TO REVIEW RURAL MARKETING COOPERATIVES.

FFF PROGRAM OF OVERALL REFORMS:

(1) IN THE AREA OF PRICE REFORM, THE MISSION FOCUSED ON GRAIN PRICING AND MARKETING, AND IS CONCERNED THAT THE RECENT DECISION TO REIMPOSE ADMINISTRATIVE CONTROLS IN 1989 MAY REPRESENT A MAJOR STEP AWAY FROM THE DEVELOPMENT OF THE MARKET SYSTEM, WITHOUT REALLY ADDRESSING THE BINDING ISSUE OF THE REMAINING SUBSIDIES. CLEARLY THE GOVERNMENT'S ABILITY TO STABILIZE AGRICULTURAL PRICING WILL INFLUENCE THE TRANSITION TOWARDS MACROECONOMIC BALANCE AND AFFECT ITS PACE, BUT THE BANK FEELS STRONGLY THAT THIS SHOULD CONTINUE TO BE ACCOMPANIED BY STRONG INCENTIVES TO ENCOURAGE PRODUCTION (INCLUDING GRAIN), RATIONALIZE CONSUMER SUBSIDIES, AND RENDER MORE BUOYANT, TRANSPARENT AND EFFECTIVE THE RESOURCE MOBILIZATION REQUIRED TO FINANCE ADJUSTMENTS IN THE GRAIN SYSTEM. IN THIS REGARD, WE WOULD ONLY HOPE THAT THE CURRENT INSTABILITY IS VIEWED AS PRESENTING AN OPPORTUNITY: ONE WHICH CAN BE USED TO SET IN PLACE PREVIOUSLY UNPALATABLE REFORMS TO ENABLE CHINA TO MOVE MORE SQUARELY TOWARDS INDIRECT MACRO-MANAGEMENT AND THE INDIRECT REGULATION OF THE GRAIN SYSTEM AND RELATED RURAL ECONOMIC ACTIVITIES.

(2) THE MISSION WAS INVITED TO ATTEND A CONFERENCE ON REFORM OF THE LAND MANAGEMENT SYSTEM IN ZHUNYI CITY. THIS PROVIDED EXTREMELY VALUABLE INSIGHTS INTO THE NATURE OF THE CURRENT DEBATE IN CHINA, AND THE VARIETY OF APPROACHES BEING CONSIDERED. THE NEED TO REPLACE THE CURRENT SYSTEM WITH REGIONALLY TAILORED SYSTEMS FOR ALLOCATING LAND USE RIGHTS WAS CLEARLY APPRECIATED, EACH ADDRESSING THE DIFFICULT TRADE-OFF BETWEEN ALLOCATIVE EFFICIENCY AND EQUITY/EMPLOYMENT ON THE BASIS OF REGIONAL PARTICULARS, BUT ALL FEATURING A MUCH LARGER ROLE FOR MARKET FORCES. THE MISSION ENDORSES BOTH THE THRUST AND THE FLEXIBILITY OF THIS APPROACH. THE SEMINAR ALSO RECOGNIZED THAT ROOM FOR MANOEUVRE IN LAND SYSTEM REFORM IS PRESENTLY CONSTRAINED BY AGRICULTURAL PRICING AND MARKETING POLICIES, ESPECIALLY FOR GRAINS.

(3) REFORM OF THE RURAL ENTERPRISE SYSTEM, PARTICULARLY, COULD BECOME HOSTAGE TO CURRENT ATTEMPTS TO RESTRAIN OFF-PLAN INVESTMENTS.

WHILE SOME TVES HAVE BEEN TOO RESPONSIVE TO LOCAL INTERESTS IN THEIR USE OF CREDIT AND OTHER INVESTIBLE FUNDS, MANY THAT HAVE BEEN OBSERVED BY RSAL-RELATED MISSIONS (AND OTHER BANK MISSIONS) APPEAR TO BE FINANCIALLY SOUND AND RESPONSIBLE. AN INDISCRIMINATE CUTBACK IN OFF-PLAN INVESTMENTS, WHICH CHINA SEEMS TO BE IMPOSING AT THE MOMENT, COULD FORCE SOME OF THE POTENTIALLY (OR ACTUALLY) STRONGER ONES INTO LIQUIDATION ALONGSIDE THE LESS VIABLE TVES, THUS HAVE UNDESIRABLE LONGER TERM CONSEQUENCES ON THE FUTURE DEVELOPMENT ON THIS IMPORTANT ECONOMIC SECTOR. FURTHER, IF CONFIDENCE IS LOST IN THE TVE SECTOR, AND ONLY A SLUGGISH RECOVERY ENSUES, THE ACROSS THE BOARD CUT-BACK COULD HAVE VERY DAMAGING IMPACT ON THE ATTAINMENT OF CHINA'S RURAL OFF-FARM EMPLOYMENT OBJECTIVES. WE THEREFORE URGE GOVERNMENT TO ADOPT A MORE BALANCED APPROACH, ONE WHICH REMOVES THE DISCRIMINATION AGAINST COLLECTIVELY AND PRIVATELY OWNED BUSINESS ENTERPRISES, AND SETS IN PLACE RULES GOVERNING INVESTMENTS THAT APPLY EQUALLY TO TVES AND THE STATE-OWNED ENTERPRISE SECTOR.

THE MISSION WAS ADVISED THAT RCRD HAS EXPRESSED RESERVATIONS

CONCERNING THE NATIONAL PRIVATE ENTERPRISE REGULATION PROMULGATED IN JULY 1988, AND HAS DRAFTED TRIAL NON-GOVERNMENTAL ENTERPRISE REGULATIONS WHICH, TOGETHER WITH THE TRIAL INSOLVENCY REGULATIONS, WILL BE TESTED IN ANHUI PROVINCE ONCE APPROVAL BY THE PROVINCIAL AND LOCAL PEOPLE'S CONGRESSES HAS BEEN GIVEN. WE BELIEVE THAT THE POTENTIAL NATIONAL SIGNIFICANCE OF THESE TRIAL REGULATIONS IS QUITE FAR-REACHING. IF TESTED SUCCESSFULLY, THESE MAY DEMONSTRATE WAYS BY WHICH CHINA CAN CREATE A POLITICALLY VIABLE BUSINESS ENVIRONMENT, CONDUCIVE TO STABILIZING THE TVES AND ESTABLISHING (THROUGH INDIRECT MEANS) FINANCIAL DISCIPLINE IN THE NON-STATE OWNED SECTOR. TO ENABLE TESTING TO BEGIN, WE THEREFORE URGE RCRD TO SEEK AN EARLY APPROVAL OF THESE REGULATIONS IN ANHUI.

(4) IN CONNECTION WITH REFORM OF THE RURAL INVESTMENT SYSTEM, THE MISSION EXCHANGED VIEWS WITH (A) RCRD AND THE STATE PLANNING COMMISSION ABOUT THE NEWLY ORGANIZED STATE INVESTMENT CORPORATIONS, (B) WITH CATIC ABOUT ITS BUSINESS PLAN (WHICH THE BANK ENDORSES-- AND INDEED IS GRATIFIED THAT CATIC HAS MADE A STRONG START), AND (C) WITH RCRD AND SEVERAL STATE-OWNED BANKS: THE CURRENT STATUS OF CHINA'S RURAL FINANCIAL MARKETS AND ISSUES CONCERNING THE NON-GOVERNMENTAL FINANCIAL SERVICE ASSOCIATIONS (NGFA'S) THAT HAVE PROLIFERATED OF LATE. THE MISSION ALSO DISCUSSED CONCEPTS AND ISSUES IN LAND BANKING.

-A KEY ELEMENT OF THE GENERAL REFORM OF THE RURAL INVESTMENT SYSTEM IS THE FORMAL REVIEW OF RURAL FINANCIAL MARKET POLICIES AND PREPARATION OF TRIAL RULES AND REGULATIONS FOR THE NGFA'S INDICATED IN PARAS. 32 AND 33 OF THE POLICY STATEMENT. SINCE THE MISSION WAS ADVISED THAT RCRD DOES NOT APPEAR TO HAVE SUFFICIENT IN-HOUSE RESOURCES, THE BANK WOULD BE PLEASED TO SUPPORT THESE ACTIVITIES AS A COMPONENT IN THE PROPOSED FOURTH RURAL CREDIT PROJECT OR THROUGH OTHER MEANS. THE MISSION ALSO CONVEYED ITS VIEWS THAT INVOLVEMENT OF THE PEOPLE'S BANK OF CHINA AND OTHER MAJOR FINANCIAL INSTITUTIONS WOULD LIKELY BE REQUIRED. RCRD'S OFFICIALS AGREED TO INFORM THE BANK SHORTLY OF ITS PROPOSALS.

-THE ESTABLISHMENT OF THE MEITAN LAND FINANCING COMPANY IS A REMARKABLE DEVELOPMENT. THIS IS THE FIRST INSTITUTION OF ITS KIND IN CHINA OF WHICH WE ARE AWARE, AND ITS EVOLUTION AND PERFORMANCE SHOULD BE MONITORED WITH INTEREST SINCE IT COULD SERVE AS A MODEL FOR THE FUTURE DEVELOPMENT OF LAND BANKING THROUGHOUT CHINA.

GGG PROGRESS IN THE EXPERIMENTAL ZONES:

WITH THE EXCEPTION OF THE LAND SYSTEM EXPERIMENT IN NANHAI, GUANGDONG AND THE NGFA PART OF THE FUYANG EXPERIMENT, PROGRESS WITH IMPLEMENTING THE PROGRAM OF EXPERIMENTAL REFORMS HAS BEEN QUITE GOOD. TWO GENERAL PROBLEMS, HOWEVER, ARE MORALE AND INADEQUATE FINANCING. OUR MAIN RECOMMENDATIONS ARE THE FOLLOWING:

(1) MORALE HAS EMERGED AS A PROBLEM, PARTICULARLY IN THE XINXIANG, HENAN AND YULIN, GUANGXI GRAIN SYSTEM REFORMS, RESULTING FROM UNCERTAINTIES ASSOCIATED WITH THE CURRENT ECONOMIC CLIMATE AND THE GOVERNMENT'S APPARENT STEP BACKWARDS IN NATIONAL GRAIN SYSTEM POLICIES. WE STRONGLY URGE THAT THE STATE COUNCIL REAFFIRM ITS INTENTION TO SEE THESE EXPERIMENTAL PROGRAMS THROUGH, WHICH WOULD

PROVIDE NEEDED REASSURANCE TO LOCAL PROGRAM OFFICIALS. WE FURTHER RECOMMEND THAT THE FREQUENCY OF VISITS BY RCRD'S STAFF TO THE YULIN AREA BE INCREASED, SINCE THEY ARE ABOUT TO PREPARE PHASE II OF THE REFORM AND REQUIRE TECHNICAL ADVICE AND SUPPORT.

(2) IMPLEMENTATION FINANCING HAS BECOME AN ISSUE IN MOST OF THE EXPERIMENTAL PROGRAMS. PARTICULARLY AFFECTED ARE (A) THE MONITORING AND EVALUATION COMPONENTS OF EACH PROJECT, WHICH REMAIN INADEQUATELY STAFFED AND POORLY EQUIPPED (AND ARE VIRTUALLY NONOPERABLE UNDER ARRANGEMENTS MADE FOR THE FUYANG EXPERIMENT), ALTHOUGH GOOD PROGRESS IS BEING MADE WITH INITIAL STAFF TRAINING AND THE IDENTIFICATION OF MONITORING INDICATORS, AND (B) THE BASIC SUSTAINABILITY OF THE XINXIANG AND YULIN EXPERIMENTAL PROGRAMS. WE RECOMMEND THAT THE BUDGETARY RESOURCES FOR M & E IN ALL OF THE PROGRAMS, AND THE GENERAL BUDGET AND PRODUCTION INPUT ALLOCATIONS FOR THE GRAIN SYSTEM EXPERIMENTS BE SUBSTANTIALLY AUGMENTED AS SOON AS POSSIBLE.

(3) THE EXPERIMENTAL REFORM IN GUANGZHOU'S NANHAI COUNTY SIMPLY IS NOT WORKING. THE LURE OF OFF-FARM EMPLOYMENT AND RETURN TO THE PRODUCTION OF VEGETABLES AND OTHER HIGH-VALUED CROPS (WHERE GAINS FROM LAND CONSOLIDATION WOULD IN ANY EVENT BE MARGINAL) SUGGEST THAT THE LOCAL AUTHORITIES ARE TRYING TO IMPLEMENT AN INAPPROPRIATE EXPERIMENTAL DESIGN. THERE DOES APPEAR TO BE A NEED, HOWEVER, TO EXPERIMENT WITH LAND USE RIGHT TRANSFERS AND/OR OTHER FORMS OF LAND MANAGEMENT IN THE CONTEXT OF A DYNAMIC AND HIGHLY COMMERCIALIZED AGRICULTURAL ENVIRONMENT, SUCH AS NANHAI'S. THE NANHAI EXPERIMENTAL PROGRAM, IF APPROPRIATELY REFORMULATED, PRESENTS AN OPPORTUNITY TO BEGIN THIS KIND OF REFORM. THE MISSION SO RECOMMENDS, RATHER THAN IMPOSE STRONGER, EVEN PUNITIVE, MEASURES TO COERCE PARTICIPATION BY FARMERS IN THE "SCALE OPERATION" REFORM AT NANHAI.

(4) WITHIN THE FUYANG EXPERIMENTAL PROGRAM, THE MANAGEMENT, TECHNICAL AND FINANCIAL STANDARDS OF THE NGFAS REQUIRE URGENT ATTENTION. THESE ENTITIES APPEAR TO OPERATING WITHOUT INFORMED ADVICE FROM THE EXPERIMENTAL OFFICE, AND LIMITED REGULATION BY PROVINCIAL AND CENTRAL BANKING AUTHORITIES. THE MISSION FOUND THAT SEVERAL OF FUYANG'S NGFAS HAVE CONCENTRATED THEIR LOAN PORTFOLIOS ON POLITICALLY-MANDATED INVESTMENT HAVING DOUBTFUL VIABILITY, AND HAVE A FINANCIAL RESOURCE STRUCTURE WHICH COULD QUICKLY EVAPORATE SHOULD "SHAREHOLDER" CONFIDENCE TURN SOUR. IF THESE ENTITIES FAIL (AND SOME OF THE NGFAS IN FUYANG ARE APPROACHING INSOLVENCY), THE IMPACT ON INVESTOR AND DEPOSITOR CONFIDENCE, AND REACTION FROM THE ALREADY BELEAGUERED STATE BANKS COULD SWEEP AWAY THIS IMPORTANT INSTITUTIONAL INNOVATION (WHICH IS ANOTHER REASON FOR DEVELOPING TRIAL RULES AND REGULATIONS FOR NGFAS AS SUGGESTED IN PARA. FFF (4) ABOVE).

HHH DISBURSEMENT OF LOAN/CREDIT PROCEEDS: AS OF NOVEMBER 22, 1988, THE EQUIVALENT OF ABOUT USDOLLAR 236 MILLION HAVE BEEN DISBURSED FROM THE RSAL, LEAVING RESPECTIVE BALANCES OF ABOUT USDOLLAR 57 MILLION IN THE LOAN ACCOUNT, AND A ZERO BALANCE IN THE CREDIT ACCOUNT. THE LATTER WAS OFFICIALLY CLOSED ON OCTOBER 17, 1988 BY RECENT LETTER FROM MR. BURKI TO THE MINISTER OF FINANCE. THIS REPRESENTS AN EXTREMELY RAPID DRAW DOWN OF LOAN AND CREDIT

PROCEEDS, WHICH WERE EXPECTED TO DISBURSE OVER A 12-18 MONTH PERIOD. ON THE OTHER HAND, THE URGENCY FOR RAPID DRAW DOWN IS APPRECIATED IN VIEW OF PRESSURES BEING PLACED ON CHINA'S FOREIGN ACCOUNTS AND DOMESTIC BUDGETARY RESOURCES.

III PROCUREMENT PROCEDURES: DURING LOAN NEGOTIATIONS, IT WAS GENERALLY UNDERSTOOD THAT PROCUREMENTS IN THE NEIGHBORHOOD OF US\$125 MILLION WOULD BE CARRIED OUT USING SERIAL INTERNATIONAL COMPETITIVE BIDDING PROCEDURES. IT WAS FURTHER ANTICIPATED THAT THESE PROCEDURES WOULD BE USED MAINLY FOR FERTILIZER PROCUREMENTS BY THE SINOCEM. ALTHOUGH RCRD AND CATIC MADE A CONSIDERED EFFORT TO IMPLEMENT THESE PROCEDURES, THE MISSION WAS ADVISED THAT SINOCEM REMAINS LESS THAN ENTHUSIASTIC ABOUT USING SERIAL ICB. HOWEVER, WE WERE GRATIFIED TO LEARN THAT GOVERNMENT INTENDS TO PROCURE AT LEAST US\$50 MILLION UNDER THE RSAL USING SERIAL TENDERING PROCEDURES, THOUGH IT IS UNFORTUNATE THAT MORE WILL NOT BE ATTEMPTED IN VIEW OF THE SAVINGS NORMALLY ASSOCIATED WITH INTERNATIONAL COMPETITIVE BIDDING.

JJJ IT WAS UNDERSTOOD DURING LOAN NEGOTIATIONS THAT SEMIANNUAL REPORTS FOR THE RSAL WOULD BE FURNISHED COMMENCING JANUARY 1989. A FORMAT WAS PRESENTED BY RCRD DURING THE MISSION'S VISIT, WHICH WILL BE ACCEPTABLE SUBJECT TO A FEW SUGGESTIONS MADE BY THE MISSION DURING ITS REVIEW.

KKK ORIGINALLY SCHEDULED TO VISIT CHINA IN FEBRUARY, 1989, WE PROPOSE TO POSTPONE THE NEXT FORMAL SUPERVISION UNTIL MAY/JUNE 1989 TO PROVIDE RCRD AND EXPERIMENTAL ZONE AUTHORITIES WITH SUFFICIENT TIME TO IMPLEMENT CHANGES IN PROGRAM DESIGN CURRENTLY BEING CONSIDERED. IF THIS PROPOSAL IS ACCEPTABLE, THE NEXT MISSION ALSO WOULD CARRY OUT THE PROGRAM REVIEW SCHEDULED FOR MAY/JUNE, AND INITIATE FORMAL IDENTIFICATION OF THE PROPOSED SECOND RSAL.

LLL IN SPITE OF CURRENT SETBACKS, WE IN THE BANK ARE CONVINCED THAT THE RURAL REFORM ENDEAVORS SUPPORTED BY THE RURAL SECTOR ADJUSTMENT LOAN WILL SUCCEED, AND FEEL PRIVILEGED TO ASSIST WITH THIS HISTORICALLY SIGNIFICANT UNDERTAKING. BUT SHOULD THE APPARENT RETREAT TO TRADITIONAL ADMINISTRATIVE MEASURES MEASURABLY CURTAIL THE MOMENTUM FOR REFORM, WE ARE FEARFUL SUCH WILL MERELY AGGRAVATE THE OPERATION OF ECONOMIC FORCES ALREADY UNLEASHED IN RURAL AREAS WITHOUT BEING ABLE TO SECURE AN EFFECTIVE COORDINATION OF THESE FORCES. THE POSSIBLE CONSEQUENCES FOR REGAINING MACROECONOMIC STABILITY AND FOR DEVELOPING THE SOCIALIST MARKET ECONOMY ARE RATHER WORRISOME.

WITH WARM PERSONAL REGARDS. JOSEPH R. GOLDBERG, DIVISION CHIEF, CHINA AGRICULTURAL OPERATIONS, ASIA REGIONAL OFFICE, WORLD BANK.

Rural Sector Adjustment Loan
Status of Compliance With Loan Covenants: 12/88

<u>Loan No.:</u> 2967-CHA <u>Credit No.:</u> 1932-CHA <u>Amount:</u> US\$200.0 million SDR 72.2 million	<u>Completion Date:</u> -na- <u>Closing Date:</u> July 31, 1990
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<u>Covenants</u>	Status ----- Yes No N/A	Remarks
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CREDIT AGREEMENT

Section 1.01. Govt to submit PCR not later than six months after closing date (07/31/90)	XX	
Section 3.01 (a). IDA to review program with Govt not later than June 30, 1989.	XX	Formal program review scheduled 05/15/89.
Section 3.01 (b). Govt to furnish progress report prior to exchange of views.	XX	Format agreed. 1st report to be submitted 01/31/89
Section 3.03. Govt to submit not later than June 30, financial statement audited by independent auditors.	XX	First report due 06/30/89.

LOAN AGREEMENT

Section 1.01. PCR: same as Section 1.01 of Credit Agreement.

Section 3.01. Program Review: same as C.A. Section 3.01 (a).
 Progress Report: same as C.A. Section 3.01 (b).
 Accounts & Audit: same as C.A. Section 3.03.

CHINA

RURAL SECTOR ADJUSTMENT LOAN

Post-Effectiveness Supervision Mission (Sept.-Nov. 1988)

DRAFT PARAGRAPHS FOR THE PRESIDENT'S STATUS REPORT

1. Declared effective on September 19, 1988, the loan and credit were offered to support a package of national and regional initiatives to restructure China's agricultural land management system, grain system, the business environment for rural enterprises, rural financial markets, and cooperatives' marketing policies. The Statement of Rural Reform Policies indicated that reforms to national policies would be prepared during 1988, for implementation during 1989 and 1990. The regional reforms, in the form of 12 "experimental" programs (RRPs), would either be initiated in 1988, or--for ongoing ones--move into their second phase. It was further agreed that monitoring systems would be developed for the regional reform programs along lines suggested by the Bank.

2. The 1988 program was generally implemented on schedule. Among national policies, a framework for national land management regulations was established (to be enacted in 1989), and national Private Enterprise Regulations were issued in July, 1988. Ten of the 12 RRPs were implemented smoothly, and an additional nine have been endorsed for implementation since the Loan/Credit Agreements were signed. As a result of the Government's recent stabilization policies, however, an overall reform of grain pricing and marketing (scheduled for 1989) could be postponed, while the restructuring of the business environment for rural enterprises could be set-back.

CHINA

RURAL SECTOR ADJUSTMENT LOAN

POST-EFFECTIVENESS SUPERVISION MISSION

Progress With Implementing The Land Management Reforms

by- Martin C. Evans (C)

CHINAPROGRESS WITH IMPLEMENTING THE LAND MANAGEMENT REFORMSA. The Land Management System Conference at Zunyi City

1. During September 20-24, 1988, RCRD organized a major conference in Zunyi City, Guizhou Province to discuss all aspects of land management system reform. The primary purpose of the conference was to consider how, without violating the basic principle of public land ownership, progress towards a socialist commodity economy could be speeded up by using land transfer mechanisms as an important means to achieving greater agricultural productivity. Presided over by the Deputy Director-General of RCRD and chaired by the Director of RCRD's Experimental Programs Office, the seminar was attended by academics, researchers and government leaders at various levels from all over China as well as RCRD staff. A declared intention was the airing of diverse views, criticism, suggestions, etc on both the theoretical and practical aspects of land management reform in order that the full range of policy options could be explored, though broad agreement on a general policy framework was achieved. Consensus and conclusions were not sought at this stage. The venue for the conference had been chosen to allow participants to see at first hand the policy reform experiment being undertaken in nearby Meitan county, the first Experiment Area (EA) to be officially declared.
2. Reports on all five of the land management system RRP's -- Meitan, Guizhou; Southern Jiangsu; Pingdu, Shandong; Shunyi, Beijing and Nanhai, Guangdong; -- were presented first by leading local figures involved. These were followed by presentations dealing with general issues concerning property rights and land ownership in the context of a developing economy given by speakers from Beijing and Nanjing Universities, the CP Central Committee's Senior Cadre Training School, the Ministry of Agriculture, the Chinese Academy of Social Sciences, the State Land Administration, Guizhou Agricultural College and RCRD. A particularly profound and penetrating analysis of the political economy of property rights in a historical Chinese and in an international context was given by a research fellow of the Development Institute. The plenary sessions were followed by discussions among subgroups of participants on certain issues, these deliberations being reported to the whole assembly at the end of the conference.
3. The conference afforded valuable insights into the nature of the current debate in China on land management issues and the variety of approaches being considered. Though there is disagreement as to which level within the "collective" land ownership should be vested, and about just how much "freedom" farmers should be allowed to have in land use decisions, there is clearly widespread acceptance of the need to replace present administrative procedures for allocating land use among households and economic activities by a system which allows a much greater role for market forces. However, confusion over asset ownership in general under the new institutions which are emerging as successors to the commune structure of administration pose

problems for the land system changes as they do for other areas of reform. It is also recognized that room for maneuver is constrained by agricultural pricing and marketing policies and food security strategy and that, conversely, the options available for reforming these policies are themselves partly defined by the potential impact of land management reform on agricultural productivity. The conference left the observer with the strong impression that efficiency objectives in land management are of paramount concern to the Chinese leadership and that while every effort will be made to minimize any negative distributional effects of reforms in this area, some trade-off will be accepted as inevitable.

B. The Meitan RRP

4. Highlights of the Meitan RRP which were emphasized to the Mission include:

- (a) the link between entitlement to land and individual household size has been severed in 1988, with any new land available for redistribution now offered through a bidding process--this was seen as one way of preventing land fragmentation as well as encouraging agricultural specialization;
- (b) a land bank has been established to provide individual farmers or farmer groups with the means to finance long-term agricultural development and land improvement and thus, indirectly, facilitate land transfers to the more enterprising and capable farmers;
- (c) reclamation/development of unexploited hill land is a key feature of Meitan's land management reform strategy since this could absorb the 'surplus' labor on under-sized or under-performing farms in the lowlands; and
- (d) a recognition that reforming land institutions by itself will not be enough to sustain agricultural growth in a commodity economy. Meitan's price system also had to change to allow the demand for farm products to be reflected in land values.

Implementing the Land Transfer Facility

5. Representatives from the Provincial Land Management Bureau visited Meitan in November 1988 to supervise the issuing of Land Certificates (LCs), the County EZO acting as an agent in this process. These certificates cover all land in the County on the basis of a comprehensive land management plan. So far Y 50,000 has been set aside for this purpose. These new LCs will supplement the existing land (household) contracts and are intended to streamline the process of land transfers across the boundaries of collectives. The originals of the LCs, which carry the name of the farmer responsible for the parcel of land concerned, will be kept by the collective (village or township economic cooperative) with the farmers holding copies. The collectives will transact the land transfer fees directly, the collective to which the farmer who is giving up the land belongs being responsible for

compensating him. It is being stressed that these LCs will function as "legally binding" documents.

6. The land certification process is not expected to generate too many disputes, at least in the lowlands. Here boundaries have been recognized since the introduction of the production responsibility system, some even existing during the commune period. Certification of hill land may be more problematical, given that the land demarcations here are recent and the fact that there has been some protest at the generous contracting terms offered to certain planters whose claims to the land will be seen to be unchallengeable once LCs have been issued.

The Land Bank

7. A "Land Finance Company" (LFC) was formally established on September 15, with a charter designed largely by the Meitan EZO.1/ The recent People's Bank of China (PBC) embargo on the opening of new banks resulted in some delay in the setting up of the LFC (and caused it to adopt the provisional title of 'company') which made local farmers anxious. Farmers will be able to borrow from the LFC using their land contracts as collateral. Stock and housing will also be accepted for this purpose. If farmers fall into arrears with repayments, the collective will have the power to revoke the farmer's rights to use the land; i.e. the farmer will effectively be mortgaging this rights when he borrows from the LFC. (The question of how land is to be valued--in the absence of a freely functioning land market--is a difficult one which has not yet been resolved). If a land use right is revoked in this way, the LFC can transfer it to another party. This party could be from another collective, but if the LFC is obliged to foreclose before the lease on the land has expired then the collective with whom the farmer had the contract has first option on bidding for the land. (Land use contracts are for 20 years, while the maximum loan term will be 10 years).

8. The LFC is registered with the Provincial Industrial and Commercial Bureau and the PBC and has an authorized capital of Y 3.45 million. This is comprised of Y 1.0 million from the Provincial government, Y 1.0 million from the County, Y 1.0 million from the village economic cooperatives, Y 0.4 million from land use fees (see below) and Y 0.05 million from TVEs. Another Y 3 million will be borrowed from the PBC at 5.3% p.a. The LFC is authorized to take in saving deposits at a slightly higher rate than the specialized banks and it is intended to establish LFC branches in townships and villages throughout the County. All village economic cooperatives are members of the LFC. The bulk of the LFC's lending is envisaged as 3-10 year loans for such purposes as agricultural works (capital construction) and the clearing, preparing and planting of land for tree crops. To provide an immediate profit center, 40% of LFC lending will be earmarked for short term "commercial" activities such as trading, working capital for TVEs, transportation and so on at 11.5% p.a.

1/ cf. Section III, Annex 7 ("Rural Industrialization and Finance") of the RSAL Project Implementation Index File for additional detail.

9. Farmer interest in the LFC is reported to be high, but lending has not yet begun (nor, it may be noted, have arrangements yet been made to finance the LFC's operations on a sustainable basis by borrowing long term itself from the money market). Activities are presently confined to appraising farmer's applications and conducting related feasibility studies.

The Land Use Fee

10. This fee--set at Y 3/mu for paddy land, Y 2/mu for nonpaddy land and Y 1/mu for private plots and new hill land and introduced last year on a trial basis--is reported to have gained general acceptance among farmers though they have apparently expressed anxiety about the use which will be made of the funds (Y 0.3 million has been collected so far this year, with another Y 0.9 million expected by the end of this autumn's harvest). To counteract these worries, the County has declared that fees collected in one collective may not be used by another unless the money is formally loaned. The purpose of the land use fee is to accumulate funds for capital works (e.g. irrigation) and encourage efficient land use, though the rates are rather nominal in the latter respect.

Other Developments

11. Revenue-raising and financing of local level activities in Meitan County has been streamlined by formally making villages administrative sub-units of townships. This reduces the haphazard element in village finance where much is collected by various 'dues' levied on the inhabitants by cadres in return for their administrative services. It also de-links village finances from the production quotas set. Quotas and contract purchases in Meitan were reduced in amount this year, thus effectively raising average farm produce prices in an attempt to encourage greater use of agricultural inputs. Grain resales to rural consumers have also been reduced.

C. Other Land Management RRP

12. RCRD considers that good progress has been made with the Shunyi County RRP in the environs of Beijing with over 93% of the land area now consolidated under 'scale farming' operations of various kinds. Grain production, particularly wheat, has increased. Factors which have been conducive to success in this respect include (i) the strong financial backing from the County Government, TVEs and farmers, (ii) as one of the main wheat-growing areas in the country, Shunyi already had a well-established mechanization program, and (iii) the local administration is regarded as being particularly competent, not least due to its closer proximity to Beijing. However, the financial cost to date of the land consolidation/scale farming experiment has been high, it remains doubtful whether this type of agriculture could become self-financing under the present pricing and procurement arrangements and the economic case for it is not proven. RCRD regards Shunyi rather as a 'one-off' prototype of economic adjustment which is unlikely to have much relevance to other areas; certainly there have been no indications to date that the Shunyi model is being adopted elsewhere.

13. In the Southern Jiangsu RRP, some 359 consolidated farming units are now operating in the three counties involved. Summer harvest grain yields

were nearly 6% up on last year, and some farmers want to see the duration of their land contract and the area of their responsibility land extended (some other farmers remain unwilling to give up land for this purpose). Of the three institutional forms for scale farming which have developed--viz (a) the collective form whereby an agricultural production team is attached to, and 'sponsored', by an industrial enterprise, (b) specialized households using relatively little hired labor and (c) groups of households who have pooled their scattered land holdings under a cooperative farming arrangement--it is the specialized households which appear to have the greatest potential, particularly where they can also combine grain production with forestry and animal husbandry.

14. However, implementation of the RRP has encountered problems, including specific technical difficulties with compact rice harvesters being introduced with the reform (n.b. these are manufactured in Wuxi, one of the three countries within this RRP), and the general efficiency of farm machinery usage. The establishment of support services for the scale farming operations has also not progressed as smoothly as had been hoped, with the implication that more investment by the community as a whole in agricultural machinery research and development is needed. There is also the more intractable problem of local attitudes to the reforms. The returns from grain and cotton production under present pricing policies are considerably less attractive than the returns from other agriculture/aquaculture/sericulture activities (let alone from TVEs) and some farmers resent what they see as government efforts to keep people hooked into these systems of production, despite the support and subsidies provided. Some local leaders would like to see more land put into mulberry bushes to feed the silk industry since exports of silk are doing well at present and the domestic market could comfortably absorb any diversion from exports due to a downturn in the international market. Of the 50-60 billion jin of grain produced in Jiangsu Province, about 7-10 billion is reserved for animal feed, mainly to meet the required sales of 20 million hogs annually. The possibility of importing some of this feed, particularly maize, from other parts of China or from abroad in order to release grain land for agricultural export production is being actively explored.

15. Shangdong's Pingdu County has been experimenting with land management reform since 1984, but did not begin implementing them on a large scale until last year. The system adopted is to divide all farmland into two categories--household food plots and responsibility plots. The responsibility land is graded according to its inherent productivity and, after setting some aside to cater for the needed and disabled, is then auctioned off to farmers through a public bidding process. The maximum amount which can be contracted by a farmer is 15 mu and a floor price (land use contracting fee) is set to start the bidding. These prices are determined by a formula based on the total contract fee which the collective concerned requires to meet administrative costs, investment needs and welfare payments and the amount of land of different grades available. A minimum grain yield is also specified for each grade of land representing the farmer's tax and quota obligations. The contractual period is 5 years in most cases and the contracting fee is adjusted annually for inflation.

16. This system has proved very popular in Pingdu. Following trials limited to selected villages and townships in 1985 and 1986, it was adopted on

a County-wide basis in 1987. A total of 672 villages, or about one-third of all villages in the County, took up the system in this year, followed by a further 955 in 1988. To date, over 90% of all villages have adopted the system. So far, this process of land auctioning has resulted in just under 11% of the total land area (i.e. 0.27 million mu) being relinquished by farmers. The proportion of unsuccessful bidders is 16%. Most of these farmers have retained their food plots, though a small percentage have given these up also. Complaints about the system have been few and there has been a marked absence of litigation.

17. In stark contrast, the attempt to introduce a system of land consolidation/scale farming by specialized households in Guangdong Province's Nanhai County has not met with much success. Despite extensive support and subsidy and the long contractual period offered (15 years), only 34 such households have been established, farming 2,400 mu in total and contributing less than 1% to the County's grain quota. Farmers are reluctant to give up their land use rights, even though the opportunities for employment in TVEs are excellent, because of what they perceive to be many other more profitable agricultural opportunities (e.g. horticulture and aquaculture) particularly since farm produce prices have been deregulated to a much larger extent in Guangdong than elsewhere in China. Farmers thus prefer to move into non-agricultural employment but retain their interests in land by hiring labor, leaving family members to farm or farming themselves on a part-time basis. Substantial financial remittances are required from the ex-cultivators to pay for inputs needed to fulfill quota obligations or to buy grain directly for this purpose. An alternative approach being considered for the Nanhai RRP is to introduce a system for auctioning fishpond land--apparently farmers would welcome the chance to bid for this--and, if this is successful, extending this to the allocation of other types of land along the lines of the Pingdu experiment.

18. The Shunyi, Southern Jiangsu, Pingdu and Nanhai RRPs are all attempts to tackle the problems caused by the high opportunity cost of producing low value grain quota crops in an environment of rapidly rising incomes and employment opportunities in nonagricultural sectors, competing agricultural (and even nonagricultural) uses for quality cropland, and strongly increasing demand for high value farm produce. In some cases, export possibilities further add to the real resource costs of grain production in these localities. The Shunyi, Southern Jiangsu and Nanhai (as formulated to date) experiments represent the testing of administrative solutions to achieving efficient land allocation within the constraints imposed by the quota/contracting system, whereas the Pingdu experiment is trying out a more market-based approach. Shunyi and Southern Jiangsu appear to be 'working' in terms of the physical progress indicators, though even at this early stage it is hard to escape the conclusion that financial support from the nonagriculture sector to the specialized farming communities will remain high and will be permanently needed. Nanhai, however, is not working at all and probably should be abandoned else radically redesigned in a way which would improve the land allocation system infrastructure, support and marketing services for products which farmers are willing to produce (i.e. vegetables, other cash crops and fish). Because the opportunity cost of land is so high in this area, the farmers failure to participate no doubt reflects a belief that it will only be a matter of time before the authorities bow to economic

logic and allow land to be 'released' from quota production. Meitan resembles Pingdu in its approach to land allocation, but faces a more difficult task since it lacks the prospects of the substantial off-farm employment opportunities present in Pingdu. It remains to be seen whether the availability of good quality upland and market accessibility will be sufficient, and the form of production management system adopted (e.g. smallholdings, mini-estates or some combination of the two) appropriate, to allow cultivators from the lowlands to be employed productively in numbers of any consequence.

19. Notes on other aspects of the Shunyi and Pingdu are given in the Appendix. Monitoring arrangements are reviewed in Annex 9 to the Project Implementation Index File, Section III.

F. Follow-up Action by the Next Supervision Mission

20. With regard to the Meitan RRP, the progress made with issuing the Land Certificates should receive special attention. Key aspects to follow up are: (i) the nature and purpose of the land management plan referred to above; (ii) the extent and location of the land in the County covered by LCs and the process for agreeing boundaries, with particular attention to the certification of hill lands; and (iii) the nature and frequency of disputes about certification and/or reasons for delays. The mission should also review progress with making the LFC (the first such land bank to be established in China) operational and with developing a sound strategy for its long term financing. The other main topic proposed for follow up in February is progress made with M & E staffing, organization and budgetting.

ADDITIONAL NOTES ON ASPECTS OF THE LAND MANAGEMENT SYSTEM RRPS1. Progress with Land Management System Reform
in Shunyi County, Beijing

1.1 Of the two main types of farm organization--cooperatives and government-run farming enterprises--it is the latter which predominates. There are now 193 County-organized consolidated farms averaging 3,200 mu in size, compared with an average of 5-600 mu last year. The average amount of land cultivated per farmer (farm worker) is now 26-30 mu, compared with 16-18 mu in 1987. With the specialized grain production teams established, the TVEs now no longer have to release their employees for work on the land during peak periods, a practice which seriously disrupts some factory operations. Townships and villages provide services only; farm management and grain disposal is entirely the farmers' responsibility. The total cultivable land area of the County is 860,000 mu, of which 620,000 was in grain this year. Scale farming operations covered 95% of this, compared with 93% last year. There are 50,000 mu in private plots mainly growing grain and vegetables, but this area is diminishing. The summer wheat crop was 400 M jin and 560 M jin is expected from the autumn harvest, making the year's total 1,000 M jin. This compares with 960 M jin in 1987 and 8650 M jin in 1986.

1.2 This production increase has been associated with a substantial investment in farm machinery: over Y 100 M has been spent during the last year, mainly on combines and sprinklers. Of this capital outlay, Y 30 M was contributed by TVEs, Y 30 M by the farmers themselves, Y 5 M from municipal investment funds and the rest (Y 35 M) from bank loans. Eighty per cent of the summer harvest was mechanized, with 6,000 units operating, enabling the crop to be harvested in six days instead of the usual 15. (One combine can cut 1,000 mu in a 7-day working week). Sprinkler irrigation on 400,000 mu increased yields by 20% compared with surface irrigation and meant that only half as much water per mu was used. Agricultural machinery hire stations are located at the township level, with village teams maintaining and operating the equipment. The township coordinates machinery use among the village teams, particularly in the case of the larger plant.

1.3 The total labor force of the County is 220,000 of which 170,000 are in TVEs (i.e., an increase of 10,000 over last year's industrial employment level). The standard of education among farmers is relatively high; they are selected from among those who have completed Senior High School, are Technical School graduates or agricultural technicians. Each farm has two technicians recruited at County level. However, there are too few experienced and qualified farm managers who can handle consolidated holdings of 3-5,000 mu. An additional problem is that most farm workers are female or elderly. Farms distribute profit according to output; thus if a farmer can meet the quota set by the County his or her net income per mu is Y 80-90 giving a total annual income of Y 2,000 - Y 2,700.

1.4 The planned (contract) quota and negotiated grain deliveries for both seasons was 90 M jin, but the summer harvest alone turned in 130 M jin. Thus 40 M jin was sold at negotiated prices which means that the whole of the autumn grain harvest will be sold at free market or negotiated prices. Prices this year are very similar to last year's: free market = Y 0.35/jin for wheat; contract price = Y 0.25/jin; negotiated price = Y 0.31/jin. The County Government will open the depots to take in grain surplus to the contracted and negotiated sales at free market prices in competition with the private traders.

1.5 Vegetables are grown on 40,000 mu throughout the County, 80% being seasonal production and 20% greenhouse (under plastic). There are four marketing channels: (i) the County-owned Vegetable Marketing Corporation; (ii) vegetable marketing companies at township level; (iii) representatives of Beijing industrial enterprises who buy directly from the farmers in Shunyi; and (iv) farmers selling to the free markets themselves. The County supplies about one-fifth of Beijing's vegetables; growers in some other supplying areas in the inner suburbs have reduced production because of its low profitability compared with other occupations.

2. The Land "Auctioning" Process in Pingdu County, Shandong

1.6 Household plots for personal food consumption requirements are allocated on the basis of 0.5-0.7 mu per capita. The only levy invoked for use of this land is the agricultural tax. All other land is designated as "responsibility" land. Using the village as the basic accounting unit, the total value of the contracting fee which the responsibility land must yield is calculated. This is based on the average amount retained by the (former) collective concerned in previous years and represents the cost of (i) remuneration of village leaders, (ii) agricultural investment/maintenance, and (iii) community welfare support. This total is divided by the total area of responsibility land to give an average contracting fee per mu.

1.7 All the responsibility plots are graded into three major categories of productiveness, each category being further divided into three sub-categories. Different rates of contracting fee are then set for each of the nine land grades in such a way that the total of rates times area of each grade adds up approximately to the total contracting fee required. For example, the fees in category 1 land may be in the range Y 30-40/mu, for category 2 land in the range Y 50-60/mu and for category 3 in the range Y 60-70/mu. The scales vary between villages.

1.8 These calculated contracting fees are the opening prices at which bidding starts in the land use auctions. The result overall for the County as a whole is that the average fee finally contracted is some 20% higher than the minimum required. However, there have been some instances where bidding failed to move off the opening price. The contracting fee is paid annually and is pegged to an index of inflation based on the free market prices of a "basket" of agricultural produce (e.g., 30 jin wheat, 50 jin maize, 20 jin cotton). The contract stipulates a cropping plan which the farmer must follow over a pre-determined period, such as five years. It is estimated that the successful bidders under this system have realized an average net profit (i.e., after paying the contracting fee) of Y 200/mu.

1.9 The farmers using the responsibility land have to be encouraged to manage it well and maintain its productivity. It is intended to monitor soil fertility during the currency of the land use contracts to determine whether land originally classified as belonging to one particular category has been up- or down-graded to another category. This will be done by "pricing" land according to its agricultural value as revealed by the average net profit/mu of the preceding three years. (These prices are a quite separate concept from the land contracting fees set by bidding). For example, if a village has 100 mu of category 1 land, 200 mu of category 2 and 160 mu of category 3 and averaged Y 50,000 net profit then the land might be priced as follows: category 1 = Y 51/mu (i.e., Y 50,000/k mu); category 2 = Y 102/mu and category 3 = Y 153/mu, where $k = 100*1 + 200*2 + 160*3$. This land revaluation will be carried out at the end of each contract period, which means the first such exercise will take place in 1989. Any changes in land "price" will form the basis for calculating penalties (for mis-management) and compensation (for good management).

CHINA

RURAL SECTOR ADJUSTMENT LOAN

POST-EFFECTIVENESS SUPERVISION MISSION

Reform of the Grain System

by- Mohinder Mudahar (ASTAG)

GLOSSARY

ABC	-	Agricultural Bank of China
CATIC	-	China Agribusiness Trust and Investment Corporation
GAR	-	Guangxi Autonomous Region
MT	-	Metric Ton
RCRD	-	Research Center for Rural Development, A Policy Arm of the State Council
RRP	-	Regional Reform Program
RSAL	-	Rural Sector Adjustment Loan
SMC	-	Supply and Marketing Cooperative

CONVERSIONS

1.00 jin	=	0.50 kg
1.00 kg	=	2.00 jin
1.00 mu	=	0.0667 hectare (1/15 ha)
1.00 ha	=	15.00 mu

EXCHANGE RATE

Currency Unit	=	Yuan (Y)
1.00 US\$	=	Y 3.72
1.00 Y	=	US\$0.27

CHINA

RURAL SECTOR ADJUSTMENT LOAN

SUPERVISION REPORT

Grain System Reform

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ANNEXES

CHINA

RURAL SECTOR ADJUSTMENT LOAN

SUPERVISION REPORT

GRAIN SYSTEM REFORM 1/

I. INTRODUCTION

1.1 The grain system reform program in China, both at the national and regional levels, is an important component of the rural reforms initiated during 1987. The regional grain system reform programs fall into two categories: (a) those which were designed, implemented and are being monitored under the direct supervision of the Research Center for Rural Development (RCRD) of the State Council; and (b) those which were initiated by local and provincial governments with the approval of central government. The Rural Sector Adjustment Loan (RSAL) -- and hence the grain system reform and this report -- deals primarily with those regional reform program (RRPs) which are being supervised by RCRD. 2/ The objectives of this report are (a) to review the status and progress in implementation of grain system reforms, (b) to identify any emerging and potential problems related to these reforms, and (c) to make recommendations in order to alleviate these problems for the successful implementation of these reforms.

1.2 A World Bank Mission visited China from October 18 - November 16, 1988. One of the objectives of the Mission was to supervise the grain system reform component of RSAL to China. 3/ While in China, the Mission (a) met senior RCRD and China Agribusiness Trust and Investment Corporation (CATIC) officials in Beijing, and (b) visited two grain system RRP, including the grain system reform in Xinxiang, Henan, during October 20-24, and the grain system reform in Yulin, GAR (Guangxi Autonomous Region) during October 31 - November 5, 1988.

1/ This report was prepared by Mohinder S. Mudahar (Bank), with contributions from Alan Piazza (Bank).

2/ Grain system reform in China is discussed in Working Paper No. 3 of the RSAL Loan Implementation Volume.

3/ The World Bank Supervision Mission for the grain system reform component consisted of Mohinder S. Mudahar and Alan Piazza. This Mission followed the main World Bank RSAL Supervision Mission led by Mr. Richard Burcroff in September 1988.

1.3 The Mission was accompanied by an RCRD official to Xinxiang and a CATIC official to Yulin. During each of the field visits, the Mission received detailed briefings from senior officials responsible for the design, implementation and monitoring of different aspects of these reform programs. As part of the supervision, the Mission focused on five aspects of each of these RRP's: (a) design, (b) implementation, (c) impact, (d) monitoring, and (e) plans. The report is divided into four broad sections, including (a) national grain system reform, (b) Xinxiang grain system reform, (c) Yulin grain system reform, and (d) lessons and recommendations.

II. NATIONAL GRAIN SYSTEM

A. National Programs

2.1 In early 1988, there were plans to initiate national level grain system reforms dealing with grain procurement, grain distribution, grain prices and grain subsidies. However, in the last few months, these plans for grain system reform have slowed down. This is mainly due to the fact that inflation has emerged as a major national problem. For the next 2-3 years, one of the highest national priority will be to control inflation. At present, annual inflation rate is over 20% by some estimates.

2.2 At this point, it is not clear as to what the impact of macro-economic strategies designed to control inflation will be on grain system reform. There are two possibilities. First, food price increases may be contributing to current inflation and central government is determined to control inflation. Any effort to control inflation may, in turn, slow down grain system and price reform. Second, an increase in food prices is mainly due to supply shortages. Grain supply may not increase due to lack of needed economic incentives for farmers to expand grain production -- hence need to provide incentives and accelerate grain system reform.

2.3 Grain sector is facing several problems. First, grain production peaked in 1984 at 407 million mt; declined to 402 million mt in 1987; and is estimated to be only about 398 million mt in 1988. Second, government has difficulty procuring grain since farmers are not very enthusiastic to sell contract grain to government at low prices. Third, investment in the grain sector is relatively low and has not improved in the last few years. Fourth, expenditure on grain subsidies to the urban sector is skyrocketing due to widening gap between the procurement and ration prices. Fifth, grain market is not functioning efficiently and equitably. Grain policy for 1989, which does not address all the above problems, may consist of (a) an increase in grain procurement price (upto 18%) and the biggest increase is expected to be for rice; (b) no change in ration grain marketing arrangements; (c) no increase in ration price for grain; and (d) some reduction in the sale of non-ration grain by the government.

2.4 At present, government is in the process of developing and implementing strategies to control inflation. ^{4/} This consists of (a) investment in fixed assets will be reduced by Y 50 billion over the previous year; (b) consumption growth will be controlled; (c) credit expansion and money supply will be curtailed; (d) serious penalties will be imposed on those involved in profiteering, hoarding and corruption; (e) comprehensive and coordinated reforms will be promoted in a planned way; and (f) market stability will be achieved by expanding supply and reducing demand for key commodities. Government appears to be committed to continue economic reforms and rationalize prices but the pace and method to achieve these goals may change in the light of concern for inflation and changed economic environment. One of the outcome of credit squeeze to control inflation is that local governments and local branches of Agricultural Bank of China (ABC) do not have adequate funds to purchase grain (and other crops) even at contract prices.

2.5 Government also appears fully committed to accelerate grain production and agricultural development. Growth in the agricultural sector is expected to be accomplished by expanding agricultural investment and promoting the use of modern agricultural technology, including the use of modern inputs. The available evidence in China and in other developing countries, however, indicates that this is essential but not sufficient to increase grain production. Provision of appropriate economic incentives to farmers is equally important. In the last few months, the gap between contract prices and market prices for grain has widened and needs to be reduced.

2.6 In case the government decides to increase grain contract prices -- as has been indicated -- without any corresponding increase in grain ration prices, the grain subsidy burden on the government can skyrocket. On the other hand, if government decides to maintain current levels of grain contract prices, farmers may not have the needed economic incentives to expand grain production and deliver their quota obligations to the government. Clearly there is a need to address macro policy issues at the national level but this must be accompanied by price reforms, including an increase in incentives for grain producers and a reduction in consumer subsidies.

B. Regional Programs

2.7 As has been indicated earlier, regional grain system reform programs fall into two categories: those which are being supervised by RCRD (in Xinxiang and Yulin) and those which are being carried out by local and/or provincial governments at their own initiatives. Depending upon the perceived problems and stated goals, the scope of each of these reforms may vary.

2.8 Guangdong province, which is located in southern part of China, is considered the leader in grain system reforms. The reform consists of (a)

^{4/} According to Chinese authorities, these strategies are designed to (a) improve the economic environment; and (b) rectify the economic order.

higher price for contract grain (paddy rice), (b) no subsidy on agricultural inputs, (c) higher price for ration grain, (d) sharing of subsidy burden and cost of the reform by all the agencies involved, including the provincial government. However, there has been a slow down in grain system reform this year, even in Guangdong. During October 1988, Guangzhou (capital of Guangdong and a pilot city for China's economic reforms) decided to freeze price on 45 kinds of daily necessities including non-ration foodgrains. Fujian province is following somewhat similar approach as Guangdong.

2.9 The grain reform in Shenzhen -- a Special Economic Zone in Guangdong -- was started in November 1984. As part of this reform, ration grain coupons were abolished and grain purchasing and marketing was liberalized, except for armed forces and people with overseas remittances. Wages have been adjusted to compensate for reduced grain subsidies. Shanxi province, as part of the grain reform, decided to reduce ration grain amount per person in 1988, rather than increase ration price. However, there has been a slowdown in grain reforms in these and other areas partly due to inflation concerns at the local level and partly due to their worries for unknowingly violating any price guidelines from the central government.

III. XINXIANG GRAIN SYSTEM REFORM 5/

3.1 Xinxiang City is a prefecture-level municipality in Henan province, near the Yellow River. The total population of Xinxiang City is estimated to be about 4.4 million, 85% of which is agricultural population. It is a wheat growing area in central China. Xinxiang City consists of eight counties and four districts, out of which two are industrial and two are commercial. The Xinxiang RRP is divided into two phases; phase I deals primarily with rural sector and phase II deals primarily with urban sector. This supervision report discusses phase I only.

A. Design

3.2 The Xinxiang RRP consists of four reform components. These are (a) an increase in contract price of wheat, other grains and edible oil; (b) an increase in price of ration grain for rural resale (no adjustments have been made in urban ration grain prices in phase I); (c) an increase in sale prices of agricultural production inputs, including urea and diesel fuel; and (d) an increase in agricultural tax. The key feature of Xinxiang RRP is that it was designed to be financially self-sustained i.e. the incremental revenue from increased agricultural tax and input prices must cover incremental expenditure due to higher contract purchase prices for wheat, other grains and edible oil in the post-reform period.

5/ The initial details of the key features of the Xinxiang RRP are provided in Section III of Working Paper No. 3 of the Loan Implementation Volume for RSAL.

3.3 There are four major differences in the initial RRP design (reported in the Working Paper No. 3) and the final design which was implemented. These are (a) the contract price of wheat was increased from Y 0.242/jin to Y 0.295/jin, rather than Y 0.300/jin; (b) the price for grain sold to food industry (beer, soy sauce and vinegar) was not increased, as planned; (c) the amount and price of electricity for agriculture did not change since it was taken out of the reform; and (d) the agricultural tax was increased from 12.6 jin/mu to 23.0 jin/mu, rather than 25.5 jin/mu.

B. Implementation

3.4 The final design of Xinxiang RRP was completed on March 12; it was approved by RCRD on April 5; it was approved by the provincial government on May 14; it was announced by the City government on May 18 and implementation began on May 18, 1988.

3.5 Since the contract grain procurement is not truly contract, the Reform Office prefers to call it quota, as was the case prior to 1985. The volume of procurement target for 1988 was set at 485 million jin of grain (primarily wheat) and 6.2 million jin of edible oil (Annex 1). The Xinxiang City procurement target was 505 million jin which is 4.18% higher than the provincial target in order to allow for any unforeseen procurement problems. The Grain Bureau is not allowed to procure, at contract prices, more than the procurement target of 505 million jin and 6.2 million jin of edible oil. The summer 1988 procurement dealt with wheat and rape seed oil.

3.6 The process of assigning procurement contract flows from city to county to township to village and to household. The nongrain farmers are also required to fulfill their procurement contract obligations. However, they are allowed to pay cash to grain stations, who in turn purchase grain on behalf of these nongrain farmers. The amount of cash obligation of nongrain farmers is determined by (a) the difference between contract procurement price and the price which grain station pays to procure additional grain, and (b) 7% service fee to cover handling costs. The magnitudes of price difference and the service fee are determined by the county government. The grain farmers must sell contract procurement grain to government, unless they have prior permission from the government which is rather difficult to obtain.

3.7 The underlying principles used for determining contract price were (a) the contract prices for different commodities were raised to a level close to the market prices prevailing in early 1988, and (b) the market prices during the procurement period are to be used as a reference for a particular commodity. Related considerations for contract price determination included (a) contract price should be fixed once and remain valid throughout the year; (b) contract price, which is recommended by the Reform Office and approved by the City government, is announced prior to the planting season; (c) previous year's market price will serve as a reference for determining contract price; (d) no price adjustment is made in case the market price during the procurement period drops below the pre-determined contract price; (e) contract price will be adjusted upward in case the market price during the procurement period is more than 5% higher

than the contract price. The adjustment would be equal to 50% of any price increment higher than 5%.

3.8 Wheat procurement began on June 15, 1988; five days later than during 1987. The delay was primarily due to delay in determining new agricultural tax obligations for each agricultural household. The procurement of wheat was smooth (the market price for wheat during the procurement period was about Y 0.31/jin, both within and outside Xinxiang City). The government was able to procure more wheat in 1988 than during the same period in 1987 and farmers were happy to sell contract wheat to the government. However, two counties were not able to fulfill their quotas for wheat due to drought and have to fulfill their obligations by selling corn or millet in the forthcoming season. Since market prices for corn and millet had gone up, the contract prices for them were adjusted upward from Y 0.167/jin to Y 0.204/jin.

3.9 During the post-procurement period, the market price for wheat had also skyrocketed to Y 0.40/jin. This unprecedented price increase is attributed to (a) drought, (b) increase in cost of cultivation due to increase in input prices, and (c) "panic" buying of grain by consumers. During October 1988, market price for wheat had dropped a little to Y 0.37 - Y 0.38/jin. Government is now worried that next year farmers may hold wheat and force market price to go up before selling it to government. The market prices of other commodities had also gone up. As a result, the contract procurement prices for these commodities have been adjusted upward as follows (for medium grade):

Sesame seed:	Y 1.445/jin
Cotton seed:	0.236
Peanuts (without shell)	0.961
Peanuts (with shell)	0.681
Sesame oil:	3.188
Cotton seed oil:	1.955
Peanut oil:	2.303

At this point, the authorities do not anticipate any procurement problem for these commodities.

3.10 The agricultural tax liability is determined in physical terms (jin/mu) but farmers pay it in the form of cash. The amount of tax liability in the form of cash, of course, depends upon tax grain prices. The total taxable area in Xinxiang city is 5.8258 million mu. The agricultural tax has been increased from 12.6 jin/mu to 23 jin/mu of grain after the reform. As a result, the potential agricultural tax revenue has increased from about 73 million jin to 134 million of grain. Using new contract price for wheat (Y 0.295/jin), the potential total tax revenue is estimated to be about Y 39.5 million. Since agricultural tax is subject to many exemptions and reductions, the net tax revenue is about 25% lower than the total tax revenue.

3.11 After the implementation of Xinxiang RRP began, the immediate task was to determine and assign the new tax liability to each rural household prior to initiating summer grain procurement. The authorities had only about 20 days. During this short period, the new tax liability was

determined and every rural household was informed about their new taxes. The authorities successfully completed this process within the assigned period. Agricultural tax is collected twice a year and the deadlines are July 31 for summer crop and December 21 (changed from December 31 after the reform) for the autumn crop. Of the total tax revenue 70% is collected during summer season and 30% is collected during autumn season. For the grain farmers, the grain stations deduct tax from grain sales receipts and hand it over to the finance department. For non-grain farmers or farmers with small quota, the finance department collects taxes directly or village cadres do it on behalf of the finance department.

3.12 The distribution of agricultural tax in the post reform period was determined by two principles. From city to counties and districts, 60% of the tax liability was distributed as per the proportion of total agricultural tax paid in 1987; and 40% was distributed as per the proportion of total crop output value in 1987. These principles, with some modifications, were also applied to distribute agricultural tax from counties to townships and villages. At the village level, a village committee was responsible for distributing tax to the households but with the help of township government and finance department. At the village level, the guiding principle was the family size or farm size. This was considered equitable and objective since family size was the guiding principle for land distribution.

3.13 As indicated earlier, the agricultural tax is subject to many exemptions and reductions. The following tax exemption/reduction principles were used in determining the magnitude and distribution of tax adjustments:

- (a) Agricultural tax exemptions and reductions due to natural disasters average about 14.5% of the total tax revenue, as per the experience of last three years. Any natural disaster affects grain yields, reduces grain production and thereby reduces rural household's ability to pay tax. In order to determine the magnitude of loss in grain production, actual grain yields are compared with normal yield benchmark which is equal to the previous 5-year average grain yield. Depending on the severity of crop loss, agricultural tax adjustments are made as follows:

Percent Reduction in Grain Yield	Percent Reduction in Agricultural Tax
Less than 20%	No reduction
20-40%	20-40%
40-50%	50-60%
50-60%	60-70%
≥ 60%	100%

- (b) Some rural households, including army families, bereaved families and families with no labor force, are allowed agricultural tax exemptions/reductions based on social welfare grounds. This exemption/reduction accounts for about 2% of total agricultural tax revenue.
- (c) Households in poor localities are also eligible for agricultural tax exemptions and reduction. This is being handled in two ways: (i) those townships which were designated as poor townships prior to the reform will remain eligible for agricultural tax exemptions/reductions; which accounts for about 5.12% of total tax revenue. (ii) those townships which are designated as poor townships (a township with annual average per capita income less than Y 167 qualifies for this category) after the reform are eligible for agricultural tax exemptions/reductions from the additional tax; which is estimated to be about 8% of incremental agricultural tax revenue after the reform.
- (d) Households in those areas which suffer loss of agricultural land due to conversion of arable land for other uses are also eligible for agricultural tax exemption/reduction. This amounts to about 0.3% of total agricultural tax revenue.

3.14 After making necessary adjustments for all the exemptions/reductions, except for natural disasters, the total potential agricultural tax revenue was estimated to be Y 15.316 in 1987 (before reform) and Y 35.349 in 1988 (after reform), implying the incremental tax revenue to be about Y 20.033. After allowing for natural disaster exemption/reduction (14.5%), the estimated incremental tax revenue from change in agricultural tax policy is estimated to be about Y 17.447 million. In addition to agricultural tax, there has also been an increase in local extractions. This increase, however, varies from one locality to another and the local officials attribute that increase to inflation rather than to grain system reform. In any case, overall tax burden on rural households has increased. This made farmers in Xinxiang County (cotton area), suburban area and Bai Zhan district (vegetable areas) unhappy since they did not really benefit from the grain system reform. As a result, the local authorities implemented two measures to pacify these farmers. First, the new agricultural tax was reduced to a level less than 23 jin/mu. Second, cotton farmers were allowed to purchase agricultural inputs at pre-reform planned prices.

3.15 The agricultural inputs covered by the grain system reform are urea and diesel fuel; not electricity as was proposed earlier. The primary goals of the reform were to increase input prices to a level close to prevailing market prices -- thereby reducing input subsidy -- and to improve efficiency of input distribution system. The market price for urea in May 1988 was about Y 1000/mt and the reform price was fixed at Y 900/mt, 10% lower than market price. Different prices for diesel fuel in May 1988 were as follows:

Planned Price:	Y 500/mt
High Price:	Y 900/mt
Negotiated Price:	Y 1200/mt

The reform price for diesel fuel was fixed Y 920/mt. Since then the market prices for both urea and diesel fuel have increased. In October 1988, market price for urea was between Y 1100 - Y 1300/mt. The input price policy still remains two-track price policy but the gap between these two prices was reduced. However, as market prices increased, the gap between two prices (reform price and market price) has again widened but lower than what it was prior to the reform.

3.16 The retail outlets of Agricultural Inputs Corporation for urea and Petroleum Corporation for diesel fuel sell these inputs to farmers at new reform prices. The difference between the old planned and new reform prices is channelled to the Reform Office through the finance department. This is one of the two major sources of revenue for the Reform Office to pay higher contract prices for grain procurement. After some initial operational problems, the system appears to be working smoothly.

3.17 The agricultural input reform system is facing several problems which need to be rectified for the successful implementation of the reform program.

- (a) There has been and continues to be serious shortage of all agricultural inputs, especially urea and diesel fuel. As a result, Xinxiang City will not be able to fully realize the grain production potential which has been made possible by an increase in economic incentives through higher contract grain prices. Xinxiang authorities requested additional supply of 20,000 mt of urea, over and above the planned urea supply, but only half of that was approved (we were advised that this additional allocation required the approval by the State Council). By end of October 1988, only 7,000 mt of additional urea was actually supplied. Even at higher prices, the potential demand for fertilizer far exceeds the available supply.
- (b) One of the objectives of the reform was to delink input supply from contract grain delivery (5 jin urea and 5 jin diesel fuel for every 100 jin of contract grain delivered). Because of serious input supply shortage, the reform authorities were not able to delink input supply from contract grain delivery. As a result, the dual input market continues and has serious implications with respect to leakage, hoarding and profiteering. Input supply and marketing problems are as serious now as they were prior to the reform.
- (c) Input prices have increased rapidly in the last few months. Most of this increase is due to nation-wide inflation phenomena, uncertainty about price reforms and input supply shortage. However, the maintenance of dual input market and two-track price policy has contributed to serious price problem, especially open market prices for high grade fertilizers.
- (d) At the time of reform design, the estimates for potential revenue from input price increases were for the whole year. However, the reform was implemented on May 18. By this time, almost half of urea and diesel fuel were already sold at old planned prices.

Since the share purchased at old prices was different for different counties, townships and localities, the reform authorities decided that 50% of the allocated input supply will be sold at old planned prices and the remaining 50% at the new reform prices. The decision was equitable and administratively sensible. However, it was financially disastrous since it reduced the potential revenue from higher input prices to one-half, thereby creating serious financial problems for the grain system reform.

3.18 As far as marketing is concerned, resale price for grain and edible oil were increased from ration to negotiated prices. Vegetable farmers and rural households in poor localities and disaster areas were eligible for ration grain; whereas only vegetable farmers had access to ration supply of edible oil. The grain prices were increased from Y 0.168/jin to Y 0.295/jin; in addition rural households were also required to pay an additional Y 0.020/jin to cover transportation and handling costs. The total amount of grain for rural resale is about 80 million jin; out of which 63.5 million jin is for disaster areas. However, the revenue from higher grain prices for rural resale is expected to be returned to the concerned localities to improve their social welfare. On the other hand, grain prices for brewing, soya and vinegar industries have not been increased, as planned.

C. Impact

3.19 The impact of grain system reform in Xinxiang is discussed under four broad categories: (1) response of farmers, (2) response of cadres, (3) economic impact, and (4) financial impact.

3.20 Overall, the response of the farming community to grain system reform has been positive. The Reform Office carried out a survey of 700 farmers during August/September; out of which 587 farmers responded. The preliminary survey results indicate that (a) about 77% of the farmers surveyed were either neutral or supported the reform program; (b) 96% of the farmers prefer lower grain quota and higher contract price; and (c) 95% of the farmers attributed all price increases to grain system reform, clearly indicating their lack of knowledge about the reform contents. Overall, however, farmers had only marginal gains in their income since they had to sustain higher input costs and pay higher agricultural tax. Farmers in some areas (Xinxiang County, Bai Zhan district and suburban areas) did not benefit from higher contract price for wheat but were required to pay higher input prices and agricultural tax. However, government made necessary adjustments in prices and agricultural tax to pacify farmers in these areas, after the reform was implemented.

3.21 Depending on their response towards the reform, the cadres can be divided into four groups.

First, a large number of cadres have negative attitude towards the reform due to (a) there is no real increase in farm income; (b) it requires additional efforts to collect agricultural taxes and market inputs; (c) reform has uneven regional impact since farmers in some localities did not benefit; and (d) the benefit margin is

too small in those localities which have benefitted from the reform in order to make additional efforts worthwhile.

Second, another group of cadres was in favor of reform but felt that there are too many political and economic risks, especially when reform is implemented in one small area with no control over many factors -- such as prices -- which affect the performance of the reform.

Third, another group of cadres felt that the reform is biased against the rural sector and favors the urban sector, making it difficult to improve relations between the rural and urban sectors.

Fourth, only a small minority of cadres felt that the reform, as designed and implemented, is good and government needs to stick with it.

3.22 Initially, the economic impact of the reform has been positive. Wheat production has increased in spite of input shortages. With the exception of two counties (which experienced severe drought), government was able to procure quota grain ahead of schedule and without any problems. Furthermore, government was able to collect 86% of the expected total agricultural tax revenue by end of July, as opposed to 70% which is considered normal in wheat region. The commodity and input prices in the reform area were not any higher than those prevailing in the surrounding areas. As a matter of fact, by middle of June the vegetable prices in Xinxiang City were 10% lower than those in adjoining areas. The grain market prices during the procurement period were Y 0.31 - Y 0.32/jin, about the same in both Xinxiang and adjoining areas.

3.23 The financial impact of the reform on the city budget has not been positive. The reform is experiencing serious financial problems and may not be able to balance the budget, i.e. equality between incremental revenue and incremental expenditure due to grain system reform, as planned. This is primarily due to the fact that reform implementation started in the middle of 1988 and by that time half of urea and diesel fuel were already sold at old planned prices. As a result, the potential revenue from increased input prices was cut into half; whereas, there was no corresponding reduction in the incremental expenditure on grain procurement. Furthermore, Xinxiang had not yet received all of its assigned allocation of diesel and additional urea due to various problems, including transport bottlenecks.

3.24 Initial estimates were that (a) the year-end (1988) revenue from the reform was anticipated to be Y 30.657 million (Y 17.44 million from agricultural tax, Y 7.307 million from diesel sale, Y 2.446 million from urea sale -- annual allocation, and Y 3.457 million from urea sale -- additional allocation); (b) the year-end expenditure on the reform was anticipated to be Y 28.441 million (Y 26.781 million for contract grain procurement and Y 1.660 million from contract edible oil procurement); and the year-end positive balance to the government was anticipated to be Y 2.216 million. However, by end of October most of the expenditure and only about 58% of the revenue were realized. If all goes well, only about

50% of the anticipated revenue from urea and diesel sale will be realized, thereby leaving a large financial gap -- clearly indicating that input price increases were not very reliable sources of additional revenue.

3.25 Since the reform was designed to be financially self sustained, the city and provincial governments did not allocate any resources from their budgets to cover any reform related expenditure. As a result, there is a serious shortage of financial resources and the Reform Office is in a fix. Since the gaps between contract grain prices and market prices; between ration grain prices and market prices have widened in the last few months, it will not only increase the need for incremental financial resources, but it will also make the implementation of phase II of the reform even more difficult. Furthermore, the morale of the reform group is down due to uncertainty and lack of direction from higher authorities about the future course of action for the price reform program.

D. Monitoring

3.26 The Reform Office has the overall responsibility for the monitoring group which consists of staff from 15 local government and other agencies. These participating agencies are listed in Annex 2. The Xinxiang Statistical Bureau has taken a lead role in the design and implementation of the monitoring program and have assigned six staff members, on a part time basis, to participate in all aspects of the monitoring work. The other 14 participating agencies have each assigned one or two staff members on a part time basis. Overall, about 30 staff members are involved in the monitoring program. The spatial coverage includes eight counties and four districts in Xinxiang; and two control counties in the neighboring areas, Jian Zuo county in the West and Wua county in the Northeast.

3.27 In close conformance with the suggestions of the RSAL appraisal team (see Working Paper #3 pp. 46-49), Xinxiang's monitoring program focusses on assessing the impact of the reform program on the following six areas:

- production of agricultural commodities;
- production budgets and input use;
- procurement and retail sales of agricultural inputs and outputs;
- planned, negotiated and free market prices for farm inputs and outputs;
- urban and rural income and expenditure; and,
- agricultural taxes.

A large number of monitoring indicators are subsumed within these six categories. These indicators are briefly summarized in Annex 2. However, other than the 700 farmer survey, no report has been published which specifically deals with monitoring the impact of the reform.

3.28 The Xinxiang government has appropriated only limited funding, Y 30,000, to cover the operating costs of the monitoring program. Even though the participating agencies routinely collect a large part of the data critical to monitoring the impact of the reform, this funding may not be sufficient to cover additional data collection costs. The Reform Office has provided additional funding of about Y 10,000, to cover the costs of two additional surveys which have been undertaken to supplement information supplied through the regular data collection systems. One survey, undertaken prior to the reform, assessed county and lower level agricultural taxes, fertilizer availability and prices, and rural household income and expenditure. The second survey, undertaken during August/September assessed farmers' and rural cadres' understanding and opinion of the reform.

3.29 The monitoring program has benefitted from technical support provided by RCRD. However, this did not include training of the staff of the participating agencies responsible for the majority of data collection. This may not adversely affect the performance of the monitoring program since most of these staff are practicing statisticians or accountants and the participating agencies have a proven track record of data collection.

3.30 The monitoring program can be expected to bring together detailed information on all important aspects of the reforms except urban grain and vegetable oil consumption. Although the Statistical Bureau routinely surveys the income and expenditure of 120 urban households, the survey questionnaire does not adequately distinguish between ration and nonration purchases or sufficiently differentiate grades and prices of grain and vegetable oil. This is a serious gap in coverage, especially since urban consumer grain and vegetable oil prices would be radically altered under the planned phase II of the reform program. The monitoring program provides only limited coverage of post-reform agricultural taxes, local extractions and local free market commodity prices. Since the participating agencies routinely collect some of this data, these gaps in coverage could be filled.

3.31 Another important issue is that the monitoring program is focussed too heavily on data collection and places insufficient emphasis on the evaluation of available information. The monitoring program is simply not geared to synthesizing well organized summary information from the large volume of data routinely produced by the local data collection system. As a practical matter, the lack of even one desk computer for the sole use by monitoring program staff make regular data analysis and timely report writing nearly impossible.

E. Plans

3.32 The Phase II of the grain system reform program is expected to rationalize grain/edible oil marketing and prices. The Reform Office is in the process of designing phase II which will address three issues: (a) reduce quota procurement and marketing; (b) make consumer subsidies transparent; and (c) target consumer subsidies. More specifically, they are considering two plans:

Plan I: (a) reduce grain procurement and distribution from current 485 million jin to 385 million jin, and (b) increase edible oil prices from current ration prices to negotiated prices. This will raise enough financial resources to raise contract procurement price for wheat to Y 0.34/jin.

Plan II: (a) increase ration prices for grain and edible oil to negotiated prices, and (b) make necessary wage adjustments for employees to compensate for these price increases. This will generate enough financial resources to raise contract procurement price for wheat to Y 0.38/jin. This plan will target subsidies for standard grade flour and is expected to benefit about 20% of all the consumers, i.e. those consumers who are in low income category.

Local authorities have not yet decided but seem to prefer plan I. Given (a) serious financial problems, (b) inflation and central government's austerity plans to control inflation, and (c) lack of clear direction from the central government for future price reform, there is a good possibility that Xinxiang authorities may choose to postpone the implementation of phase II.

IV. YULIN GRAIN SYSTEM REFORM 6/

4.1 Yulin City is a county-level municipality and is located in southeastern part of the Guangxi Zhuang Autonomous Region, near the Guangdong province. Total population is estimated to be about 1.3 million; 90% of which is rural. It is primarily a rice growing area. Population density is higher and farm size is lower than the corresponding national averages.

A. Design

4.2 The phase I of Yulin RRP consists of (a) an increase in contract purchase price of rice and other grain crops (edible oil prices have already been liberalized); (b) an increase in price of ration grain for urban consumers and rural resale; (c) an adjustment in wages of ration recipients, thereby compensating price increases and making consumer subsidy transparent; (d) an increase in input prices and making input subsidy for contract grain transparent; and (e) sharing the burden of increased cost due to reform implementation between the government, farmers and enterprises. Unlike Xinxiang, however, the Yulin City and provincial governments agreed to pay part of the reform cost. Furthermore, the Yulin RRP is relatively more comprehensive since, in addition to the grain system reform, it consists of financial system reform, accelerated development of

6/ The initial details of the Yulin RRP are provided in (a) Section IV of Working Paper No. 3 of the RSAL Loan Implementation Volume, and (b) Mudahar's preliminary draft paper entitled, "Grain Purchasing, Marketing and Price Reform in Yulin, China."

TVEs, market management system reform, and the establishment of economic development zones.

B. Implementation

4.3 The Yulin RRP was implemented on April 1, 1988. The implementation of the grain system reform has been smooth. The grain farmers and traders were rather happy, at least prior to a sudden increase in grain prices and the reimposition of government restrictions in grain trade. The implementation has been timely and efficient. Different aspects related to reform implementation, including reform organization, resource mobilization (grain buffer stock and risk fund), communication and training were planned and handled well. The Reform Office encountered many problems during implementation but they did a commendable job by addressing these problems efficiently and in a timely fashion. The Reform Office appears dedicated to the success of Yulin grain system reform.

4.4 There was no change in the grain purchase system but the contract purchase price was increased for ordinary paddy from Y 0.1959 to Y 0.22/jin, and for hybrid paddy from Y 0.21 to Y 0.24/jin. The prices for other grades of rice and other commodities were also adjusted accordingly. The hybrid rice is not of higher quality but has higher yield than ordinary rice. Higher price for hybrid rice was expected to provide the needed incentives to bring more area under hybrid rice. The grain procurement target for 1988 was 118.3 million jin, out of which 38 million jin was for agricultural tax. ^{7/} The procurement was without any problem and government was able to fulfill 96% of the annual procurement target. However, since August 1988, market prices for both agricultural inputs and rice have gone up and the gap between contract and market prices of rice has increased; thereby making it difficult to procure rice.

4.5 The ration price of rice was increased substantially from Y 0.139/jin to Y 0.40/jin. ^{8/} On the average, per capita grain ration is fixed at 30 jin/month; which consists of rice (about 70%) and wheat and corn flour (about 30%). Total ration sale is estimated to be about 66 million jin. There has been a slight decline in ration rice sale from 71 million jin in 1986/87 to 66 million jin in 1988/89. This is due to a deliberate government policy to reduce rice sale on ration price by closing loopholes for ration grain entitlements and by excluding food industry from ration grain sale. The available evidence indicates that the average actual per capita grain consumption is less than 30 jin/month. In the past, consumers were allowed to accumulate leftover ration coupons for later use but have been prohibited (only in Yulin municipality) after the reform was implemented. However, leftover coupons that were issued during

^{7/} Unlike Xinxiang, agricultural tax in Yulin City is already very high and ranges between 50-60 jin/mu of paddy. As a result, the psychological tolerance of farmers for even higher agricultural tax is considered low.

^{8/} This price is for No. 3 grade of rice. The reform prices for No. 2 and No. 1 grades of rice are Y 0.43/jin and Y 0.46/jin, respectively. Most of the rice produced in Yulin City is No. 3 grade.

the pre-reform period are still valid and consumers are allowed to purchase rice against these coupons at the pre-reform ration price.

4.6 The supply of old accumulated coupons and the current surplus ration coupons and the demand for these coupons from migrant workers, who are not eligible for ration coupons, has led to the development of an "illegal coupon market." The ration coupon holders are making extra money through ration grain or coupon trade and thereby undermine the smooth operation of the official grain market. Even after the reform, there has been a net inflow of provincial and national ration coupons which the Yulin government has to honor (6 million jin worth rice coupons from January to September 1988). This inflow of ration coupons is not only creating instability in the grain market but also increases the financial burden on the Yulin government. Clearly, the marketing reform is a major step forward but there remain problems due the existence of many types of ration coupons, net inflow of people with valid coupons to Yulin City, and lack of information on the exact amount of ration grain against valid surplus coupons.

4.7 Grain subsidies, both farm input and and consumer, have been made transparent. Farm input (urea and diesel) subsidy is linked with contract grain and was estimated to be about Y 6.00/100 jin of unprocessed contract grain (paddy). Farmers, who choose to deliver more than their assigned grain quota at the contract price, are also eligible for this subsidy. Now farmer has the option between (a) cash the Y 6.0 coupon and purchase specified amount of inputs at market price, or (b) return the coupon to the Supply and Marketing Cooperative (SMC) retail store and purchase specified amount of inputs at subsidized price. However, there was and continuous to be a serious shortage of these inputs. As far as consumer subsidy is concerned, it has been increased and made transparent. The post-reform grain subsidy (for milled rice) is Y 0.261/jin which is equal to the difference between the old and new ration prices for rice. Ration grain subsidy has increased from Y 0.1149/jin "hidden" subsidy (pre-reform) to Y 0.261/jin "transparent" subsidy (post-reform). In other words, the per capita grain subsidy was estimated to be about Y 8.0/month. The actual subsidy is, however, even higher since the ration prices do not account for grain marketing and processing costs.

4.8 The Yulin RRP is not self-financed (like Xinxiang) and the reform cost is shared by government, enterprises and farmers as follows:

- | | |
|-------------|---|
| Farmers: | They receive contract grain price which is lower than market price and pay higher input prices. |
| TVEs: | They pay consumer subsidy in the form of higher wages and hence higher cost of production or circulation. |
| Government: | Government bears additional cost of consumer subsidies. |

Initial estimate indicate that an increase in reform cost is expected to be about Y 4.9 million -- which will be shared between provincial government (Y 1.0 million), local government (Y 1.3 million) and enterprises (Y 2.6

million. The farmers and enterprises were able to bear their share of the burden. However, the Mission was advised that the Yulin government is having serious financial problems to be able to pay for additional costs associated with the reform. The Yulin City's financial problems were closely linked with the financial problems faced by the provincial government. Partly due to financial problems, the Yulin Grain Bureau was not able to purchase sufficient additional rice at negotiated prices from outside the Yulin area for resale -- which was done during 1987. As a result, Yulin City lost another potential source of additional revenue.

C. Impact

4.9 The impact of grain system reform in Yulin is discussed under three broad categories: (a) response of farmers, cadres and enterprises; (b) economic pact; and (c) financial impact.

4.10 Unlike Xinxiang, Yulin RRP did not carry out any specific survey to monitor the response of farmers, cadres and enterprises towards the grain system reform. Until the harvest of first rice crop (which was harvested in August, later than normal, and is a major rice crop of the year), both farmers and cadres were happy with the reform. However, as (a) the gap between contract and market prices for rice widened, (b) input supply became scarce and input prices went up, and (c) government imposed tax on high value crops (grown by both grain and nongrain farmers), both farmers and cadres became relatively less enthusiastic about the reform. Enterprises are fully cooperating with the government and all, but seven, have already made needed wage adjustments to compensate for an increase in ration price for grain.

4.11 The general economic impact of the grain system reform has been positive. (a) Area under ordinary rice increased from 548,000 mu to 560,000 mu and area under hybrid rice increased from 60,000 mu to 160,000 mu. Despite drought and insect damage, rice production increased in response to improved economic incentives. (b) Grain procurement was smooth and 96% of whole year's grain procurement target was fulfilled. (c) Prior to the implementation of grain RRP there was panic buying of rice against accumulated ration coupons due to fear that these coupons will be revoked. As the government assured the consumers that the old coupons will remain valid at pre-reform price the grain sale by the Grain Bureau stabilized to below normal levels of 65,000 kg/day. However, it is too early and data is too inadequate to conclude that human consumption of rice has dropped in response to post-reform high ration prices of price. Wastage and misuse (use as chicken feed) of rice has certainly dropped. (d) The role of private retail trade expanded. The number of grain trading enterprises increased from 176 (March 1988) to 252 (May 1988). However, since then government has imposed restrictions on private trade. (e) Up to mid-July, market prices of rice were stable and even lower than in the surrounding areas and in other parts of China. After that, rice prices skyrocketed to about Y 0.80/jin (Annex 3). This was not really due to reform but rather due to nation-wide inflation, uncertainty related to grain price reform and drop in grain production at the national level. Furthermore, other nonrelated commodities also experienced similar price increases.

4.12 The estimated financial costs due to the reform have not really increased but rather the government is finding it difficult to pay for its share. The Mission was advised that the reform is experiencing severe financial problems. This is primarily due to (a) the provincial government has not been able to release both central and provincial funds which have already been allocated to Yulin; (b) Yulin City government has not been able to meet their own financial obligations for the reform due to its financial problems -- which are partly due to the financial problems faced by the provincial government; and (c) the allocated credit plan has already been oversubscribed and, thus, the City is unable to borrow from banks (partly due to restrictions imposed by the national austerity plan and reduction in credit expansion) to meet their working capital requirements. On the other hand, money has already been spent to procure grain at new higher contract purchase prices. Consequently, the reform office is unable to meet its financial obligations and the Grain Bureau is not able to purchase grain from outside at negotiated prices not only to meet City's grain needs but also to earn profit from grain marketing operations.

4.13 The gaps between the contract grain price and market price, and between higher ration grain price and markets price has widened to a level which is larger than that prior to the reform. As a result, the need for financial resources to implement phase II of the reform has increased substantially. The morale of the reform group is low due to uncertainty and lack of direction from the central government for future courses of action.

D. Monitoring

4.14 The Yulin Reform Office has established a monitoring program which relies critically on the statistical and accounting units of 15 local government and quasi-government agencies. These participating agencies are listed in Annex 4. The monitoring program is run directly by the Reform Office; unlike the Xinxiang monitoring program, the Yulin Statistical Bureau has not taken a lead role. About 32 full and mostly part time staff members are involved in the monitoring program.

4.15 Yulin's monitoring program focuses on assessing the impact of the grain system reform on the following six area:

- production of rice and principal cash crops;
- production budgets and input use for rice;
- wholesale procurement and retail sales of rice and the number of enterprises engaged in grain trade;
- free market retail prices for farm inputs and outputs;
- financial costs of the reform to the provincial and municipal governments and industrial, commercial, and private enterprises; and
- urban and rural income and expenditure.

The large number of monitoring indicators subsumed within these six categories have also been prepared. This long listing of indicators, which is summarized in Annex 4, includes free market retail price for an excessive number (156) of agricultural inputs and outputs. Unfortunately, the listing does not indicate the frequency of observation, geographic coverage, reporting deadlines and agencies responsible for these monitoring indicators -- suggesting that no specific plans have as yet been drawn up.

4.16 Funding and technical support for Yulin's monitoring program are grossly inadequate. The Yulin government has appropriated only about Y 25,000 for the whole experimental Reform Office to cover the operating costs of the reform, including the monitoring program. This amount is not sufficient to cover incremental data collection costs and certainly inadequate for the planned urban and rural household surveys. The monitoring program has received no technical support from RCRD.

4.17 The Yulin monitoring program is inadequate to bring together detailed information on all important aspects of the grain system reform and may fail to undertake an objective and critical evaluation of the impact of the reform. As in Xinxiang, one of the serious gaps in the monitoring indicators is the inadequate coverage of urban grain and vegetable oil consumption. Unfortunately, the Yulin Statistical Bureau does not undertake even the routine survey of urban households. Apparently, the Yulin Statistical Bureau has not yet set up an urban Sample Survey Team which is normally responsible for collecting data on urban consumption and expenditure patterns. Total ration grain sales are known, but it is impossible to determine even average urban per capita consumption from such data. The Yulin RRP staff are unable to assess trends in actual grain consumption disaggregated by type of grain (i.e., by ration, nonration, variety and grade) and income group. This gap in coverage is particularly unfortunate since Yulin has undertaken a major reform of urban ration grain and vegetable oil prices.

4.18 As is true for Xinxiang, another important issue is that Yulin's monitoring program is focused too heavily on data collection and places inadequate emphasis on the evaluation of collected information. The monitoring program is simply not geared to synthesizing well organized summary information from the large volume of data routinely produced by the local data collection system and lacks access to even one desk computer. Finally, Yulin's monitoring program also lacks independent monitoring and evaluation arrangements and capacity.

E. Plans

4.19 Phase I of Yulin RRP is expected to be followed by phase II (replace mandatory contract grain purchase by voluntary contract, reduce grain purchase and sale and deregulate grain purchase and sale prices) and phase III (reform input and consumer subsidies and incorporate subsidies in the wage structure). The authorities are optimistic and determined to make the Yulin RRP successful and a model for other parts of Guangxi and China. However, they feel that 3 conditions must be met before they can realistically implement proposed phase II of the grain system reform. These are (a) contract purchase price should not be much lower than market price, (b) long period of price stability, and (c) adequate current

government finance. At present, it appears that these conditions may not be met during 1989. As a result, the prospects for further progress in grain system and price reforms in Yulin do not appear good and the implementation of phase II of the grain system reform may be postponed.

V. LESSONS AND RECOMMENDATIONS

A. Lessons

5.1 Considering the complexity and risks associated with the Xinxiang and Yulin grain system and price reforms, these RRPs have made satisfactory progress in their design and implementation. Price reforms are relatively new phenomena in China. The reformers did an excellent job in designing first phases of the Xinxiang and Yulin grain system reforms but did not anticipate all the problems now being encountered. It is thus necessary to wait until the implementation is complete and all the results are evaluated before drawing any conclusions. However, based on the limited experience to date, a few lessons can be drawn which may be of some use to these and any other grain system reforms in China.

5.2 The preliminary lessons from the Xinxiang and Yulin RRPs deal with both the design and implementation of grain system reforms. First, the grain system reform design should be relatively comprehensive, i.e., it should address problems in both the rural and urban sectors simultaneously and the reform must include measures to expand grain production and reduce grain consumption. Second, the benefit/cost calculations for such reforms must be realistic, i.e., financial analysis must incorporate realistic prices, quantities and time periods. To some extent, both the Xinxiang and Yulin authorities should have been able to anticipate their current financial problems even before these RRPs were implemented. Third, an increase in prices is not a very reliable source of raising additional revenue to pay for the incremental reform costs. In other words, there is a need for budget appropriations (like in Yulin) and creation of "risk fund" which should be used in case of an emergency, especially when outside forces threaten the success of such regional reforms. Fourth, benefits from price reform are not immediate and the distribution of benefits and costs may not be equitable. Hence, there is a need for a lot of publicity about the contents and potential impact of the reform. This is especially true in an inflationary environment like China is passing through at this time. Fifth, grain system and price reforms need political support at all levels, especially since the grain sector has been considered one of the most important sectors in China's economy.

B. Specific Recommendations

5.3 Xinxiang RRP: In order to improve the usefulness of Xinxiang RRP as a pilot program and improve its chances of success, there is a need to address five important issues. (a) Wheat production must be increased through an increased use of modern technology (high yielding seeds, irrigation, fertilizer and insecticides) and an increase in investment in agricultural sector (research, extension, infrastructure). (b) There is a need to delink input supply at subsidized prices from contract grain (and

for that matter other crops) and subsidy should be incorporated in contract prices of grain. (c) Xinxiang authorities yielded to objections of farmers from three areas and agreed to reduce agricultural tax rate and sell inputs at old subsidized prices to cotton and vegetable farmers because they felt that they did not benefit from the reform. This needs to be reversed since these crops are highly profitable as compared to grains and besides it sets a bad precedent. ^{9/} There is also a need to determine increased rate of local extractions and the total tax burden on farmers. (d) The relations between rural and urban sectors needs to be improved. This can be accomplished by reforming the urban grain system (by implementing phase II) and by making the enterprises pay part of the reform cost through wage adjustments (like in Yulin). (e) There is a need to improve the monitoring system particularly by expanding the grain and edible oil consumption section of the urban household survey, providing adequate data processing facilities and improving the analytical capacity of those involved in monitoring and evaluation of the grain system reform.

5.4 Yulin RRP: Yulin RRP is slightly different than Xinxiang RRP, and together they address most of the important issues faced by the grain system in China. Consequently, in order to improve the usefulness of Yulin RRP as a pilot program and improve its chances of success there is also a need to address five important issues. (a) Rice production needs to be increased further through increased use of modern technology and an increase in agricultural investment. Specifically, there is a need to increase the supply of hybrid rice seed which was in short supply during 1988. (b) Delink input supply from contract grain (rice), thereby merging two input markets into one and eliminating any chances of leakage. The current input subsidy should be incorporated in contract grain price. (c) Enterprises should be required to increase their share of the reform cost through wage adjustments. (d) Consumers must also be required to pay part of the reform cost. This can be accomplished through many ways, including reduce in grain subsidy, freeze subsidy at current levels, pass on part of the marketing and processing costs to consumers. (e) There is a need to improve the monitoring system particularly by undertaking urban household consumption survey with extended grain and edible oil consumption components, providing adequate funds for surveys and data processing facilities and improving the analytical capacity of those involved in monitoring and evaluation of the grain system reform.

C. General Recommendations

5.5 The problems which are currently being faced by the Xinxiang and Yulin RRPs are mainly due to (a) all the potential gains from grain system and price reforms were not visible and immediate, unlike the gains from

^{9/} It is a fundamental tenet of economic reform, and indeed of the process of economic development, that some interests will be damaged while the reform is being implemented. The trick is to safeguard the interest of the most vulnerable groups (only) and not the better-off farmers, consumers, enterprise operators and the like. Otherwise, the cost of implementation can become unmanageably high, thereby imperilling its success and vitiating prospects of diffusion and the accrual of larger benefits by the community-at-large.

reforms which led to the creation of household responsibility system of farms and contract management system of enterprises; (b) the inflation has widened the gap between the controlled prices and market prices (as part of China's two-track price policy) for both prices received by grain farmers and prices paid by ration grain consumers; and (c) the government austerity program to control inflation has made it relatively difficult to obtain loans from banks in order to meet working capital needs and solve the cash flow problem being encountered by the grain system reform areas.

5.6 The mission, therefore, encourages the RCRD to immediately consider the following recommendations to assure the success and objectivity of the ongoing grain system reforms in Xinxiang and Yulin.

- (a) Political support: Since the local authorities are not prepared to take political risks associated with continuing the reform, there is a need to provide political support and clear direction for their future activities. This could take the form of directives and frequent visits by national leaders, and RCRD officials to these RRP's.
- (b) Financial support: Both RRP's are encountering serious financial problems to continue phase I and to initiate phase II of these grain system reforms. There is, thus, an urgent need to provide necessary financial support to cover reform related incremental expenditure for both the Xinxiang and Yulin grain system reforms. Any financial support, however, should be linked and made contingent to their meeting the needs and obligations of ongoing and planned reform programs. The financial arrangements, terms and amount can be worked out among local authorities, and RCRD.
- (c) Material support: Adequate supply of modern inputs, including fertilizer (urea) and diesel, is essential for grain production and for the success of grain system reforms. Both Xinxiang and Yulin are encountering serious input supply problems. There is, thus, a need to provide right type of agricultural inputs, in right amounts and at the right time, as soon as possible. The potential positive impact of price reforms on crop production is not being fully realized due to serious input supply constraints.
- (d) Technical support: The phase II of the reform program in Xinxiang and Yulin is designed to rationalize consumer subsidies for ration grain. This is essential not only to reduce wastage and increase efficiency of resource utilization but also to better serve the needs of those who truly need such subsidies by targeting them to low income consumers, low grade commodities and relatively poor regions. The grain ration amount (15 kg/month/capita, on the average) is more than adequate and there is plenty of evidence that consumers misuse surplus ration grain either as feedgrain or convert it into cash by selling ration grain (or coupons) at market prices. Furthermore, the policy to allow consumers to accumulate unused ration grain coupons does not make any economic sense. Any strategy designed to rationalize consumer subsidies will reduce the financial burden of subsidies on local governments engaged in the reform. RCRD should provide necessary technical

support to better design, implement and monitor such programs, now and in the future, in both Xinxiang and Yulin.

5.7 The lessons from the Xinxiang and Yulin grain system reforms can be extremely useful for designing and implementing such reforms at the provincial and national levels. As a result, government authorities must make sure that all the proposed future plans for the Xinxiang and Yulin RRP's are fully implemented. Otherwise, the policymakers will be denied the appropriate experience, information and lessons necessary for formulating national agricultural marketing and price policy. A tight national control on grain and agricultural input prices will discourage the grain system RRP's from carrying on further price reforms. Clearly, there is a need to address macro policy issues at the national level but this must be accompanied by an increase in incentives for farmers, rationalization of urban consumer subsidies and strengthening of grain system RRP's in Xinxiang and Yulin.

GRAIN PRODUCTION, PROCUREMENT, DISTRIBUTION AND TRADE IN XINXIANG

1. Production and Procurement. Xinxiang grain production, procurement, distribution, and trade for 1985-88 are reported in Table 1. These figures indicate that estimated 1988 total grain production of 1.89 million mt will exceed the 1984 record grain harvest by 5%. The Grain Bureau procured, on average, some 465,000 mt of grain annually during 1985-87, or a little more than one-quarter of Xinxiang's total grain output. During this period, contract procurement declined both in absolute terms (by more than one-third, from 378,000 mt in 1985 to about 243,000 mt in 1988) and as a share of total procurement (from 65% in 1985 to 60% in 1987). Negotiated procurement, on the other hand, more than tripled from 68,000 mt in 1985 to 233,000 mt in 1987. No data are available for procurement of grain by other state and nonstate agencies, but it is known that free market purchases by these groups is expanding.

2. Distribution. The Grain Bureau distributed an average of 215,000 mt of grain annually within Xinxiang City during 1985-88, or close to half of its total grain procurement. Annual urban ration sales, which on average comprise about two-thirds of total distribution, increased by more than 50% from 117,000 in 1985 to 177,000 mt in 1988. The number of grain ration recipients increased by less than 15% over the same period, suggesting that each ration recipient now obtains significantly more ration grain than in previous years. 1/ The Grain Bureau's sales of grain to the rural population vary greatly from year to year, having increased to 106,000 mt in 1986 and declining to some 44,000 mt in 1988. These annual fluctuations in rural resales primarily correspond to jumps in rural demand induced by localized crop failures due to bad weather and other natural disasters.

1/ The Grain Bureau reported to the supervision mission that Xinxiang's "nonagricultural" population (i.e., those entitled to grain rations) increased from 548,000 in 1981 to 662,000 in 1986. This 25% increase corresponds to average annual rate of 4.5%, or almost four times the growth rate of 1.2% registered by Xinxiang's general population. It was also reported that only 75% of Xinxiang's urban district population was entitled to grain ration (i.e., some 425,000 of Xinxiang's 1986 urban district population of 554,000 was classified as "nonagricultural" and hence entitled to grain ration). Unfortunately, very little is known about the 129,000 urban residents not entitled to receive grain ration.

TABLE 1: Grain Production, Procurement, Distribution and Trade in Xinxiang ('000 mt)

	1985	1986	1987	1988
Production				
Total	1627	1762	1799	1891
Wheat	691	1076	992	1064
Other	736	685	807	827
Procurement				
Total	445	475	473	na
Contract	378	265	239	243
Negotiated	68	210	233	na
Distribution				
Total	183	245	206	222
Urban ration	117	140	120	177
Other	66	106	85	44
Trade (net exports)				
Total	228	183	183	na
Within plan	206	136	39	na
Outside plan	22	47	124	na

Source: Xinxiang Municipal Grain Bureau.

Note: Figures are for Xinxiang Grain Bureau grain procurement, distribution and trade only. All 1988 figures (except wheat production) are Xinxiang Grain Bureau estimates.

3. Trade. The grain trade figures (net intra- and extra-provincial exports) presented in Table 1 indicate that net exports of grain declined from 228,000 mt in 1985 to 163,000 mt in 1987. Within plan exports declined sharply during this period, from 206,000 to 39,000 mt, while negotiated (outside plan) exports increased from 22,000 to 124,000 mt. This rapid transition from mostly planned to mostly negotiated exports of grain is consistent with the financial interests of the Grain Bureau and farmers and was likely hastened by anticipation of the 1986 procurement price reforms. Prior to the 1986 reforms, the Grain Bureau procured grain for planned exports from farmers at low contract prices and sold this grain outside Xinxiang at cost plus a small margin for handling. The Grain Bureau broke even on planned exports while Xinxiang's farmers received below market prices and were in effect subsidizing grain consumption in outside urban areas. By comparison, grain for negotiated exports is procured and sold at higher negotiated prices. The Grain Bureau is allowed to turn a moderate profit and Xinxiang's farmers receive prices more closely approximating market value on negotiated export grain. By switching to negotiated exports in 1986-87, the Grain Bureau was able to both improve its financial balance sheet and substantially increase average producer prices. The 1988 reform of procurement prices further diminished the Grain Bureau's interest in planned grain exports since, as all planned interregional grain trade continues to be transacted at pre-reform prices, it now suffers a loss of at least 60 yuan on each ton of planned grain exports. The Grain Bureau appears to be limiting its losses by quietly reducing planned grain exports.

MONITORING THE GRAIN SYSTEM REFORM IN XINXIANG

1. Responsible Agencies. The monitoring component of the Xinxiang Grain System Reform Office consolidates data collected by 15 municipal agencies, including Statistical Bureau, Agricultural Bureau, Grain Bureau, Industry and Commerce Bureau, TVE Bureau, Foreign Economic Relations Commission, Economic Commission, Urban Survey Team, Vegetable Office, Supply and Marketing Cooperative, Production Inputs Company, Petroleum Company, Fertilizer Company, and the Meat Packing Company.

2. Monitoring Indicators. The proposed monitoring indicators are classified into four broad categories:

(a) Production

- Area, yield and output of main crops.
- Output of animal products.
- Production capacity, planned production, and fertilizer stocks.

(b) Production Budgets and Input Use:

- Production budgets for wheat, corn, rice, soybeans, cotton, peanuts, and vegetables.
- Production budgets for pork and chicken.
- Use of fertilizer and diesel per mu of wheat, corn, rice, soybeans, cotton, and peanuts.

(c) Procurement, Sales and Prices:

- Planned and actual contract procurement of grain and vegetable oil by the Grain Bureau.
- Urban sales and interregional trade of grain and vegetable oil.
- Rural Sales of grain.
- Negotiated procurement and sales of grain and vegetable oil by the Grain Bureau, Trade Department, Supply and marketing Cooperatives, TVEs, and SOEs.

- Free market procurement of grain and vegetable oil by the Grain Bureau.
 - Free market trade volume and prices of pork and eggs.
 - Sales and retail prices of vegetables.
 - Free market prices of grain, vegetable oil, meat, eggs, and vegetables in other cities.
 - Within and outside plan sales of urea.
 - Free market price of fertilizer.
 - Within and outside plan sales of diesel.
- (d) Income:
- Urban distribution of income.
 - Average urban per capita income and expenditure.
 - Budget shares by food category for average and poor urban households.
 - Average rural per capita income by township.
 - Average rural household income and expenditure by township.
 - Rural income and expenditure by township for poor households.

FREE MARKET RETAIL PRICES IN YULIN

1. The Yulin Municipal Industry and Commerce Bureau (ICB) and the Yulin Municipal Price Bureau (PB) monitor local free market retail prices. The ICB manages Yulin's 46 urban and rural trade fairs (free markets), collecting a 2% revenue tax on sales of agricultural products and 1% on sales of industrial products in these fairs. Using its observations of total sales value and prices, the ICB also estimates total sales volume. Sales value, volume and price data for approximately 135 agricultural inputs and outputs and 10 daily use items are reported monthly to the Guangxi Regional Administration of Industry and Commerce. The PB monitors planned, negotiated and free market retail prices for a much larger number of agricultural and nonagricultural inputs and outputs, but does not record or calculate total sales value or volume for these products. These price data are collected three times each month and reported to the State Price Bureau.

2. The ICB monthly free market price data for rice, soybeans, peanut oil (the principal vegetable oil in the area), and four animal products for 1987-88 are presented in Table 1. These data indicate that during the first three months of 1988 free market prices of these eight farm products followed trends similar to those observed for the first three months of 1987. However, the prices increased steadily during the six months following implementation of the grain system reform (April to September of 1988) -- clearly diverging from the trend observed for the same months of 1987. By September 1988 prices were substantially greater than in September 1987. The September 1988 free market price of rice, at 1.37 yuan/kg., was more than 60% greater than in 1987. Prices for soybeans and duck were up approximately 15%, peanut oil, eggs and chicken up about 30%, and pork up roughly 45%. Yulin RRP staff reported that these price increases were in line with trends observed throughout southwest China. However, a more carefully documented comparison of free market prices in southwest China is warranted.

TABLE 1: Free Market Retail Prices for Selected Agricultural Commodities
in Yulin (y/kg)

Year	Month	Milled Rice	Soybeans	Peanut		Chicken		Duck
				Oil	Pork	Egg	Chicken	
1987	1	0.90	1.20	4.00	3.50	4.20	6.20	3.70
	2	0.97	1.18	4.30	3.45	4.00	7.50	4.40
	3	0.86	1.10	4.00	3.44	3.80	7.30	3.80
	4	0.88	1.28	4.25	3.60	3.80	7.10	4.20
	5	0.92	1.20	4.10	3.50	4.00	7.70	3.80
	6	0.88	1.25	4.10	4.00	4.20	na	na
	7	0.85	1.15	4.50	5.60	4.50	7.80	4.40
	8	0.84	1.28	4.50	4.50	4.80	7.10	3.20
	9	0.90	1.35	4.80	4.40	4.70	7.00	4.10
	10	0.90	1.40	4.90	4.60	5.40	na	na
	11	0.92	1.50	5.00	5.50	5.20	na	na
	12	0.90	1.50	4.90	5.10	5.50	na	na
1988	1	0.93	1.30	5.00	5.00	5.50	7.40	4.50
	2	0.96	1.28	4.80	5.10	5.00	8.40	5.00
	3	0.94	1.25	4.80	5.00	5.60	7.20	5.00
	4	1.04	1.37	4.98	4.92	5.47	6.94	4.80
	5	1.10	1.36	4.80	4.80	5.10	7.00	4.40
	6	na	na	na	na	na	na	na
	7	1.12	1.27	5.70	6.25	5.70	8.50	4.50
	8	1.20	1.37	5.95	6.82	5.95	8.60	5.00
	9	1.37	1.55	6.15	6.30	6.20	8.90	4.75

Source: Yulin Municipal Industry and Commerce Bureau.

MONITORING THE GRAIN SYSTEM REFORM IN YULIN

1. Responsible Agencies. The monitoring component of Yulin Grain System Reform Office consolidates data collected by 13 municipal agencies, including Statistical Bureau, Agricultural Bureau, Grain Bureau, Price Bureau, Industry and Commerce Bureau, Commerce Bureau, Planning Commission, Economic Commission, Agricultural Commission, Economic System Reform Office, Agricultural Production Office, Finance Office, and the Supply and Marketing Cooperative.

2. Monitoring Indicators. The proposed monitoring indicators are classified into five broad categories:

(a) Production

- Area and output of rice (total and by season and type).
- Area, yield and output for sugarcane, bananas, tobacco, and bast fibre.

(b) Production Budgets and Input Use

- Production budget for rice.
- Use of Fertilizer, manure and labor in rice production.

(c) Procurement, Sales and Prices

- Contract procurement of rice (total and by type).
- Monthly ration sales of rice (total and by type).
- Negotiated sales of rice (total and by type).
- Free market sales of rice.
- Number of enterprises engaged in grain trade.
- Retail prices of 16 farm tools, 15 fertilizers, pesticides, and diesel fuels, 9 other farm inputs, 7 staple foods, 60 nonstaple foods (mostly vegetables, meats and fish), 15 tobacco, tea and beverage products, 28 other foods (mostly fruits), and 6 heating fuels.

(d) Financial Analysis

- Absolute value and share of the fiscal costs of explicit grain subsidy (by prefectural and municipal government and industrial, commercial and private enterprises).

(e) Income and Welfare

- Planned sample survey of 100 urban households covering income distribution, monthly allotment of ration grain and actual grain consumption.
- Planned sample survey of 100 rural households covering area sown to grain, production expenses, contract and noncontract grain sales, grain purchase and consumption, and sources of income.

CHINA

RURAL SECTOR ADJUSTMENT LOAN

POST-EFFECTIVENESS SUPERVISION MISSION

Reform of the Urban Ration Grain System

by- Alan Piazza (AS3AG)

CHINA

REFORM OF THE URBAN RATION GRAIN SYSTEM

1. Introduction. China's urban ration system was initiated in the 1950s as a means of guaranteeing urban consumers adequate supplies of staple foods at stable prices. The ration system operated at a small profit during its first decade, but began suffering moderate losses in the 1960s as the government increased agricultural producer prices while keeping ration sale prices constant. These losses grew dramatically in 1979 and subsequent years as producer prices were sharply increased as part of the rural reform program. By the mid-1960s the government was spending an average of Y 25 billion annually on urban consumer food subsidies, an amount representing 15% of total state expenditure and seven times state expenditure on agricultural infrastructure (Y 3.5 billion).

2. Providing urban ration recipients with cheap grain and vegetable oil accounts for 60%, or about Y 15 billion, of the fiscal costs of these urban food subsidies. The fiscal cost of the subsidies for grain and vegetable oil includes both (i) the difference between the government's procurement costs and sales revenues plus (ii) its losses on handling, storage, processing, transport and retailing. The economic value of these subsidies substantially exceeds their fiscal cost, furthermore, since free market grain prices greatly exceed the government's average procurement prices. In 1967, for example, the government's average procurement price for the two principal ration grains, rice and wheat, was Y 600 and Y 480 yuan per ton respectively--well below their free market price of Y 950 and Y 620. The government provided these grains to urban ration recipients at Y 260 per ton, taking a loss of Y 390 and Y 270 on each ton of rice and wheat (the difference between the procurement and retail price of rice and wheat plus handling costs of about Y 70 per ton). The differences between the free market and the government's procurement price for rice and wheat, Y 350 and Y 150 per ton, is in fact a hidden subsidy provided by China's farmers to urban ration grain recipients. Including this hidden subsidy, the true economic value to ration recipient of the subsidies on rice and wheat in 1987 were Y 740 and Y 410. As long as the ration price for grain remains fixed at Y 260 per ton, the grain ration system will continue to claim a large share of the government's resources, ration recipients will be encouraged to overconsume, and farmers will be obliged to sell a portion of their marketed output at below-market prices.

3. Reform Programs. As a first step toward controlling the mounting fiscal cost of the ration grain subsidy, the central government has promoted a number of regional ration grain reform programs. The most common approach adopted in these reform programs has been to increase the price of ration grain while compensating ration recipients with offsetting income transfers. Grain ration prices were increased from Y 0.25/kg to Y 0.61/kg on a province-wide basis in Guangdong and Fujian provinces were compensated with an increase

in their monthly wages of Y 8, an amount estimated to offset the increase in their grain purchase costs. In Yulin City, Guangxi, grain ration prices were increased from Y 0.28/kg to Y 0.80/kg. All ration recipients, both employed and unemployed, were compensated with a monthly income transfer of Y 7.92. Zhuozi County in Nei Monggol is reported to have undertaken a reform similar to that implemented in Yulin, but the supervision mission was not informed of the details of the Zhuozi reform. A second approach, in which the central government limited its direct subsidy expenditure to the standard monthly base ration quantity of 15 kg of grain per person, was adopted in Shanxi province in May 1988. Prior to implementation of the reform, the central government had also directly covered the costs of additional job-specific "variable" grain rations. The costs of these variable rations, which are reported to run as high as 25 kg per worker per month in Shanxi's coal industry, are now covered by the provincial and local enterprises employing workers entitled to such benefits. In most cases these enterprises have simply monetized the value of the variable ration grain as an addition to monthly wages. Since the increase in these enterprises' wage bills is considered to be a regular cost of production, the central government continues to indirectly subsidize part of the cost of variable grain rations through reduced enterprise profit taxes.

4. Issues. Of particular concern to China's policy makers was that these planned increase in ration grain prices neither prove unacceptable to ration recipients nor unduly contribute to inflation. The successful implementation of the ration grain system reform programs has proven that ration recipients will readily accept increased grain ration prices when they receive an offsetting money transfer. This is not surprising since ration recipients would be expected to prefer the greater discretionary power of a direct money transfer. The impact of the reforms on prices has been less clear, however, since implementation coincided with a period of increasing general inflation. It could be argued that reform of the ration system should not exert much influence on the general price index since ration grain comprises only a small portion of total urban household expenditure and that the money transfers provided to ration recipients only complete the monetization of an already partially monetized subsidy. However, a critical assessment of this important issue is certainly warranted. As a first step, RCRD should initiate a quantitative comparative analysis of trends in free market prices within and outside the reform program areas.

5. Designers of the ration grain system reform programs also faced the practical issues of (i) whether to compensate only currently employed or all ration recipients and (ii) whether to continue to honor the backlog of unused grain ration coupons at pre-reform prices after implementing the reform. In Guangdong and Fujian it was decided to provide offsetting money (wage) transfers only to currently employed ration recipients. Employed ration recipients receive 150% of the estimated average per capita incremental cost of purchasing higher priced ration grain in order to cover greater expenditures for their dependents. The Yulin government, on the other hand, decided to compensate all current ration recipients regardless of their employment status. Acknowledging the greater operational and management costs involved, the Yulin reformers felt that compensating only currently employed recipients would have an adverse impact on income distribution and the welfare of the

urban poor. The Yulin government also decided to continue to honor pre-reform ration coupons at the pre-reform ration price. Since the Yulin government suffers a loss of Y 0.52 on each kg of rice sold at the pre-reform ration price,^{1/} outstanding pre-reform ration coupons for some 4,000 tons of grain represent a post-reform financial liability of Y 2 million. Fearing that this would set a precedent for future national-level reform, the central government strongly advised against honoring the pre-reform coupons. However, arguing that invalidating pre-reform grain coupons would prove unacceptable to ration recipients, the Yulin government was eventually able to secure central government approval to continue honoring the coupons.

6. Yulin. Adoption of the ration grain reform program in Yulin proceeded smoothly and provoked little local opposition. Sale of ration grain did increase sharply immediately prior to implementation of the reform on April 1 (March 29 ration sales were four times the usual daily rate), but declined to pre-reform levels during the latter part of April. Redemption of pre-reform grain ration coupons at the pre-reform price also declined sharply over the summer months. This decline was of great importance to the Yulin government, since continued redemption of pre-reform ration coupons would have entailed a heavy and perhaps unsustainable burden on the city's financial reserves (para. 5). The principal unforeseen difficulty encountered during implementation of the ration grain reform has been the steady increase in the free market price of rice (which accounts for more than 80% of Yulin's ration grain sales) from Y 0.94 in March to Y 1.37 in September. Since similar price increases have been experienced throughout south China this summer, this price increase is not considered to have been induced by the Yulin reform program. The increase in the free market price is nevertheless of great concern to the Yulin reformers since it has resulted in a resurgence of a large gap between free market and ration grain prices--the gap between the free market and the ration price of rice was reduced from Y 0.66/kg to Y 0.14 with implementation of the reform on April 1 but had recovered to Y 0.43/kg by September.

7. Outlook. Subject to the outcome of the several ration grain system reform programs implemented in the first half of 1988, the central government had intended to extend the reforms nation-wide in 1989 and most of China's provinces have designed their own reform programs. With the upsurge in inflation and the decision to temporarily bring a halt to price reform, it appears certain that extension of the ration grain system reform program to additional provinces will be delayed until 1990 at the earliest. Fortunately, it appears unlikely that the central government will require any of the ongoing ration grain system reform programs to reverse actions taken earlier this year.

8. The reform programs in Guangdong, Fujian, Guangxi, Nei Monggol and Shanxi have taken the important first step of monetizing the subsidy value of ration grain. However, none of these reform programs have either (i) exposed the urban ration grain recipient to variable free market prices or

^{1/} As a central part of its reform program, the Yulin Grain Bureau now procures rice (milled equivalent) at Y 0.80/kg. Redeeming pre-reform ration coupons at the pre-reform price of Y 0.26/kg, the Grain Bureau suffers a loss of Y 0.52/kg.

(ii) reduced the value of those subsidies. Both the Yulin and Xinxiang governments have plans to undertake these more radical steps in the next stages of their reform programs. Yulin's plans call for first setting ration grain prices equal to current free market prices and then gradually reducing the subsidy value. In Xinxiang the government would first monetize the subsidy value and then reduce total subsidy outlays by targeting benefits to the poor. Unfortunately, it does appear likely that the central government decision to delay further price reform for at least one year will also apply to Yulin and Xinxiang.

9. Recommendations. While the government's decision to delay further price reform is disappointing, it does provide additional time to more carefully evaluate the impact of this year's reform programs and better plan the next steps of the reform. As noted above, one important issue is to examine the impact of the reform programs on food and nonfood prices. Although it is expected that reform of the ration grain system should not exert significant upward pressure on prices, being able to convincingly demonstrate this point may prove essential to expediting wider adoption and deepening the reforms. Another important area to research is the functioning of ration system and, in particular, its impact on grain consumption and urban welfare. A detailed assessment of urban grain consumption disaggregated by income group would certainly prove useful to any future efforts to target reduced subsidies to the urban poor. Lastly, future RSAL or sector work missions should try to improve the Bank's understanding of the ration grain system reform programs in Guangdong, Fujian, Shanxi, and Nei Monggol. A field visit to Shenzhen, where the ration system is reported to have been completely abolished, might be warranted.

CHINA

RURAL SECTOR ADJUSTMENT LOAN

POST-EFFECTIVENESS SUPERVISION MISSION

Marketing Systems for Perishable Food Products In China
With Emphasis on Fruits and Vegetables

by- Harold M. Riley (C)

To: Richard Burcroff, Acting Chief
China Agricultural Operations Division
The World Bank

From: Harold Riley, Consultant

Subject: **Marketing Systems for Perishable Food Products in China with Emphasis on Fruits and Vegetables**

I. Terms of Reference

In mid-August, 1988, I was contacted by Ramesh Despande regarding a two-to three-week consultancy in China to assist in an assessment of problems in the marketing of perishables. Due to prior commitments I was unable to accept this assignment, but I offered to carry out a more limited assessment during a trip that would bring me to China for a two-week, travel-study activity with a professional group sponsored by Michigan State University and the Kellogg Foundation. Our group held meetings during early October with public officials responsible for food system programs in Guangzhou and Beijing. I then extended my trip to include a visit to Nanjing.

The Terms of Reference (Appendix I) were presented to me by T. J. Goering on October 17 while I was in Beijing. My report responds to the requested emphasis on the operation of the perishable marketing systems (especially fruits and vegetables) in the areas visited. However, the identification of problems and suggested measures to improve market performance will draw heavily on concepts and approaches that have been useful in our technical assistance programs in other countries and in our training of graduate students specializing in agricultural marketing and policies in developing countries. For this reason I have attached a copy of a paper which I presented at a 1987 Seminar on Food Marketing Policy in China on the topic, "Vertical Coordination of Food Systems and Commodity Sub-Systems" (see Appendix III). I am also sending copies of two monographs which illustrate more detailed, empirically based food system assessments actually carried out in Latin America and a working paper that outlines procedures that we have found useful in carrying out preliminary diagnostic assessments of commodity systems.

A list of some of my contacts during my most recent China field trip are summarized in Appendix II. Unfortunately, the visits which I hoped to have in the Development Institute with Messrs. Luo and Gao did not occur because of travel schedules which took them away from Beijing during the brief time that I was there. However, I had previous visits with them in June 1988. Fortunately, I had some very useful contacts in Nanjing which are mentioned later in this report.

2. The Perishables Marketing System Serving Large Cities

2.1 Introduction

The perishable commodity systems provisioning large cities are expanding and adapting to major changes in China's economy. The liberalization of market forces has set in motion sizeable increases in consumer demand for fruits, vegetables, pork, poultry, meat, eggs and fish. Aggressive initiatives by producers, traders and private intermediaries to take advantage of new profit opportunities have set in motion a major transformation of perishable commodity production and marketing.

Any attempt to describe the perishable commodity systems at this point in time is an extremely difficult task given the complexities of those systems and the diversity of conditions within China. Furthermore, the grain system has been the centerpiece of the Chinese food system. Hence, basic data and in-depth descriptive studies of commodities systems have been focused on grains with relatively little attention to the perishable commodities.

Given these conditions I am quite aware of the limitations of the observations which I am able to share with you. The seminar discussions with public officials during October 1988 provided fragments of useful information which I am supplementing with information and perceptions obtained by directly observing production and marketing activities during three previous trips to China and a continued probing of available literature on the Chinese economic reforms. My interest in the China situation has been stimulated by my direct contacts with Chinese graduate students and my involvement as the major professor for Yao Xianbin who is currently completing field research for his Ph.D. thesis on the

changing grain marketing system in the Xinxian area of Henan province where the World Bank is assisting the GOC in an experimental change in pricing and marketing policies. Yao's study is being supported and supervised by staff members in the Development Institute in Beijing. Messrs. Gao and Luo are directly involved. I have also benefited from my continuing contacts with two Chinese professors who are participants in the Kellogg International Fellowship Program in Food Systems administered by Michigan State University. Wen Simei, a professor at South China Agricultural University is becoming recognized for his research and writing on reforms in the Chinese marketing system. Yan Rui-zhen, a senior agricultural economist with the People's University in Beijing, has been researching, writing and advising the government on the broad issues of agricultural sector reforms.

2.2. Changing Organizational Structure

Prior to 1978 the perishable commodity systems provisioning the large cities were directed by municipal food companies. These companies organized the procurement of staple vegetables through contracts with production brigades specializing in vegetables. The contracts specified the area to be planted to particular vegetable crops. All of the harvested crop was to be taken by the municipal food company at a price fixed. The food companies collected and transported the vegetables to their city-based facilities for redistribution to a network of retail outlets. In this system the municipal food companies operated as a branch of government in developing plans for future production to match anticipated urban demands. The companies were responsible for the operation of a single channel government system of assembling and distributing food for the population residing in the large cities. The assortment of fruits and vegetables handled by those companies was limited to the more durable staple products. The supply areas were typically located near the city being provisioned. Hence, there were wide seasonal fluctuations in vegetable supplies and a narrow assortment of items especially in the colder regions of the country.

The dismantling of the communal system in the period 1978-82, the institutionalization of the "Production-Responsibility System" and the legalization of multiple market channels, including so-called "free markets" and private trading, has unleashed a multitude of initiatives that are transforming the organization of the food system and especially for perishables. Thousands of "free markets" have sprung up across the country making it possible for individual producers to sell directly to consumers, especially in the small to medium sized cities and, to some extent, in the larger cities. However, the municipal food companies still function as the major provisioner of the more staple perishable commodities to the consumers in the large cities. I was informed that in Beijing and Nanjing these companies are collecting and distributing approximately 70 percent of the fresh fruits and vegetables. However, consumers are paying higher prices to producers and private sector retailers who can provide a wider assortment and higher quality products. Private traders (assemblers, wholesalers) are undertaking a profitable and important role in the changing market system as they attempt to match product availabilities with alternative market opportunities.

The municipal companies are continuing to procure their vegetable and fruit supplies through contractual arrangements with farm-level production groups. The contracts are providing some flexibilities for adjusting quantities and prices during the production-harvesting cycle. Seasonal price adjustments are also being made to influence production decisions. Some problems from the municipal company point of view are the poor quality of products and unreliability of delivery of contracted quantities. Perhaps more important is the high cost of subsidies to cover municipal enterprise losses as they attempt to operate under the more flexible open market environment where prices have been relatively volatile and where they sometimes try to support prices to producers above "market-clearing" levels in order to assure future availability of supplies. In Beijing, the municipal food companies were subsidizing consumers by selling at prices below the purchase price plus their operating costs.

There is general agreement that Guangzhou City and the Province of Guangdong has evolved more rapidly towards a "free market" as compared with Beijing or Nanjing. This is probably a result of the strong trading relationships between Guangdong Province and Hong Kong and other international markets. Beijing seemed to have a more government regimented food system with attempts to hold down food price inflation at the time of our October visit.

Although current inflationary pressures and growing evidence of inequality of benefits from economic reform policies are slowing the structural and organizational changes in the food system, it seems highly probable that the production-marketing systems for perishables will continue their present direction of change. But in the context of the Chinese socialist system there is a need for a clearer vision of the goals being sought and the means for step-by-step achievement of an improved system for producing and marketing perishable commodities.

2.3 Some Observations on Market Performance

2.3.1 A Conceptual Framework

It is fundamentally important to assess the performance of China's marketing systems for perishables in a dynamic developmental context. For this reason I call your attention to the attached paper on "Vertical Coordination of Food Systems and Commodity Sub-Systems" where I attempted to summarize and adapt a conceptual and operational approach for diagnosing commodity system coordination problems and formulating strategies for improving performance. Six broad food system performance goals were suggested as representative of the longer-term development goals in "market oriented" economies (Appendix II, page 1-4). This was followed a brief explanation of methodologies for conducting diagnostic-prescriptive studies of commodity subsectors (Appendix II, pp. 5-10). Four subsector performance criteria were suggested as a guide to subsector assessments. These were as follows:

1. The matching of supply and demand at each stage in the production-distribution system.

2. Efficiency in carrying out the physical transformation, handling and delivery of commodities as well as in arranging and carrying out transactions.
3. Progressiveness in developing and adopting more productive technologies, management methods and institutional arrangements.
4. Equity in returns to subsector participants in relation to value added to the final product, costs and risks incurred. Equity can also include access to markets, information and support services, such as credit.

2.3.2 Performance Assessments

The following assessments are offered as a preliminary diagnosis of "market system" problems in the provisioning of fruits and vegetables to the large cities that I have visited.

Matching Supply and Demand

Farm-level production has apparently responded strongly to increased urban demands. Tree fruit production is responding more slowly as would be expected due to biological requirements for growth.

Prices have trended sharply upward on many products, adding to overall inflationary pressures and the rising discontent among urban consumers.

Prices have become much more volatile as a result of temporary gluts and shortages within particular markets. This is an important problem that calls for measures to improve coordination between production decisions and market demand. The information system influencing the distribution of products among different markets also needs to be further developed.

One of the more serious deficiencies of the existing system is the wide seasonal fluctuations in the availability of many fresh fruits and vegetables or their equivalent in low-cost processed products.

An over arching problem is the negative influence of increasing risk and uncertainty as the commodity systems evolve towards a more open market

environment. Institutional innovations and adaptations are needed to improve system coordination and thus to achieve dependable and remunerative markets for producers while delivering high-quality products to consumers at affordable prices.

Operational and Transactional Efficiency

Probably the most striking characteristic of the Chinese food system is the labor intensive methods used at all levels of production and distribution. This condition will persist for some time, since capital equipment is very expensive compared to labor; the workforce is large and many rural people are underemployed; meanwhile, socialist policies continue to emphasize the maintenance of employment for all persons in the workforce. Given these constraints, what can be done to increase the operational and transactional efficiency of the marketing system for perishables?

Transportation and the physical handling of perishables appeared to be a major problem area. Within and around the large cities a substantial volume of products move by bicycle and hand or motorized carts. Municipal food companies depend on the services of specialized trucking companies, also publicly owned. Although the local system of transport could benefit from access to more and better equipment, I believe the most important bottleneck is the highway and rail systems that could facilitate longer distance volume movement of products within and between provinces. This would encourage greater regional specialization in production and could greatly increase the year-around availability of a wider variety of fruits and vegetables.

The damage and loss of products in the public sector market channel appears to be large. The entire process of harvesting, sorting, packing and shipping needs improvement, but the lack of a personal investment interests in the product by public enterprise personnel is a deterrent to be dealt with. Improved handling in the private sector market channels also needs assistance through credit, training and public investments in market facilities including collection stations, wholesale and retail markets. However, emphasis should be on simple, low-cost facilities

designed to fit Chinese conditions.

Transaction costs in the free market channel are probably higher than necessary. This deflects the small size of production units; the lack of well managed producer cooperatives; small-scale, under-capitalized private traders; non-standardized containers; and an undeveloped market information system. An improved legal and regulatory framework could also be cited as important requisites for a smoothly functioning, low-cost transaction system. At the moment these requisites are lacking.

Progressiveness

The boldness of PRC political leaders in launching and promoting the economic reform program has created an environment for rapid changes in the perishable commodity systems where centralized market controls were among the first to be dismantled in the market liberalization campaign. Although the pace of change has been impressive, there are undoubtedly many unexploited opportunities to produce and deliver a more appropriate mix of higher quality products at the places and the times that are convenient to consumers. As indicated previously, there is a great deal of institutional rigidity in the municipal food company system of procurement and distribution and in the operations of so-called rural supply and marketing cooperatives. Discussions with Chinese university professionals indicate their skepticism about the adaptability of existing rural supply and marketing cooperatives to become more efficient, member-directed institutions.

The longer-term trend will be towards increased marketing services and a rise in marketing margins as more of the final value of consumer products will be added after the raw product leaves the farm. Although the level and distribution of household incomes will continue to constrain the pace of change, there is plenty of evidence that the process is moving ahead. The public sector can play a crucial role in nurturing and guiding the development of commodity systems through macro economic policies and more directed support of applied research, training, and investments by private and public sector enterprises.

Equity

Statements by high-level PRC political leaders have sometimes described the economic reform program as being an effort to bring about a "market guided system with socialist characteristics." This indicates the continued commitment to equalitarian values. However, the reform program has resulted in growing income inequalities and a rising level of tension and resentment as individuals observe others doing much better than they are and in some instances gaining income and wealth through questionable business practices.

At the township and village levels collectively owned enterprises are being encouraged to adopt more cost-effective operations with greater flexibility for management decision making regarding new investments, personnel management and operational practices. Nevertheless, our visits with managers of municipal and township enterprises as well as political leaders indicate that they are experimenting within the new policy framework but that social responsibility, community concerns and political pressures remain as important constraints on management decisions.

The role and functional responsibilities of the large city municipal food companies handling perishable commodities have become more confused as flexible pricing and multiple marketing channels have made it difficult to operate without subsidies while attempting to meet the government's objective of holding down food costs to urban consumers.

This suggests that further efforts to modernize perishable commodity systems serving large urban areas will be carried forward with political and social sensitivity regarding the balancing of opportunities afforded private traders and municipal enterprises regarding access to productive resources including credit, information and training. Fairness in allocating space in publicly supervised "free markets" and site locations for private wholesaling and retailing establishments are also areas of concern.

3. A Suggested Program Approach to Improving the Marketing of Perishables

3.1 A Long-Term Strategic Plan of Action

A longer-term strategic plan of action should be formulated by Chinese professionals. Some initial discussions among well informed professionals could launch this activity. These professionals might include top-level policy analysts from the RCRD and selected individuals who have in-depth knowledge of perishable commodity systems serving the largest cities.

What is needed is a quick assessment of the problem situation and a follow-up course of action that would produce a preliminary diagnostic policy-oriented paper that would point the way toward the development of a strategic plan. This would then be discussed with appropriate political leaders prior to pushing ahead with a more in-depth set of investigations and analyses that would support policy decisions and the design of programs to improve market system performance. (A useful reference would be John Holtzman's Working Paper, "Rapid Reconnaissance Guidelines for Agricultural Marketing and Food System Research in Developing Countries," Michigan State University, Department of Agricultural Economics, 1986). A strategic action plan would emerge from the process but should be regarded as a guide to be modified on the basis of experience evaluated by an on-going program of applied research and development. Much of applied research and program development can be carried forward at the provincial or municipal level with networking arrangements to stimulate and strengthen the total effort.

3.2 An Existing Research Project

While in Nanjing I visited with a group of professors in the Department of Agricultural Economics at Nanjing Agricultural University who are conducting a study of fruit and vegetable provisioning of five large cities. The study is being done under contract with the Ministry of Agriculture, Animal Husbandry and Fisheries (MAAF). This is a five-year project to be completed in 1990. Interim reports are to be submitted in December 1988 and December 1989. The Nanjing group is doing some subcontracting with university based researchers in other cities. The main thrust of the current research has two objectives. One is to

project future demand for selected fruits and vegetables for each of the large cities. The other objective is to identify the likely supply areas for these commodities. I presume that their study will also attempt to give direction to actions required to stimulate and guide production expansion. I would hope that they can also deal with the problems of institutional and infrastructural requirements to support the market system development but I am doubtful that this will be accomplished. One of my concerns about the project is the lack of any clear linkages with the Ministry of Commerce and the Municipal Food Companies in the large cities. The professor who seems to be a key person in the project is Chu Baojing who, in 1987, submitted a master's thesis to the University of Reading entitled, Agricultural Marketing in China With Special Reference to Jiangsu Province. I found his thesis to be a very useful and insightful document, although largely descriptive.

This prompts me to suggest that one of the first tasks in the development of a strategic action plan would be to review recent papers and publications addressing the problems of expanding and modernizing the perishable commodity production and marketing systems. Concurrently, the professionals who have the interests and qualifications to participate in a policy relevant applied research program should be identified.

3.3 Priority Areas for Policy and Program Initiatives

The current economic crisis is pressuring political leaders towards actions to slow down the market liberalization program. Price inflation has adversely affected many urban based households whose incomes have not kept pace with rising food costs, especially for perishables. Under these conditions there may be some retrogression towards price controls and other measures, e.g. rationing of selected staple perishable commodities. Even though control measures may be reimposed, there are opportunities to improve the functioning of the marketing systems for perishables, especially fruits and vegetables. Areas for immediate attention and continued long-term efforts include the following:

1. Market Information

The development of a market information system to provide growers and traders with current prices and supply conditions in the large city markets. Outlook regarding future supply and demand conditions should be added as a basic information gathering and analysis system capability is established.

2. Regulations

I am of the opinion that the rapid liberalization of perishable commodity markets has created considerable uncertainty about rules and orderly procedures for insuring fair trading practices, prompt payment for merchandise and fulfillment of contracted obligations. This problem needs attention but with a well-informed approach so as to avoid unnecessary cost increasing regulatory measures.

3. Credit to the Private Sector

The potential economies of size in the assembly, transport and wholesale distribution can only be achieved as firms can access sufficient financial resources for investments in facilities and equipment and for operating capital to finance buying and selling activities. The Agricultural Bank of China probably has limited capacity to provide credit other than in rural areas, but could be instrumental in supporting rural assembly and transporting enterprises. Other, more urban-based, financial institutions would have to respond to the credit needs of wholesaling and retailing enterprises.

4. Infrastructure - Market Facilities

Investments in rural assembly centers and wholesale markets in the large cities should be approached with caution so as to avoid uneconomic, over-investments that have occurred in other developing countries. Nevertheless, wholesaling facilities need to be substantially expanded and upgraded to better protect the more perishable products and to achieve greater logistical efficiency. Critical issues are the role of the private sector in providing wholesaling facilities and/or services and the institutional-functional linkage between commodity assembly on the one hand and retail distribution on the other. Our experience in Latin America

provides some useful lessons in this regard.

5. Infrastructure - Transport

Substantial and carefully planned investments in highway and rail transport systems are a prerequisite to the development of a more coordinated regional and national system which reduces seasonal supply fluctuations and makes available a wider variety of fruits and vegetables. Over a period of years efficient regional specialization patterns of production and marketing can evolve, but this is a long-term development process, given the transport constrained system that now exists.

6. Institutional Reforms

Three sets of institutional reforms should receive priority attention, but it will take considerable time and effort to make the major changes that could improve system performance. At the producer level the rural supply and marketing cooperatives will either have to be modified to operate more effectively as part of the perishable commodity systems or new, more tightly organized, producer groups should be promoted.

The second set of institutions are the municipal food companies that are now struggling to adapt their operations to the more liberated market environment. The forward contract system of procurement can continue to have an important stabilizing effect on the vegetable marketing system but needs modification to overcome current problems of non-fulfillment of contracts, poor quality and condition of products reaching consumers, and financial losses associated with present management practices.

The third set of institutions will be new supportive actions by governments to promote the growth and development of a strong private sector. Included would be research, education, information, financing and regulation. The design of specific programs would emerge from the development of a long-term strategic plan of action (see 3.1).

Appendix I

The World Bank

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

1818 H Street, N.W.
Washington, D.C. 20433
U.S.A.

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Cable Address: INTBAFRAD
Cable Address: INDEVAS

Date: October 17, 1988
To: Prof. Harold Riley, Consultant
From: T. James Goering, RMC
For: Mr. Richard Burcroff (Acting) Chief, AS3AG
Subject: CHINA - Terms of Reference - Marketing Systems for
Perishable Food Products

1. During your visits to Guangdong Province, Beijing Municipality and Nanjing City you will gather information on operation of the perishable food marketing systems in those areas, with a particular emphasis on fruits and vegetables. On the basis of information available to you, you will prepare a report which describes briefly the marketing systems observed, provides a general assessment of the efficiency of those systems, identifies the major factors which prevent more efficient marketing and recommends in outline form a phased program of policy measures to improve efficiency of those systems.

2. The above report will be provided in draft form to Mr. Richard Burcroff (AS3AG) no later than November 15, 1988 for review and comment. On the basis of any comments by the World Bank, a final version of the paper would be made available to Mr. Burcroff by November 30.

3. It is expected that the total input for this task would cumulate to about five working days.

APPENDIX II

Selected List of Contacts During My Travel Study in China
October 4 - 21, 1988

A. Individuals that met with the Kellogg International fellows

_____ Vice Mayor of Guangzhou

Pan Jianian, Director of the Guangdong Province Agricultural Commission

Jiang Hui-sheng, Director of Agricultural Policy Research in the Guangdong
Agricultural Commission

Chen Bo, Guangdong Prices Bureau

Officials in two townships located within 50 kms of Guangzhou

_____ Manager, Nan Fang Flour Mill, Guangzhou

_____ Manager, Heinz Joint Venture in Guangzhou

Officials in Yucha Township, Liqun County, located about 100 kms out of Xian

_____ Secretary, Commercial Bureau, City of Beijing

Wu Shuo, Senior Research Fellow, Economic Research Institute, Ministry of
Commerce, PRC

Xu Yulong, Head of Research Institute of the Agricultural Bank of China

Du Ying, Research Center for Rural Development, State Council, PRC

_____ Manager, Beijing Dairy Corporation

_____ Manager, Beijing Flour Mill and Bakery Operations

B. My own personal contacts and field visits in Nanjing

Niu Zhenjang, President, Nanjing Food Economy College

I presented a seminar to a group of 70 faculty and students and met with a
faculty group.

Chu Baojing, Professor of Agricultural Economics at Nanjing Agricultural University.

I also had an informal seminar with eight faculty members. Chu and Yao Xianbin accompanied me on a visit to two wholesale markets, one handling fruit, the other vegetables. Interviews were conducted with producers and private traders.

APPENDIX III

SEMINAR ON FOOD MARKETING POLICY IN CHINA

20 to 24 July 1987

Beijing

VERTICAL COORDINATION OF FOOD SYSTEMS
AND COMMODITY SUB-SYSTEMS

prepared by

Harold M. Riley
Professor of Agricultural Economics
Michigan State University

The Seminar was Co-Sponsored by The Ministry of
Commerce of Peoples Republic of China and The Food
and Agriculture Organization of the United Nations

Agricultural Economics Staff Paper No. 87-38.

Introduction*

This paper focuses on the problems of organizing and managing food commodity systems in a dynamic environment where flexible prices and other incentive mechanisms play an important role in coordinating production and distribution processes. The first part of the paper develops a conceptual perspective of vertical coordination of food systems in the context of economic growth and development and relates this to the recent and projected Chinese situation. The importance of the public sector's role in planning and guiding food system operations within a medium to long-term strategic development plan is assumed in this conceptual statement. The second part of the paper describes the methodologies we have developed and used in the U.S., in Latin America and Africa for identifying problems and opportunities for improving food system performance. This is followed by a brief summary of our experience in applying these research methodologies in selected countries. The paper concludes with a suggested set of research questions that would seem to be relevant to the current efforts to stimulate the future development of a progressive, efficient and equitable Chinese food system. Since I have limited knowledge of the Chinese food system, I will emphasize approaches that we have found useful in addressing food marketing problems in other countries.

Vertical Coordination of Food Systems

A basic set of problems that exists in all national food systems is how to achieve a reasonable matching of supply and demand given biological uncertainties and the institutional complexities of a changing economic environment. The changing environment typically includes increasing population pressures, rising levels of income and the need to expand food supplies. Broad food system performance goals usually

* The author acknowledges the helpful comments of Michael Weber, James Shaffer, Darrell Fienup and Yao Xianbin.

include the following along with other more country specific objectives.

1. To achieve an abundant, nutritious and reliable food supply at economical prices.
2. To promote and facilitate the production and distribution of the combination of foods and related services that best reflect consumer preferences and real relative production costs.
3. To stimulate the development and adoption of improved technologies and organizational arrangements that will lead to increased resource productivity in all aspects of food production and distribution.
4. To stimulate the creation of productive and remunerative employment opportunities.
5. To create the conditions necessary to ensure equitable exchange relationships.
6. To discourage uneconomic uses and spoilation of natural resources and the environment.

In the more developed countries there has been a long-term industrialization process wherein the creation and adoption of new technologies and new institutional arrangements has led to greater specialization of labor; increased labor productivity; shifting employment from farm level food production to service industries; population migration to towns and cities; rising levels of income; shifting patterns of food consumption and a rapid increase in the demand for marketing services. The shifts in demand call for new food products, higher quality products, more convenient shopping arrangements, relatively greater increases in the production of livestock products, fruits and vegetables and decreased per capita production of basic grains and starchy tubers.

The growth of large urban centers and secondary cities has been a dominant force in the transformation of food systems in many countries. As demand grows, the geographic supply areas expand, and there is a trend towards greater regional specialization in agricultural production. This generates a growing demand for

investments in transport, storage and market facilities and the development of complementary institutional arrangements for assembly, processing and distribution of food commodities.

Vertical Coordination is a term that I am using to include all the ways of adapting and harmonizing the various stages of production and distribution within a commodity system that is responding to changing supply and demand conditions. Flexible market prices may provide the primary means of coordination but must be accompanied by institutional mechanisms and policy guidelines which involve varying degrees of public sector participation. Hence, the central political-economic question is how should the market system be instituted to achieve desired performance. What should be the role of government and what would be the most effective approach to create the incentives and to provide the support and guidance for a progressive, efficient and equitable commodity system?

In a market directed economy prices and related information serve as critical messages to farmers and managers of units that process, transport and provide wholesaling and retailing services. If the system is well coordinated, prices will move up and down with biologically based patterns of production and other market forces. Price differences between different locations in the market area should reflect actual differences in transfer costs. Seasonal price variations will bear a close relationship to storage costs or, in the case of perishables, to seasonal differences in costs of production. Price spreads between raw products at the farm level and prices paid by urban consumers will be closely related to the actual costs of providing the necessary marketing services. Returns to farmers should be sufficient to call forth the quantities and the quality mix of products that will satisfy consumer demands in the sense of clearing the market without significant surpluses or shortages.

There are various institutional mechanisms for facilitating vertical coordination within commodity systems. These mechanisms can also be instruments for introducing

cost reducing innovations in arranging transactions and in physical handling of products. Specific coordinating mechanisms include open markets where prices are established through negotiations between buyers and sellers, cash markets where prices and/or marketing margins are government regulated, and various forms of forward contracting designed to reduce risks and lower transaction costs (Minot, 1986).

Prior to 1978 the Chinese marketing system for perishable commodities was organized around rural supply and marketing cooperatives that collected products from communal production units and delivered shipments to urban-based municipal food companies. The transactions and physical movement of products was coordinated through forward contracts that specified quantities, qualities and prices. The municipal food companies distributed products to urban consumers through a network of specialized retail food markets (Abbott, 1977).

Since 1978 the marketing system for perishable commodities has been significantly modified to permit freer movement of prices and opportunities for opening new marketing channels involving direct sales by individual farmers to private traders and/or consumers. This change in policies has been accompanied by increases in prices for fruits, vegetables and livestock products, expanded output and much higher incomes for farmers who could take advantage of the new situation.

I have the impression that the organization of the Chinese production, processing and distribution systems for all agricultural commodities is still very much in a state of transition to the new policy framework. Institutional arrangements usually respond slowly. Transportation and infrastructure-type facilities are no doubt lagging behind actual and potential needs. Although the forces of change are at work it will take considerable time and effort to achieve the desired performance results. Meanwhile, there appears to be a need for studies to support the design of policies and programs to guide the development of more productive and well coordinated commodity systems.

Methodologies for Diagnosing Commodity System Coordination Problems

Over the past several decades the agricultural economists in the United States have developed and made extensive use of a variety of analytical methods for diagnosing market system problems. The methods range from descriptive, qualitative assessments to more quantitative econometric and simulation models. While each of these methods have potential usefulness, it often requires a combination of techniques to effectively analyze the more complex food system organization problems. However, the fundamental concept of a food system provides the analytical framework for diagnosing problems and formulating strategies for improving food system performance. A food system has both vertical and horizontal dimensions. In a vertical plane it includes all the activities that link farm-level production to the final consumer. In a horizontal plane it includes the organization of activities among participants at a particular level within the system such as processing, wholesaling or retailing. The advantage of viewing market processes in a food system context is that we can identify constraints and possible opportunities for improving system performance, taking into consideration the dynamic interactions that will occur in response to changes in policies, institutional arrangements and technology utilization.

Over the past decade a group of agricultural economics researchers from several universities and the U.S. Department of Agriculture carried out a coordinated set of studies under a project entitled, Organization and Control of U.S. Food Production and Distribution System. Important outputs from this project included a wide range of publications culminating in a book, The Organization and Performance of the U.S. Food System (Marion and the NC-117 Committee, 1986). I call attention to this research effort because of its contribution to the development of methodologies that could be adapted to the Chinese situation. Of particular interest is the "commodity subsector" study approach. This approach has also been developed and used in several Latin American and African countries by our Department of Agricultural Economics faculty at

Michigan State University working in collaboration with professionals within specific countries including Brazil, Colombia, Costa Rica, Senegal, Mali and Rwanda.

The subsector study framework provides a pragmatic approach for identifying problems in a systems context. It is particularly useful in situations where major political, economic and technological forces are changing food systems. For this reason I am suggesting that this approach may be useful in China. The sub-sector study methodology has been developed and used in market oriented economies, but in all instances there have been significant public sector involvements in administering food system policies and programs. This has been particularly true in Latin American and African countries where governments have taken an active role in regulating and facilitating food system development. It should be recognized that the public sector always has an important role in establishing policies to guide and regulate market processes and to provide a major portion of the investment capital for marketing infrastructure. These public sector initiatives are an important force in encouraging private sector investments and overall market system development (Shaffer, 1987).

I will use the term "subsector" to mean essentially the same as "commodity system." The "subsector" is a vertically linked set of participants that produce, process and distribute a particular commodity or closely related set of commodities, e.g., grains, fruits, vegetables, pork, eggs, milk. Participants in the subsector will include input suppliers, farmers, assemblers, processors, wholesalers and retailers, and consumers.

The subsector study approach focuses on the coordination process among the various stages in commodity systems. Emphasis is on the review of alternative institutional arrangements that facilitate needed physical transformations and exchange functions. The descriptive-diagnostic investigations attempt to identify problems with the existing coordination arrangements and opportunities to improve performance of the system by aligning the production-distribution processes with new product markets and by increasing efficiency. The diagnosis should identify constraints to improved

performance and prescribe policies and programs to overcome these constraints giving attention to interrelationships among the various stages within the system.

The desired performance attributes may vary among commodities but a suggested list that we have found useful includes the following:

1. The matching of supply and demand at each stage in the production-distribution system.
2. Efficiency in carrying out the physical transformation, handling and delivery of commodities as well as in arranging and carrying out transactions.
3. Progressiveness in developing and adopting more productive technologies, management methods and institutional arrangements.
4. Equity in returns to subsector participants in relation to value added to the final product, costs and risks incurred. Equity can also include access to markets, information and support services such as credit.

It should be apparent that there are potential conflicts among the performance attributes which must be taken into consideration in designing new policies and programs, e.g. equity goals may conflict with progressiveness and efficiency goals.

The evaluation of subsector performance must be supported by gathering and organizing data and information in three main categories.

Basic conditions--

Commodity characteristics

Calendar of production, processing and distribution

Geographic location of production and consumption

Consumption patterns

Price relationships over time and space

Geographic movement of products

Trends, projections and forces of change

Subsector Organization

- Stages in the production-distribution process
- Institutional organization and types of participants
- Relative importance of market channels
- Physical infrastructure
- Changing structure of the subsector and the forces of change

Coordination Processes

- Planning and strategizing
- Transaction procedures
- Information flows
- Government programs, regulations and support services

Although there is a need for accurate descriptions of basic conditions, subsector organization and coordination processes, it should be guided by a purposeful diagnostic perspective. This can reflect the search for problems and opportunities linked to established performance goals. The actual conditions and perceived problems of market participants, such as farmers, managers, and workers engaged in processing, wholesaling, retailing and government officials, are important inputs into a subsector study.

On the basis of our food system field research experience in Latin American countries and more recently in African countries, we have developed a modified two-stage approach to conducting subsector studies in situations where there is an urgent need for some preliminary guidance on important food marketing policy decisions. The first stage is what we now refer to as a "rapid reconnaissance" technique. This activity is designed to be carried out by a small team of two to five people over a period of one to three months. Ideally, the team should include professionals with different backgrounds and skills, e.g., an agricultural economist, an agribusiness management specialist, a post-harvest technologist, and/or an institutional analyst. The scope of the

reconnaissance will often need to be limited to a particular geographic area, e.g., a major urban market and the rural area from which it draws its supplies of the commodities being investigated.

The study would be designed and carried out within the general food system subsector framework described earlier. However, emphasis would be on the following:

1. A quick assessment of previous studies and readily available data on prices, supplies and market conditions.
2. Direct observations of food system facilities and operations relevant to the selected commodity.
3. Informal, in-depth interviewing of a carefully selected, small number of commodity system participants, including some knowledgeable observers and recognized organization leaders.

This type of informal interviewing requires skilled individuals equipped with a basic set of leading questions to be followed by more probing questions as the interview proceeds. Different team members will have questions related to their area of responsibility and expertise. If carefully done, the "rapid reconnaissance" will provide useful, current and reasonably reliable assessments of actual market operations, the problems as perceived by participants at different stages in the production-distribution process, the opportunities for changes in policies, institutional arrangements or for new investments in facilities and technology. We have published a handbook (Holtzman, 1986) which elaborates a set of guidelines for this type of investigation. The potential misuse of the rapid reconnaissance technique is recognized since the results are based upon a relatively small amount of information. Nevertheless, if carefully carried out the technique will satisfy some of the needs of decision-makers and can serve as the basis for designing a more comprehensive and reliable subsector assessment with well-reasoned prescriptions for market improvements. In some instances the quick assessment will

identify potential pilot project activities where new ideas can be tested and further developed before recommending widespread adoption.

Applications of Food System - Subsector Study Methodologies

During the late 1960s and early 1970s, a team of Michigan State University researchers undertook food marketing studies in four Latin American countries (Brazil, Colombia, Bolivia and Costa Rica). In each country the studies were planned and carried out in collaboration with local institutions with substantial participation of their personnel. The primary objectives of the studies were (1) to diagnose food system organization and coordination problems; (2) to design medium to long-term strategies for improving marketing performance; and (3) to formulate a comprehensive, integrated set of recommendations for market system reforms. A secondary objective was to expand our knowledge and understanding of the dynamic role of market processes in economic development.

I will now turn to a brief summary of some of the experiences in Colombia, South America, a country where I have field experience extending over a period of twenty-five years and including actual residence in the country for two assignments of two years each and numerous shorter visits. For a more complete report on our Latin American food marketing studies, I refer you to a summary publication by Harrison, et al, 1974.

The initial studies in Colombia were focused on the Cauca Valley Region, a very productive agricultural area with a high population growth rate and a rapidly growing urban population. The dominant urban-industrial center in the region was Cali with one million inhabitants and annual growth rate of six percent.

The most pressing food marketing problem confronting local authorities was the eradication of an antiquated, highly congested and socially undesirable food marketing complex located in the center of the city. The perceived solution by local political leaders was to construct a new physical facility at a more acceptable location and to transfer the existing wholesale-retail operation to the new facility.

In our preliminary discussions with local officials and with the participation of professionals from local institutions we evolved a research plan of work designed to assess future marketing facility needs, taking into consideration the major forces of change in consumer demand, agricultural and urban development. The urban study components included systematic surveys of urban households, food wholesalers and retailers. The rural study components were commodity subsector studies for five commodity groups: (1) fruits and vegetables; (2) grain; (3) red meats; (4) milk; (5) poultry and eggs. Surveys were carried out at the farm, assembly and processing levels for each commodity and linked with the urban food distribution study results.

In addition, we conducted special studies of technical farm input distribution, transportation, laws and regulations, information and communication, and credit availability for food production and marketing. We also investigated the constraints for expanded employment opportunities in residential construction and in the manufacture and sale of non-food consumer goods. The latter studies were in anticipation that recommendations for modernizing the food marketing system might require some marginal shifting of an expanding labor force from agricultural and food distribution jobs to industrial and service based industries.

Within a period of one year our research team prepared 16 technical reports and a draft summary report for local policy makers and leaders within the Cauca Valley food system. The reports included descriptive-diagnostic assessments and a set of proposed actions to improve food system performance. The results of the studies were discussed with local leaders prior to the preparation of a revised, final report (Riley, et al, 1970). Follow up assistance was provided for the more detailed development of planned market facility investments, especially a central wholesale food market primarily for perishable commodities. A major outcome of the studies was to promote the adoption of a more comprehensive, systems approach to the development of planned reforms in food marketing. Very important in the process was the increased realization that market

production and marketing of perishable fruits and vegetables was more difficult and involved greater risks as compared to the well-established coffee production and marketing program.

Our more recent field experience with commodity sub-system studies is taking place in five African countries under a project funded by the U.S. Agency for International Development. The main focus of the work is to assist these countries in their efforts to achieve greater food security for their rapidly growing populations. The emphasis is on improving the performance of the food grain production and distribution systems through coordinated changes in policies, institutions and technology. In all countries there are significant efforts underway to strengthen the role of markets, to identify effective incentives for farmers and merchants to invest in new activities, and to modify the government's direct interventions in market operations.

A Suggested Set of Research Questions

Based upon our experience in several countries, I will sketch out a list of research questions that may be relevant to the planning and guidance of a more market oriented Chinese food system.

1. What has been the pattern of consumer response to changing prices and availabilities of major food commodities? What are the demand projections for selected commodities in major urban centers and in rural areas?
2. What has been the farm level response to more flexible prices and new market channel opportunities? How does the response vary among regions and among commodities?
3. What changes have occurred in the flow of food commodities through different market channels and what have been the relative costs?
4. What are the likely changes in the location of agricultural commodity production in response to the new marketing policies?

facility investments should be carefully conceived so that complementary institutional and technological changes were taken into consideration and in the context of a desired longer-term pattern of development.

Immediately following the food marketing studies in Cali, Colombia, a similar study was undertaken by a newly created public sector food marketing institution (CORABASTOS) in Bogota, the capital city of Colombia. Many of the Colombian professionals who participated in the Cali studies were engaged to carry out the Bogota studies. CORABASTOS moved rapidly into an action program that included the construction of a new wholesale market and the organization of related programs to improve food retailing within the city and the development of coordinated systems of commodity assembly and delivery to the new central market.

Concurrently with the planned construction of Bogota's new wholesale market, the Federation of Coffee Growers initiated a program to encourage farmer members to shift some of their land into fruit and vegetable production as a means of adjusting coffee output to potential world markets and as a means of responding to growing urban demands for fruits and vegetables. Increasing employment and incomes of farmers were also important goals. Our University staff was invited to provide technical advice to their program development unit. It was decided that a limited set of pilot activities would be undertaken to help develop production and marketing capabilities for selected fruits and vegetables. This included the establishment of a market information service and rudimentary assembly centers for grading, packaging and transshipment to the Bogota market. Meanwhile, arrangements were made for an MSU doctoral student to conduct a detailed study of the possibilities for the development of an enlarged fruit and vegetable production-assembly activity that would link a selected coffee producing zone with the new Bogota wholesale market. The study included a careful feasibility study to guide potential investments in assembly centers within the production zone. The results of this study and the experience with pilot projects provided useful guidance to the Coffee Federation Diversification Program. Among other things it convinced them that the

5. What are the perceived impacts of the marketing changes as seen by farmers, private traders, market administrators and government officials? What constraints need to be addressed and what suggestions do market participants have for improving market performance in the context of the Chinese socialist system?
6. What are the different mechanisms for establishing prices and coordinating the flow of products from farms through assembly, wholesale and retail market channels?
7. How can marketing and supply cooperatives be reorganized to be cost-effective and progressive components of the food system?
8. What public sector facilitating services and investments are needed to assist subsector participants in undertaking new activities that would improve food system performance?
9. What are the potential costs and benefits of alternative investments and institutional arrangements for assembling, processing and distributing food commodities? How should these be combined into medium to long-term food system development plans?

Concluding Remarks

All food systems must perform certain basic functions which become more complex and more costly during the process of economic development. Each country has the opportunity to promote and guide the development of their food marketing system so as to achieve their own social and economic goals. In China there is an immense challenge to effectively design policies and institutions to modernize the food system within the existing socialist political-economic framework. I have suggested some procedures that have been useful in diagnosing opportunities for improvements in food commodity systems in other countries. This is a flexible methodology that can be adapted and used in the planning and management of food systems within different political environments.

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CHINA

RURAL SECTOR ADJUSTMENT LOAN

POST-EFFECTIVENESS SUPERVISION MISSION

Fresh Vegetable Marketing: Review and Assessment of
Beijing Municipality and Guangdong Province

by- Leonard Duboff (C)

FRESH VEGETABLE MARKETING
 REVIEW & ASSESSMENT
 OF
BEIJING MUNICIPALITY & GUANGDONG PROVINCE

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PURPOSE

Review and assess the government's policies and programs for:

1. Improving the delivery and marketing of fresh produce in China's metropolitan areas.
2. Penetrating export markets with fresh and processed vegetable products.

Review and assess:

1. The fresh vegetable marketing programs for the environs of Beijing and Guangzhou.
2. Identify major issues bearing on marketing efficiency.
3. The export development programs for fresh and processed vegetables being established in these municipalities.

The two areas which were reviewed by briefings and field analysis:

1. Beijing Municipality, the urban, suburban and rural areas.
 - Retail fresh vegetable markets - State & Private sector
 - Wholesale fresh vegetable markets - State & Private sector
 - Specialized farming - grain & vegetable
2. Guangzhou Municipality, urban, suburban & Guangdong Province.
 - Retail fresh vegetable markets - Private sector
urban and rural areas
 - Wholesale fresh vegetable market - Private sector
 - Vegetable production - Individual household and private
land contracts
 - Fresh vegetable processing - export Joint-venture

GENERAL SUMMARY

The implementation of the agricultural related reforms has been very successful. Beijing Municipality and Guangdong Province appear to enjoy a very good economy. An abundance of consumer goods and food products are very evident in the market place. The consumer has a disposable income with which to pursue these luxuries and necessities. Free enterprise is apparent and has economically motivated the citizens and in turn their productivity

Fresh vegetables are abundant and in demand. Quality, variety and availability on a year round basis are the key issues for the consumer. Although price is also a concern, it appears the majority of consumers are willing to pay for quality and service.

Winter seasonality is an issue as fresh vegetables of the up-scale variety, quality and supply are greatly diminished. Shipments from southern provinces and greenhouse production helps somewhat, but the northern urban center consumer demands a consistent quality supply.

Addressing fresh vegetable supply on a more meaningful level requires the development of an infrastructure which takes into consideration:

- * Agricultural Production Levels
- * Marketing/Distribution Systems
- * Wholesale Markets
- * Retail Markets

Good examples of each of the four issues are currently being practiced in a number of different localities. The most progressive is the land consolidation specialized grain farming and on a very small scale the Bao Sian Export Company vegetable supply and processing system.

However, there is a strong need to develop this total infrastructure so all segments can contribute to a modern fresh vegetable industry that will service domestic needs and export opportunities.

Developing this producer through consumer infrastructure must be done on a slow carefully planned schedule so it is built on a solid base and does not disrupt the existing supply and market price. It should be gradually implemented in areas where good management and successful programs are already documented. It can then be used as a model for other areas.

This is a long term project with a great deal of development required.

BEIJING MUNICIPALITY

FINDINGS

REFORMS

1978 — 1st Reform - Individual household land output responsibility.

1979 — 1st Reform Adjustment - Government increased state purchasing price of grain, cotton, pork and vegetables (from the producer).

Retail price of some commodities were also increased. Government employees given a subsidy of 5 Yuan per month per employee.

1983 — 2nd Reform - Fish and fruit prices released (no state control).

1985 — 3rd Reform - Pork and vegetable prices released. State purchasing quota only on cotton and grain.

1985 — 3rd Reform Adjustment - May 1985 Beijing Municipality released the control of price on all vegetables. They increased the state purchasing price (from the producer) and retail price of pork, chicken and eggs.

Soon after the price release of vegetables the Beijing government created the two tier pricing system:

- 60% of vegetable production must be purchased by state. This is purchased at a higher price than the old system, but lower than the free market price.
- 40% of the vegetable production can be sold on the free market or sold to the state at a higher (than 60% pricing) negotiated price.

This two tier system was implemented to prevent inflation and panic due to rapidly rising vegetable prices.

BELJING REFORMS (continued)

1988 -- 4th Reform - State Marketing Systems - increased the retail price of pork, chicken, eggs and sugar. Prior to the increase the purchasing price (from the producer) was constantly increased and the retail price was fixed low so they had to increase the retail price.

Subsidies were given to the state employees of 10 Yuan per month per employee.

BEIJING (continued)

BEIJING RECOMMENDED REFORM DIRECTION

The ultimate goal is to achieve a balanced stable supply of quality perishable vegetables at reasonable prices.

The implemented reforms were directed to achieving this. However, this has still not been accomplished, although there is an abundance of fresh vegetables of a wide variety found in the retail market. The quality varies from very poor to very good with a great deal of waste in the post-harvest area. They still experience shortages during the winter season.

To achieve a year round meaningful supply of quality vegetables the following issues must be addressed:

- In order to give the farmer incentive - remove the 60% - 40% two tier pricing system and allow all vegetables and their prices to be determined by the free market.
- Remove all vegetable quotas and allow the farmer to make his own decision on what to grow and where to sell.
- The establishment of vegetable production on large tracts of land utilizing a variety of private structures:
 - .land consolidation
 - .contractual land agreements
 - .cooperatives
 - .specilized farming - shareholding
- Agricultural technical support information services for the vegetable producing farmer.
- Develop non-government/private enterprises for marketing/distribution of fresh vegetables within the Beijing Municipality as well as throughout the provinces:
 - .shareholding
 - .leasing
 - .cooperatives
- Develop non-government/private fresh vegetable wholesale market organizations:
 - .shareholding
 - .cooperatives

BELJING RECOMMENDED
REFORM DIRECTION (continued)

- Develop non-government/private fresh vegetable retail market organizations:

- .shareholding
- .cooperatives

- Develop non-government/private organizations that represent each of these 4 key areas; production, marketing/distribution, wholesale and retail.

What is difference?

This organization can then begin to serve all of the needs of the perishable vegetable market by co-ordinating each area and establishing a system of information for the contractual growing and marketing of these commodities.

GUANGDONG PROVINCE

FINDINGS

REFORMS

1978 -- 1st Reform - Individual household land output responsibility.

1980 -- 2nd Reform - Fish market prices released.
After the price release the price of fish increased rapidly.
Production went up and the prices declined.

1983 -- 3rd Reform - Poultry (chicken, goose & ducks) and fruit prices released.

1984 -- 4th Reform - Vegetables all prices released.

1985 -- 5th Reform - Pork prices released.

1988 -- 6th Reform - Sugar And edible oil prices released.

Sugar quota price and negotiated price based on free market price.

Grain controls are still in place. However, price is higher than the surrounding provinces.

GUANGDONG RECOMMENDED REFORM DIRECTION

Guangdong Province and its major population center Guangzhou have had the most success with the implemented reforms. Guangdong Province is one of the most agriculturally important provinces and is a major supplier of fresh vegetables to the northeastern urban centers as well as developing the vegetable export market.

The Guangdong province vegetable producers are still for the most part utilizing the individual household farming concept and have not pursued large tract vegetable farming.

To accelerate the development of the agricultural base of this province and fulfill its potential as a major vegetable supplier to the northeast and as an exporter, the following issues must be addressed:

- Develop an organization to assist the vegetable producers with agricultural technical information services.
- To give the farmers incentive - develop programs/models to demonstrate and train them in large tract vegetable farming.
- Release all price controls on all commodities and industrial raw materials.
- Improve the market for agricultural inputs and raw materials.
- The establishment of vegetable production on large tracts of land utilizing a variety of private structures:
 - .land consolidation
 - .contractual land agreements
 - .cooperatives
 - .specialized farming - shareholding
- The development of fresh vegetable processing (washing, culling, sorting) facilites in the harvest area to reduce waste/rot.
- The development of non-government/private processing centers to prepare, package the fresh vegetables for shipment to the northeast and/or export.
 - .utilizing Joint-Venture technical assistance
 - .develop/use existing local technology

GUANGDONG PROVINCE
REFORM DIRECTION (continued)

- Further development of the rail and refrigerated railcar system for the efficient transport of fresh vegetables to expedite marketing/distribution and reduce waste.
- Develop non-government/private enterprises for the marketing/distribution of fresh vegetables within Guangdong Province, northeast urban centers and the export market:
 - .shareholding
 - .leasing
 - .cooperatives
- Develop non-government/private fresh vegetable wholesale market organizations:
 - .shareholding
 - .cooperatives
- Develop non-government/private fresh vegetable retail market organizations:
 - .shareholding
 - .cooperatives
- The development of non-government/private organizations which can integrate/represent each of the key areas in order to create a productive/efficient infrastructure. This to meet the needs of the year round fresh vegetable market of the urban centers the potential export and reduce the post-harvest waste.
- The key infrastructure areas to be developed and integrated:
 - .Agricultural technical support information services
 - .Agricultural base of large tract vegetable production
 - .Fresh vegetable processing at centralized harvest area
 - .Fresh/quick frozen vegetable processing facilities
 - .Refrigerated railcar transport systems
 - .Marketing/distribution systems
 - .Wholesale markets
 - .Retail markets

GUANGDONG PROVINCE
REFORM DIRECTION (continued)

This organized integrated infrastructure can then operate as a system which can serve all the needs of the perishable vegetable market by co-ordinating each area with information services for the contractual growing and marketing of these commodities.

This system could and should be non-government/private, and although organized for the productive/efficient supply of vegetables it should not be operated/controlled by one ownership, but rather segmented ownership of each of 3 or 4 key areas:

- Production
- Marketing/distribution
- Wholesale
- Retail

BEIJING MUNICIPALITY

FINDINGS

The overall view is that the land consolidation and contractual land agreements reforms have been successfully implemented. There appears to be an abundant supply of fresh vegetables and consumer goods. The vegetables which are available in the retail market are of an up-scale wide variety; tomato, string beans, cucumber, mushrooms and many others as well as the traditional cabbage and turnip. The quality of the vegetables varies from very good to very poor with mold and rot apparent on the lower quality supply.

There is an open free market as well as a state owned and operated market servicing a wide variety of consumer needs. The general population of the Beijing urban, suburban and rural areas appear to have many consumer goods and a disposable income in which to pursue their necessities and luxury goods.

RETAIL MARKET

There are fresh vegetable retail markets throughout the Beijing urban center. The two basic types of retail markets servicing the consumer are; the state owned and operated market, and the private sector retail market.

In 1985 the ~~government~~ ^{Beijing} implemented a reform adjustment which created a vegetable two tier pricing system. This system in effect established a 60% state controlled vegetable supply sold thru state owned retail markets and a 40% supply for the free market vegetable retail market.

The differences between the state and private retail markets are quite significant in all the operations servicing the consumer.

The fresh perishable vegetable supply in the Beijing urban center during the harvest season and the immediate post harvest season is very good to adequate. The variety of up-scale vegetables is excellent and the quality is on the average good. The consumer has many choices of types and can purchase at a variety of prices.

However, during the winter season the variety and quality are greatly diminished. This is due to the current inability of the Beijing rural and suburban farmer to supply greenhouse vegetables at a meaningful level. Part of the reason the farmer is not meeting this need is the lack of incentives due to the two tier pricing system.

BEIJING RETAIL FINDINGS (continued)

There is a supply of vegetables being shipped into the northern areas from five southern provinces; Yunnan, Sichuan, Guangxi, Fujian and Guangdong. Their supply is shipped to a number of urban centers, but the supply is limited due to their local vegetable production and difficulty in having sufficient railcar availability. During winter months the supply is even further diminished and the variety is reduced back to traditional basic vegetables.

In order to meet growing retail consumer demand for a year round quality up-scale fresh vegetable supply several areas must be developed:

- Large tract vegetable production in the Beijing suburban and rural areas.
- Meaningful year round vegetable greenhouse capability in the Beijing suburban and rural areas.
- Large tract vegetable production in the five vegetable supplying southern provinces.
- Meaningful year round vegetable greenhouse capability in the five southern provinces.
- Infrastructure to market these vegetables.

The significant issue from the Beijing consumer's point of view is not the price of vegetables, but the availability of an abundant year round quality supply of up-scale fresh vegetables.

BEIJING RETAIL FINDINGS (continued)

PRIVATE RETAIL MARKET

There are many private retail markets through the Beijing urban center with a wide variety of sizes. They range from individual small carts where a number of private retailers group together on the street, an organized retail street market with established stalls and stands to large well organized retail markets which are housed in a building.

The organized street and building fresh vegetable markets pay a monthly fixed fee to the government for the use of the facilities and stalls. The facilities are owned by the state, but the market is the private sector. This fee is approximately 105 Yuan per month. The fee is split two-thirds going to the Industrial Commercial Administrative Bureau and one-third to the Tax Bureau.

The stalls are leased on a monthly basis and are usually leased by the same private party on an on-going basis. The facility is maintained and managed by the state.

In almost all cases from small to large the private retailers maintain neat clean stalls and carts. The produce is usually washed and well merchandised. The variety of vegetables on any given cart or stall can be from one to a wide selection and the quality is for the most part from very good to excellent. Prices in all cases are not fixed, but negotiable.

One of the larger housed retail markets that we visited was extremely well organized and clean. The private retailers apparently took a great deal of pride in the produce they were selling. This market represented one of the three largest of its type in Beijing and I believe there are approximately 15 of this configuration serving the consumer.

The fresh vegetable stalls in this facility had a variety of types being sold from any one stall. The vegetables were of excellent quality, washed, well merchandised and clearly marked as to price. Stalls in the same building and in close proximity to one another were selling similar vegetables under the same conditions, but were not necessarily marked at the same price. Competition was open and all prices were negotiable.

The retailers were not passive, but were verbally attracting consumers and showing their produce. The consumer had the freedom and exercised it in selecting the specific vegetable they wanted.

BEIJING PRIVATE RETAIL MARKET (continued)

The private retail sector is acquiring their fresh vegetables from a variety of sources. They purchase fresh vegetables from the private wholesale markets in and around Beijing directly from the producing farmer, and in some cases the farmer is also the retailer.

The purchasing system appears to be individual retailers buying their daily produce on a need basis. There does not appear to be any medium or large scale retail fresh vegetable buying by any organized private sector group.

During the winter months it would be difficult to see how many of the private retailers could purchase sufficient quality up-scale vegetables in order to stay in business.

The consumer demand has created a market for these quality vegetables. Meeting this demand means developing a better retail system which can serve large population centers throughout the year and in turn the retail market must be served by a highly developed wholesale marketing system.

BELJING RETAIL FINDINGS (continued)

STATE OWNED/OPERATED RETAIL MARKET

The state owned/operated retail markets can be seen throughout Beijing. They are usually housed or are under a permanent awning. They can be further identified by the frequent large mounds of vegetables that are piled on the street.

The delivery of the fresh produce they receive is usually by truck and in larger amounts than the typical private retailer would purchase.

The retail sales personnel are salaried state employees. There is no reward incentives for these personnel to take any personal interest or pride in their responsibilities. Whereas the private sector pursues customers/sales the state employees take a passive role.

The vegetables at these state retail markets are price fixed at or just below the free market prices and there is no price negotiation as in the private retail markets.

The vegetables being sold are usually the same variety as at the private market. However, they are not washed or merchandised so as to attract or promote sales. The quality appears to be of a lower grade than that found at the private retailers and mold/rot appears to be more prevalent in the state retail markets. The facility is not as clean and the service is very poor.

The consumer can not make their own selection of soft vegetables, and still must pay the going price for the selection the state employee makes which could and does include produce of a variety of quality.

There is more vegetable waste at this type of retail market due to the method and volumes of vegetable delivery and the mound method of displaying.

Whereas in the private retail market, the retailer must purchase vegetables he knows he can sell by quality, type and price in a short period of time to protect his investment, the state owned/operated retail market is not profit motivated. They do not take into account inventory, quality, variety, price and what may be one of the most important considerations - merchandising and service.

The one advantage the state owned/operated retail market could give the consumer is lower pricing, but this is not the case as the prices for the vegetables are about equal to the private retail market and the quality is poorer.

BEIJING FINDINGS (continued)

PRIVATE WHOLESALE MARKET

The private wholesale vegetable market is conducted at a state owned facility. The market, although free, is controlled by the government and there is a tax to the wholesalers for the use of the facility. The tax is based on an approximate total value of vegetable and volume at a rate of 3% with a minimum fee of 15 Yuan. Below a judgement value of 15 Yuan there is no entry fee.

There is a further tax and this is considered a management fee which is levied using the same criteria and rate as the above mentioned tax.

This tax is based on a casual value judgement with a 10% deduction for vegetable waste.

There are about 15 of these large private wholesale markets in the Beijing urban area where both the state and private sector (retail) can purchase their fresh vegetables.

The produce wholesalers are farmers or marketing cooperatives who then sell to the retail. The vegetables for the most part are transported to the wholesale market by trucks which are either owned or leased by private marketing/distribution cooperatives/companies.

The wholesale market that was viewed was identified as the third largest in the Beijing urban area and is known as the Shui-Zhui-Zi wholesale market. The fresh vegetable sales per day are approximately 500,000 jin with a tax collection of over 4,000 Yuan per day.

The Shui-Zhui-Zi wholesale market is walled in with several buildings within the compound. The buildings serve as offices for the tax and managerial staff and there are several permanent stalls for longer term produce storage such as ginger root and melons (shipped from the western provinces).

The vegetables for the most part are brought to the wholesale market by trucks and some by bicycle cart. The vegetables are either loose within the truck such as potatoes and cabbage or are packaged in a variety of ways. The type of packaging varies from re-useable woven baskets to large sacks made of either burlap or some synthetic materials.

There appeared to be a great deal of vegetable waste due to transport damage, rot and general abusive handling of the vegetables in the process of selling to the retail trade. The abusive handling was due to the non existant or poor packaging of the fresh vegetables.

BEIJING PRIVATE
WHOLESALE MARKET (continued)

The general atmosphere of the Shui-Zhui-Zi wholesale market was chaotic and poorly organized/managed. The area is too confined, and although long, much too narrow to handle the volume and method of business being conducted.

The vegetables are being sold for the most part directly off of the trucks to the retail which is using the bicycle-cart transport.

The number of retailers at any given time are not restricted and the market becomes absolutey grid locked not only for the bicycle-carts, but for pedestrian traffic as well.

The fresh vegetable variety, quality and quantity were excellent. The retailers have an excellent choice of vegetable types and range of quality to choose from. The vegetables have a minimum and maximum price range and then are negotiated between the two.

This type of wholesale market, although inefficient, could service a small community or village environment. For the population base of urban Beijing or other heavily populated urban centers this type of wholesale market can not effectively supply the retail/consumer needs for fresh good quality vegetables at a continued reasonable price. The inefficient organization/structure and product waste create additional road blocks to an already difficult task of servicing an ever increasingly demanding consumer.

BEIJING FINDINGS (continued)

STATE OWNED/OPERATED MARKETING COMPANIES

The state owned/operated marketing company operates very differently than the private wholesale market. The state operation uses a district state owned marketing company (SOMC). The district SOMC co-ordinator in the producing area is informed by the SOMC as to which vegetables are needed.

The vegetables are purchased on credit and transported by trucks owned either by SOMC or collectives. These vegetables are then transported to weighing stations within the district concerned. The weighing depot gives a credit note to the transporter based on the net weight and then directs them to the area/areas where the produce is needed. This is usually large state owned/operated retail markets.

This type of system promotes delivery of an excessive fresh vegetable supply. The large mounds of vegetables seen in Beijing are another result of this system. The excessive supply at the retail level and the mounds of vegetables in the street allow for rot and therefore waste. Where the private market sectors buy fresh vegetables more in line with what they can sell in a day or two, the state operations appear to purchase and distribute an excessive volume of perishable vegetables.

This method promotes quality loss and in short order waste. The supply of perishable vegetables should be driven by the demand. Since there is little or no washing or culling the vegetable rot and waste are at very high levels and this marketing system generates more.

BEIJING FINDINGS (continued)

BEIJING MUNICIPALITY RURAL AREA

AGRICULTURE

SHUN YI COUNTY

This county is an excellent example of specialized farming and what can be accomplished through good planning and management.

The agricultural base is primarily grain and the second is vegetables. With 193 farms on rented land - specialized farming has taken on a positive image. There is approximately 3,200 mu per farm and they are utilizing mechanized technology. The specialized farming is primarily the grain production.

There are 24,000 workers in mechanized grain production with the individual farmer allocated 26 mu for grain farming. The individual farmer is fully responsible for production management and the sale of the grain produced on his 26 mu.

Land consolidation/skilled farming has been in practice for two years. There has been a steady increase of grain production since the introduction of land consolidation/specialized farming. The 1988 grain harvest is approximately 20% greater than the harvest of the first year 1986.

A number of significant productive improvements have been made in the two years of grain specialized farming. They are currently utilizing approximately 6,000 pieces of equipment for the summer harvest. This equipment accounted for harvesting 80% of the crop and the harvest time was reduced from 15 days in the previous year down to 6 days in 1988. In wide use is the water sprinkler system which is replacing the traditional irrigation ditch. They have been able to decrease their water use per mu by 50% and increase the land productivity by 20% with irrigation utilizing the sprinkler system. They are currently using the sprinkler system on 400,000 mu.

The specialized farming concept has allowed this area to increase not only the land output, but has also been able to increase the number of mu a farmer can easily manage.

The mechanized equipment used for the specialized farming is rented from the township. The township manages the equipment, co-ordinates and schedules all programs. At the village level all mechanical servicing and maintenance responsibility is managed. The village level is also responsible for the operation of all the equipment.

BEIJING AGRICULTURAL FINDINGS (continued)

The leaders of this area have attended high school and technical schools and are considered agricultural specialists. This higher education level was achieved at the township level.

Shun Yi County represents 20% of the fresh vegetable supply to the Beijing urban area. At the county level there are 40,000 mu dedicated to vegetable production and in 1988 this represented 450 million jin. Seasonal vegetable crops accounted for 80% and greenhouse crops accounted for 20%. Increases in vegetable harvest are due to increased use of the greenhouse technology.

The greenhouses are primarily used from October thru April and the main production is in cucumber, tomato, green bean and califlower. This greenhouse use was started in 1986 and has been successful. They are increasing the greenhouse use due to consumer demand for fresh vegetables during the winter months.

The fresh vegetables during harvest are sent daily to the urban area thru a variety of marketing channels;

50%-60% - State owned marketing companies
and Township level marketing companies.

40%-50% - Farmers selling direct
or Industrial enterprises purchasing
from the farmer.

The success of the specialized farming for the production and harvesting of grain has been excellent. The vegetable production has also shown very good results as to increased crop yields and greenhouse utilization. The specialized grain farming could ~~and~~ ~~should~~ be used as a model for other areas/provinces and adapted for use in the production of vegetables in the Beijing Municipality and southern provinces especially Guangdong.

There seems to be an atmosphere of farmer confidence and economic well being in Shun Yi county. The farmer households visited showed an abundance of durable goods. The homes were very spacious, neat and clean and contained a new refrigerator/freezer, color television and portable stereo radio/cassette players.

BEIJING MUNICIPALITY FINDINGS (continued)

SUMMARY

The progress made in all areas since the first reform implementation of 1978 has been excellent.

As stated in my findings the Beijing Municipality is enjoying the benefits of the successful land consolidation and contractual land reforms. There is an open free market and state market supplying the consumers with an abundance of goods and services. The fresh vegetable availability is good with a wide variety and quality.

The farmer appears confident and with an atmosphere of economic well being. The urban center in my opinion is slightly behind this, ~~but is this~~, but is also enjoying a very good standard of living.

However, there is a strong need to improve and modernize the fresh vegetable supply infrastructure if the urban population centers needs in this area are to be recognized and met. The opportunity to develop the fresh and processed vegetable export market is another aspect of the modernization of the vegetable supply infrastructure.

The success of this modernization would benefit the farmers thru the consumers and develop a marketing system that could be used for most if not all other agricultural commodities.

FRESH VEGETABLE INFRASTRUCTURE KEY AREAS

- * Production
- * Marketing/Distribution
- * Wholesale
- * Retail

GUANGDONG PROVINCE

FINDINGS

This province has had the most reforms and release of government controls of all the areas in China. The results appear to be very successful as there is a high standard of living, and an abundance of food and consumer goods.

The atmosphere of Guangdong and specifically its major, urban population center, Guangzhou is one of a very open and consumer oriented market. Guangzhou appears to be a prosperous and energetic city with a very open and noticeable free market.

Guangdong Province's rural and urban population seem to have a good disposable income with which to pursue their necessities and luxury needs.

RETAIL MARKET

Guangzhou, unlike Beijing, has no state owned/operated vegetable retail markets. All of the vegetable retail markets are free private markets.

Throughout Guangzhou there are fresh vegetables and fruit being sold from many small private retail family owned stores. These outlets are primarily neighborhood small provision stores that sell a variety of dry goods as well as both fresh and packaged foods.

The variety of vegetables are excellent and the quality is also very good. There is an abundance of fresh vegetables available to the consumer at negotiated prices. Guangdong province is a major producer of vegetables.

Another advantage that this vegetable retail market has is the absence of any government price or quota controls on the vegetable market. There is no two tier pricing system.

In Guangzhou there are approximately 8 large retail markets and about 370 small markets. This does not include those small provision outlets which are family owned/operated.

GUANGDONG PROVINCE
RETAIL MARKET (continued)

The Zhu Guang retail market in Guangzhou was visited. This market is one of the 8 large retail street markets. The market area is 6,000 square meters and 560 stands all of the stands under permanent cover.

The market, although private, is owned and managed by the state. There is a tax on each stand of 3% which is based on their total volume of sales. There is an additional managerial fee of 1% also based on their daily total sales. This tax/fee is a judgemental assesment. With the exception of friuts and vegetables all products are taxed.

The means of determining the Yuan value of tax is through monthly meetings which includes the three concerned groups:

- Industrial Commerce Administrative Bureau
- Taxation Bureau
- Private Sector - Retail Sellers

The market appeared to be well organized and clean. The abundance of food products and variety was impressive. The quality of the product being displayed was apparent and well merchandised.

The fresh vegetables were washed and well merchandised. The quality and variety was similar to what had been seen in the private retail markets of Beijing.

The fresh vegetables were displayed with prices, but all were negotiable.

A Guangzhou suburban retail market was visited in Shi Jing Township. This market was not as up-scale as the Guangzhou urban market and it was much smaller.

The retailers were charged a very moderate fee by the state to use the stands and they had continuous use of the stands on a long term basis.

There again was a wide variety of foods and vegetables being sold. They were well displayed and washed. In this market almost all the retailers were farmers and were selling the products they produced.

GUANGDONG PROVINCE (continued)

WHOLESALE MARKET & MARKETING CHANNELS

The wholesale markets in Guangdong/Guangzhou are operated in a very similar way as the wholesale markets of Beijing. The significant difference is in the overall marketing channels that have been implemented in Guangdong Province.

This difference is due to the advanced development of the free market and the reform implementation success.

There is another reason for this difference and that is the export opportunities of livestock (live & slaughtered), poultry and fresh vegetables to other areas within China, as well as, Hong Kong and beyond.

There is an excellent financial benefit for this township because of this close proximity to Guangzhou and excellent market pricing.

The transportation availability is significant in this area; railroads, highways and 300 ton ship capacity river. All of these are being utilized to move commodities to the various export and domestic markets.

The official population is 63,000 with an additional 40,000 unofficial and migratory working population.

Cultivated land is 40,200 mu broken out as follows:

- 23,000 - paddy rice
- 9,500 - vegetables
- 2,700 - sugarcane
- 2,500 - peanuts
- 2,500 - fruits

The total agricultural & industrial output for 1985 was 117 million Yuan. The total output for 1988 was 240 million Yuan more than double the 1985 output.

GUANGDONG PROVINCE (continued)

AGRICULTURAL FINDINGS & MARKETING CHANNELS

The farming population has less than 0.9 mu of cultivated land per capita. The variety of commodities are impressive;

- livestock - pigs
- poultry - chickens, ducks, geese
- vegetables - cabbage, melons, egg plant, tomato, cucumber, etc.
- rice
- fruit
- peanuts

Rice output per mu is 300 Yuan while vegetables are 2,100 Yuan per mu. This is a 7 to 1 advantage of vegetables over rice per mu productivity. However, the land is subject to a rice quota for local and state consumption.

Prior to 1986 pig raising was accomplished by the household with a great deal of difficulty. Some of the problems were related to type of pig, breeding, feed and marketing channels.

In 1986 they set up a livestock company to address all those problems. The company is considered a marketing company as it undertook the problems, as well as, the marketing channels.

They now sell to foreign export companies in Shinjin industrial zone who then export to Hong Kong. Live/slaughtered pigs and fish are being transported by refrigerated trucks to Shinjin.

The exporter purchases the products from the producer and the producer ships to Shinjin

Fresh vegetables are being exported to Hong Kong using the same channels. The vegetable export is about 300 tons per day using their own trucks.

For the pigs/fish they receive 12.5% of the selling price in foreign exchange and the balance in local currency. They are paid in all local currency for the vegetables.

GUANGDONG PROVINCE

AGRICULTURAL FINDINGS & MARKETING CHANNELS (continued)

Vegetables as they are harvested are simply packaged with no processing and shipped to Shinjin and Guangzhou. This accounts for more than 70 million jin per year.

The vegetable production is moved primarily by bicycle; approximately 70% by bicycle and 30% by truck.

Vegetables are strictly a household crop which fulfills the following:

- 3 tons per day shipped to Hong Kong (export quota)
- 7 million jin (10% of annual crop) is transported during winter months.

The marketing company supplies seeds, fertilizers and other inputs, but they must be paid for by the individual farmer. 100 kilograms of fertilizer/mu is at state price; above 100 kilograms it is at the market price. All seeds are at market price.

There are a number of marketing channels being used by this township:

- The township marketing company distributes vegetables to the north.
- Vegetable marketing companies in Guangzhou purchase from the farmer and ship to the north.
- Other provinces send marketing companies to purchase vegetables.
- Hunnan Province marketing companies, as an example, sends trucks with pigs to Guangdong and transports back vegetables.
- Private marketing companies purchase vegetables and ship to export and domestic market.

There is a Joint-Venture company for the railway transport of vegetables:

- Railway Administration
- Township Fruit & Vegetable Marketing Company
- District Marketing Company

GUANGDONG PROVINCE

AGRICULTURAL FINDINGS & MARKETING CHANNELS (continued)

The method of operation is the JV purchases the vegetables from the producing farmer at market price and ships (without processing) to a pre-arranged northern destination.

Contracts have been signed between the parties before actual seeding takes place. On arrival of the vegetables at the destination, the shipping JV is no longer responsible. The purchasing destination marketing company takes possession at this point.

The northern purchaser, before shipping, but after harvesting, sends an inspection team to approve the vegetable quality. At agreement signing a minimum price is set - at purchasing time they go with the market price if it is higher. Transportation costs and waste allowance are included in the agreement price.

Waste is generally 3 to 8% of total volume when delivered to Guangzhou (depending on crop). When received at the northern destination it should not exceed 10%. The two most significant reasons for waste is the relative humidity of the crop and the handling abuse.

The vegetables are packed in baskets, but are not washed or processed.

There is an interest in developing wide use of greenhouse production of vegetables. In winter they can increase their growing season, shorten the time it takes vegetables to reach maturity and prevent crop damage during summer heavy rains.

Qing Gao Township is an excellent example of the beginnings of an integrated - production to consumer - infrastructure.

GUANGDONG PROVINCE

AGRICULTURAL FINDINGS & MARKETING CHANNELS (continued)

Dali Township of Nanhai County is another example of the successful implementation of the reforms in the agricultural area.

They have been investing continuously in the development of the agricultural base:

- Sprinkler irrigation, hydro power, agricultural equipment
- Agricultural inputs - good quality seeds & fertilizers
- Reforestration, fruit production (in hilly areas)
- Rewarding the most productive individuals & cooperatives
- Set-up a private wholesale and retail market

There is no large tract specialized vegetable farming, although they have started contractual land agreements and land consolidation on a small scale.

Individual household farm land is on the average 3 mu per family. Examples of the land consolidation/land contracts:

- 3 households combine land - 1 family works the land; the other households work in commercial enterprises.
- A family contracts approximately 40 mu and is involved in specialized vegetable farming.
- A family contracts non-farming family land and pays them with part of the harvest.

This is also a major rice growing area and rice farming is being mechanized.

There is a great deal of enthusiasm and interest in furthering their ability to be more productive agriculturally. The direction is towards vegetable production for shipment to northern urban centers and for exportation. Poultry export has begun with 240,000 ducks.

GUANGDONG PROVINCE

AGRICULTURAL FINDINGS & MARKETING CHANNELS (continued)

A fresh vegetable processing facility has been developed in Lishui Township of Nanhai County. This company, Bao Sian is a vegetable processing export company. Bao Sian, is a joint-venture between two foreign partners, with the Chinese partner the Economic Development Corporation.

The operation was started in 1985 and is exporting fresh and fresh frozen vegetables. The frozen vegetables are currently being exported to the U.S.A., Japan and Western Europe, and the fresh vegetables are going to Hong Kong, Macao and Singapore.

For 1988 they are projecting an export volume of 2,000 tons frozen and 2,700 tons fresh. In 1989 they are expecting approximately 6,000 tons of both fresh and frozen vegetable export.

The variety of vegetables are determined by the purchasing companies:

asparagus	snap peas
pea pods	bamboo shoots
french string beans	mixed vegetables
water chestnuts	mushrooms

All of the fresh vegetables which are shipped fresh are purchased locally. The vegetables for the frozen export market are purchased locally with the exception of asparagus which is purchased from Fujian Province.

Bao Sian purchases its vegetables from a state owned contractual land company of 3,000 mu which is worked by employees from outside this province. There is further plans to contract 10,000 mu of vegetables produced by and purchased from local farmers.

The farmers would grow very specific crops on a contractual basis with Bao Sian. Bao Sian would give technical support and sell seeds, fertilizer and all inputs at below market price. They would then purchase the vegetables at close to, but lower than market price.

Bao Sian would provide all necessary packaging and the farmer would arrange truck transport. Bao Sian is also planning to use land consolidation to have an additional 3,000 mu available.

The export sales are all paid in US\$ and HK\$. 100% of the foreign exchange goes to the joint-venture and is divided according to the percent ownership. All of the vegetables are purchased F.O.B.

GUANGDONG PROVINCE

AGRICULTURAL FINDINGS & MARKETING CHANNELS (continued)

The relationship between Bao Sian and the Lishui Township is very strong and the township plans to strengthen and develop vegetable processing similar to the Bao Sian operation.

The local officials believe individual households can not service large vegetable processing plants nor meet domestic fresh vegetable needs efficiently. There are plans to educate the farmers with the concept of land consolidation.

There is 15,000 mu under vegetable cultivation, but for the most part farmed by the individual farmer. The township would like to consolidate this 15,000 mu into specialized vegetable farming.

Currently there is some export of fresh vegetables by another company (other than Bao Sian) which is township controlled. They are shipping to Guangzhou, the northern provinces and Hong Kong.

The export quota and permit are owned by Bao Sian Company. However, this other company purchases vegetables from local farmers and uses Bao Sian quotas/permit for export to Hong Kong.

Local farmers are very interested in contractual agreements with Bao Sian and other marketing companies. The purchasing contract guarantee for their crops gives them security and a ready market. They feel this is very beneficial as the crops (pea pods, waterchestnuts, etc.) that are contracted for are very profitable.

There are several marketing channels being used to move vegetables to the northern urban centers and export markets:

- State owned marketing companies
- Non-government/private marketing companies
- Joint-Venture marketing companies

These companies provide a variety of services; purchasing/shipping, contract agreements with the farmer/end purchaser, processing/export. The contractual agreement on producing/buying fresh vegetables allows for stable and high product profits. It also contributes to a more stable abundant supply of fresh vegetables to the northern provinces and export market potential.

GUANGDONG PROVINCE

AGRICULTURAL FINDINGS & MARKETING CHANNELS (continued)

The township and Bao Sian are working in the same direction; increase the vegetable agricultural base for profitable export of fresh processed vegetables to other provinces and foreign markets.

Bao Sian currently has in operation one processing/freezing line. They already have in their possession a second production line with plans to install it by early 1989 after building modifications are completed. Once this second line is installed and operating there will be a need for a consistent supply of vegetables to meet their export contracts. A larger vegetable base is under study and further land consolidation/contractual agreements will be implemented.

Nanhai County officials have plans to develop vegetable farming and export opportunities along the same lines as Bao Sian. They are planning to organize two townships within their county, Lishui and an adjoining township which will give them approximately 20 square kilometers of vegetable farming.

Their intentions are to continue production of traditional vegetables and develop more of the desirable up-scale vegetables for local consumption and export.

The province and county have set-up policies and principles for the encouragement of sound development of the vegetable production base. In order to pursue this advanced agricultural base the county is attempting to raise capital.

Guangdong Province has developed other joint-ventures and wholly owned state enterprises. They have imported technology in raising dairy cattle, egg producing chicken ranches and edible chicken ranches. These operations are well developed and self sufficient. They manage their own marketing/distribution and wholesale channels in the export and domestic markets.

There is also a state owned/operated export company which is exporting fresh vegetables through refrigerated shipping to both the U.S.A. and Japan.

GUANGDONG PROVINCE FINDINGS (continued)

SUMMARY

There is a strong desire, at all levels, to move ahead with reforms and programs. Guangdong Province wants to be the major producer and supplier of fresh vegetables to northern urban centers and to penetrate international fresh and frozen vegetable market in a meaningful way.

This province has had the benefit of having the most success with the most reforms in China. It has a relative high standard of living and an abundance of commodities and food products. It is strategically located for export market to Hong Kong and the general international market.

In order to achieve the desired and necessary goals of broadening their agricultural base for the development of the fresh and processed vegetable market both domestically and internationally, there are a number of significant issues which must be addressed.

The large tract vegetable farming concept can only be accomplished when the individual household farmer recognizes they can diversify their income through commercial enterprises (TVE's), contractual land agreements and land consolidation. This would lead to specialized vegetable farming which is essential in the development and ability to supply the major northern urban centers and export market with their year round fresh/frozen vegetable needs.

Transport systems are of course a prerequisite to this development. The highway and railroad system must be modernized and expanded. Development of more refrigerated railcar availability is essential for movement of fresh vegetables and reduction of waste.

The 4 key areas of infrastructure development are basically the same as listed in the Beijing summary. There will be some differences due to the province and their stage of fresh vegetable supply/consumption.

FRESH VEGETABLE INFRASTRUCTURE KEY AREAS

- * Production
- * Marketing/Distribution
- * Wholesale
- * Retail

BEIJING MUNICIPALITY & GUANGDONG PROVINCE

RECOMMENDATIONS

To efficiently meet growing demands for fresh vegetables in urban centers throughout the year, requires an infrastructure which addresses each of the phases of that supply. The four key phases or areas which must be developed are:

- * PRODUCTION
- * MARKETING/DISTRIBUTION
- * WHOLESALE
- * RETAIL

These are the four key focus areas which contain within and have supplementary to them several significant issues. These issues must be simultaneously developed for the total infrastructure to eventually be effectively put in place and fulfill the consumer demand for fresh vegetables.

There are two geographical areas, Beijing Municipality and Guangdong Province, which have the same basic development needs, but do have several different issues that are unique to each of them.

The key question is what direction and development must take place to build an efficient productive supply of fresh vegetables for domestic consumption and pursue the export opportunity for fresh/processed fresh vegetables.

Which ever system (from producer thru consumer) that is developed it must be built gradually and on a solid base. It must benefit all areas of production, marketing systems and, of course, the consumer.

BEIJING MUNICIPALITY
& GUANGDONG PROVINCE RECOMMENDATIONS (continued)

The Beijing Municipality has a distinct disadvantage in vegetable pricing reforms which has a 60% government quota price control on fresh vegetables. This causes a direct negative effect on the farmer and the consumer and hinders the development of the fresh vegetable market.

The direct negative effect on the producing farmer is that they must sell a significant proportion of their crop at a lower than market price. This diminishes their incentive to meaningfully develop large tract specialized vegetable production and keeps the local supply of fresh vegetables suppressed.

By freeing all aspects of the vegetable production and market place the concept of supply and demand will allow for the consumer to create the level of supply, the quality and the variety of the fresh vegetable market. The supply will increase due to profit incentives for the farmer which is prompted by the consumer off-take.

The removal of this 60% state controlled market will also eliminate the need for state owned/operated retail markets. In turn this will free up subsidies and allow the employees to be utilized in more productive commercial enterprises. It will also eliminate vegetable waste and allow for more free retail markets.

Although the prices of the vegetables will initially increase the forces of supply and demand will take effect and prices will decline. An example of this can be seen in the Guangdong Province reform of 1980 which freed the price of fish. Initially, the prices rose very rapidly which gave incentives to the fish producers to increase their production. This increased production of fish and the added supply on the market caused the price of fish to decline to a reasonable affordable level.

The issue of fresh vegetables to the consumer is not the price in the free market. The issue is a year round fresh vegetable supply which is consistent in good quality, an up-scale wide variety and an abundant supply.

Guangdong Province does not have a 60% state controlled quota. It has a one price system which is the private retail market. The prices in Guangdong are affordable and within reason.

BEIJING MUNICIPALITY
& GUANGDONG PROVINCE RECOMMENDATIONS (continued)

VEGETABLE RETAIL MARKETS

The four key infrastructure areas are interrelated. Each one has direct dependence on the other and in turn is affected by the development of the other key areas.

The need to develop any of the four areas is primarily driven by the consumer demand and the ability to service that demand in an efficient cost effective way.

Removal of the Beijing 60% vegetable quota and state operated retail markets is the first step in addressing establishment of an efficient private retail market network.

Once this is accomplished, private retail markets of Beijing and Guangzhou can be established along similar lines.

In order to properly service the consumer, the retail markets must be located so that all citizens can easily have access to them in both their general neighborhoods and where they are employed. There are many small private retail stalls/carts around the city areas which are important to the consumer and the free market, but the real need is development of large organized permanent retail markets.

These large private markets must offer the consumer competitive prices that are within the average citizens purchasing range. Quality, as is currently the situation, should be good to excellent and choice of selection left to the consumer. The variety should be the traditional, as well as, up-scale vegetables with a year round abundant supply. Produce should be clean, washed, well merchandised and clearly marked as to price.

Advantage to this type of large private retail market is, if properly organized, they can begin to purchase produce in larger volumes. A small representative group can be selected from among the retailers to make necessary purchases from the wholesale market so the majority can spend time addressing retailing needs.

Purchasing larger quantities of a variety of vegetables gives retail purchasing agents more price/quality negotiating leverage. This is reflected in profits or savings passed on to the consumer.

*requires
"large tract"
producers.*

VEGETABLE RETAIL
MARKET RECOMMENDATIONS (continued)

The organization of this type of retail market and its purchasing strategy can have a very significant positive impact on the consumer, as well as, the producer through the marketing/distribution and wholesale infrastructure.

The retail market should be permanently housed in a large building is convenient to setting up semi-permanent open stalls/stands. Floor and walls should be in good repair and easily cleaned and potable water available for the cleaning/washing of stalls/stands and vegetables.

Management of this building should be either a non-government or private cooperative. They would be responsible for the maintenance and cleaning of the building facilities. The stalls/stands would be on a long term lease to the private retailer with continued option to renew this lease.

One option is that the retailers themselves set-up the private cooperative to manage the facility and determine the guidelines for all participating retailers. Management would be responsible to ensure no unfair price fixing or monopoly of trade/retail.

The advantage of this type of retail market to the consumer is the ability to conveniently purchase at fair prices basically all their vegetables, other food commodities and dry goods at one central well organized market.

Once this type of market is established, the retailers can begin to determine their produce needs to satisfy their customers. The range of vegetables, quality and volume can then be specifically addressed to the consumer off-take and allow the retailer to purchase against this market. This gives the retailer the ability to be more cost efficient, reduce waste when determining his fresh vegetable needs on a daily/weekly basis, therefore, giving the retailers an opportunity to be more price competitive and profitable.

Retailers can organize a small purchasing group or agents to deal with wholesalers, or if convenient, directly with the market/distribution segment of the infrastructure and even with the farmers themselves.

VEGETABLE RETAIL

MARKET RECOMMENDATIONS (continued)

By organizing and determining their vegetable needs and using a purchasing agent, they can be more effective in dealing with suppliers. Purchasing for the group gives them greater negotiating leverage.

This purchasing system allows for the establishment of a relationship with the supplier to ensure the produce needs of the retailer, and the wholesaler can then begin to organize their purchasing needs.

The basics for this type of system are all ready evident in Beijing and Guangzhou. Examples of segments of this system are being utilized and these experiences can be drawn on for models.

There are established large well organized private retail markets housed under one roof. More should be established. Assistance in organizing them into a purchasing system is not difficult once the consumer purchasing patterns are determined.

Retailers purchasing direct from the farmer is taking place, but on an individual small scale. The proximity of the retail market to the farmer and the volume purchased may not be convenient for the large type retail market. Once the complete infrastructure is developed there will be several options which can be explored.

RECOMMENDATIONS

VEGETABLE WHOLESALE MARKETS

The existing wholesale markets are poorly organized and will not be capable of meeting the needs of the to be developed large network of retail markets and marketing/distribution systems.

Development of larger wholesale companies if part of the the marketing/distribution system and dealing as one marketing channel would be more efficient, this would eliminate one segment between the producer and the consumer.

The first step towards this type of system is to begin developing a more efficient wholesale company. This company, rather than being a number of small farmers or marketing companies selling their produce to the retailer, would be the wholesale/marketing company. It could be set-up as a non-government company, private cooperative or a stock holding group which would manage the sale of fresh vegetables to the retailers. It would lease the land where the wholesale market was established and through contractual agreements purchase fresh vegetables from large/small marketing companies and/or directly from large tract specialized vegetable farm.

This wholesale/marketing company would be the only wholesaler at their leased site. They would own the vegetables/product or deal on a contract consignment basis.

The large retail markets can then begin to use the purchasing agent concept with pre-determined vegetable/product needs to meet consumer off-take patterns.

The wholesaler can also begin to pre-determine his needs and contract with marketing/distribution companies in their province or other provinces as the supply or season changed. They can contract directly with the producer as well. This would allow them to reduce their cost through direct purchasing, reduce waste by pre-determining type/quantity and have the ability to buy in large volumes to be able to negotiate the best price.

*prototype
wholesaler*

VEGETABLE WHOLESALERS
MARKET RECOMMENDATIONS (continued)

In order for this to develop, the wholesaler must be able to supply on an exclusive basis several major retail markets/organizations with contractual agreements. Agreements must include all necessary details as the type, quality and volume required and at a low enough price to give both the retailer and the consumer opportunity to purchase reasonably marked up produce.

The wholesaler must also have the ability to store some inventory of non-perishable and perishable vegetables under good conditions.

There will still be the need to wholesale small to moderate volumes of fresh vegetables. Individual farmers will have his produce to sell and the small retailer will need to buy. Allocated space should be available at a very moderate fee for the smaller sellers/buyers. The larger wholesalers must set aside this designated space.

There are several very significant benefits to having a more organized larger wholesale/marketing company. The number of retailers frequenting the wholesale market will be greatly reduced which makes for greater efficiency. Number of employees required to operate the wholesale market are greatly reduced. Vegetable waste is reduced through proper supply organization and reduced handling. All of this creates a more cost efficient operation which reduces cost to the wholesaler, retailer and the consumer.

Other direct benefits are in the marketing/distribution and production fresh vegetables. This will affect the local and other province vegetable growers. A steady pre-determined guaranteed market allows for cost efficient production and transportation operations. It also assists in reducing costs to all parties concerned.

Establishment of the large retail and wholesale/marketing operations can not be instantly created. They must be carefully planned and slowly put into place. Developing the retail markets would be the first phase. Once they have been operating and organized into cooperatives, the next phase would be to establish a wholesale market that could begin to service the direct needs of several of these retail markets. Use of retail purchasing agents and a wholesale/marketing company that would purchase directly for this group from pre-determined suppliers/farmers is the next step. As these interwoven operations became experienced and successful more could be developed.

This concept must be tied to large tract specialized vegetable farming and a marketing/distribution system equal in ability and modernization.

M. J. de
Terminal?

guess that marketing/distribution system to be developed from a central point.

RECOMMENDATIONS

MARKETING/DISTRIBUTION SYSTEMS

(i.e. transport, handling, processing)

The existing transportation systems, highway and railway, are in need of extensive expansion and major development programs. The highway system in the areas I viewed and throughout China are not conducive to an efficient or even possible means of moving fresh perishable vegetables long distances. There is some ability to move the produce short distances within the same province by road, but there are no major highway systems in China. Where development of a highway network is extremely expensive, a rail system is more effective and for the most part there is a basic system in place.

The railway system is being developed and expanded and can be very effective. The need is to put on more refrigerated railcars capable of moving fresh vegetables efficiently throughout China.

Current marketing/distribution systems for fresh vegetables cover a wide variety of transport methods. Large volumes of fresh vegetables are being moved from the harvest area to the urban centers within the individual provinces by bicycle/cart and by trucks.

The bicycle/cart delivery is the farmer transporting his crops to the wholesale and/or retail market and possibly selling to the consumer himself. Truck delivery has a number of possibilities; private marketing companies, state owned marketing companies, farm cooperatives and possibly wholesale/marketing companies.

There is refrigerated and non-refrigerated railcar and truck delivery to different provinces and to Hong Kong.

The existing system does not process the vegetables after harvest and before shipping nor does it process after shipping when it reaches its destination. Processing is basically washing, culling and sorting fresh vegetables to remove soil, vegetables with rot and other waste causing substances. There is some small exceptions to this. Companies such as Bao Sian and other suppliers to the export market do process the vegetables prior to shipping/exporting.

Processing extends the life of vegetables during shipping and reduces volume of non-edible rotting vegetables that take up valuable transportation space. This non-productive means of shipping waste and potential waste drives cost of the edible produce up.

MARKETING/DISTRIBUTION
SYSTEM RECOMMENDATIONS (continued)

The existing state owned marketing companies should be converted to a non-government/shareholding company. Other structures could be private cooperatives or private companies and could also be coupled with wholesale organizations to form a wholesale/marketing company. This removes another segment from between the producing farmer and the consumer which helps to reduce cost to the retailer/consumer.

The function of current marketing/distribution organizations is to purchase fresh vegetables from the farmer and move/sell it to the wholesaler. They do this within the provinces, between the provinces and to export markets such as Hong Kong, as well as to export companies such as Bao Sian.

As the retail and wholesale markets develop, as described on the preceding pages, the marketing/distribution function can also be expanded to more efficiently service both the producer and the wholesaler.

The role of the marketing/distribution company is to develop contractual agreements with the wholesale company to supply them with their on-going fresh vegetable needs. They can also develop this same type of contractual agreement with the large scale specialized vegetable producers. This allows the producer to have a guaranteed market with a pre-agreed on price minimum and knows what variety and quantity is needed.

The marketing/distribution company can be a supplier of agricultural technology, agricultural inputs (fertilizer, seeds, etc.). They can sell these inputs at slightly below market price (buying in volume) and purchase the vegetables at slightly below market price.

The marketing/distribution company can service several large wholesale companies or merge with a wholesale company to form a wholesale/marketing company. Their function is the same, but their ability to service the system of producer to retailer is greatly enhanced through streamlining and direct negotiations. They also take on the responsibility of processing the vegetables at centralized processing centers in the farm area.

MARKETING/DISTRIBUTION
SYSTEM RECOMMENDATIONS (continued)

Through the expanded role of the marketing/distribution companies or wholesale/marketing companies an ability to supply the urban centers with year round fresh vegetables is created. These same companies can lease through government contracts refrigerated railcars.

Through pre-agreed contracts with the vegetable producer and the wholesaler or retailer they can schedule large volumes of pre-determined specific vegetables and volumes.

A further advantage to this type of marketing/distribution system is the ability to develop export opportunities since they would be the key co-ordinators of the vegetable producers and the foreign companies. Part of their expanded role can be the development of a company that processes and packages the fresh vegetables for the export market.

These concepts are currently taking place in various localities I visited in Beijing Municipality and Guangdong Province. It is not wide spread and each company/township is doing some aspect of this.

Lishui Township and the Bao Sian Company are doing much of this on a small scale mostly for the export market. The same system can certainly be used for domestic development.

RECOMMENDATIONS

VEGETABLE PRODUCTION

The vegetable farmer and his ability to produce the required supply is extremely critical in satisfying consumer demand. The farmer is the most important part of the four key areas of infrastructure. He must be willing and able to supply large quantities of a variety of quality vegetables throughout the year.

The farmer must be given the incentive and technology to accomplish large scale specialized/mechanized vegetable farming. He must be able to produce these vegetables in the winter months and be guaranteed a profitable market year round.

The individual household farmer is well established and productive. The first reform was very successful in the development of the free market and agricultural productivity. However, this system can not efficiently supply the needs of the major urban population centers. The variety, quality and volume of the vegetables that are now required to satisfy the consumers is very different than what was required in the early 1980's.

There already are excellent examples in China of what can be accomplished with large tract farming. The specialized farming of grain in the Beijing Municipality is one of those examples. There are many other examples in grain, as well as, to some degree in vegetable production.

Land consolidation and contractual land agreements with specialized mechanized farming is the first step towards increasing land efficiency and meeting the fresh vegetable market. Greenhouse use is an excellent means of providing northern cities with fresh vegetables during winter months. Greenhouse supplies can be shipped in from southern provinces or can be locally grown and supplied.

As detailed in the marketing/distribution recommendations, contractual agreements with the marketing companies for the production/supply of specific vegetable quantities is a guaranteed market for the farmer. Inputs would also be supplied by these marketing companies at lower than market price so the producer sells the vegetables to the marketing company at lower than market prices. Another benefit would be the technological assistance to the farmer for the efficient production of quality vegetables.

RECOMMENDATIONS

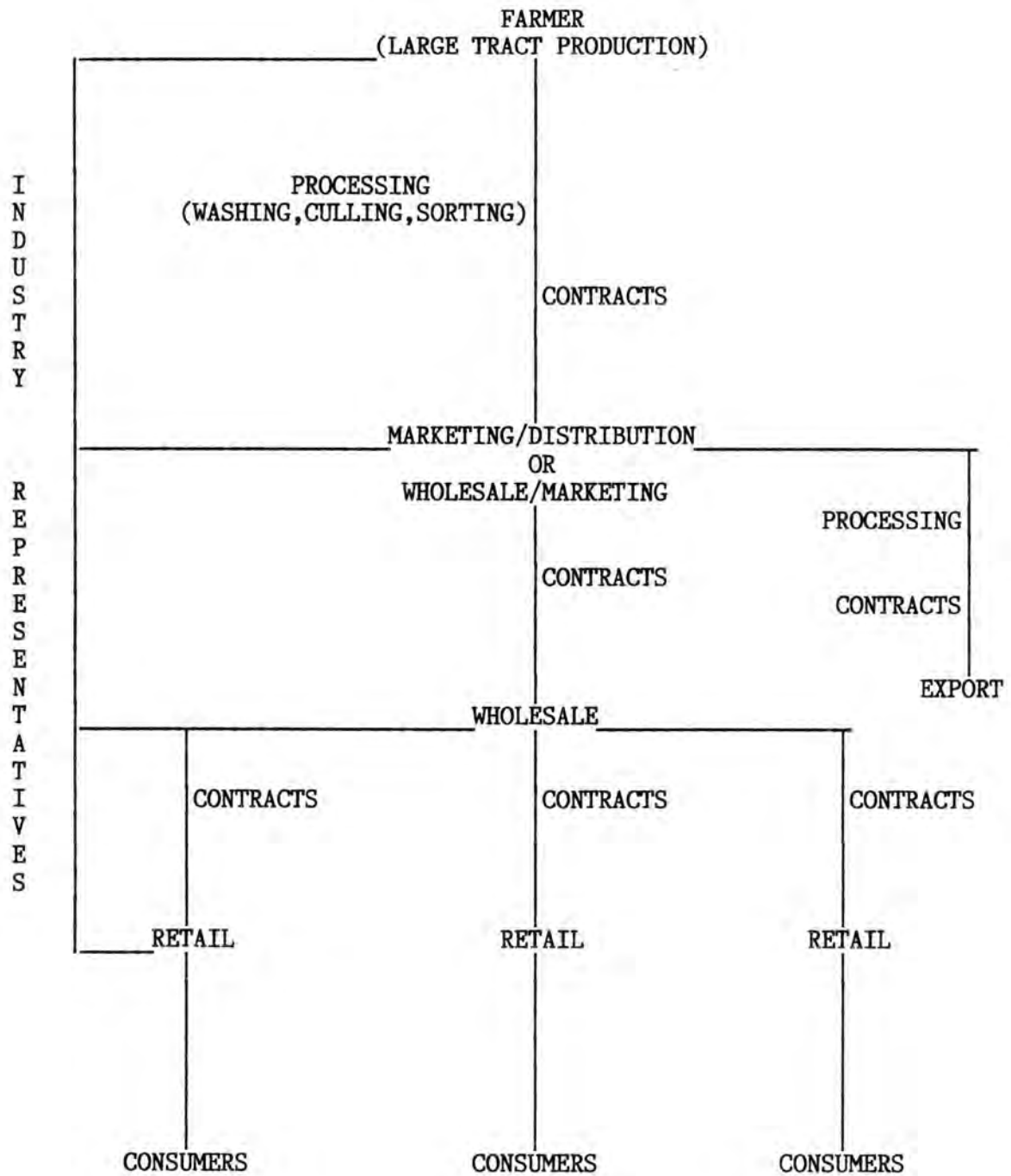
INFRASTRUCTURE INTEGRATION

The four key infrastructure functions can operate as individual companies. They can build this system and service consumers very effectively throughout the year. There is the possibility of merging the marketing/distribution function with the wholesale and forming a wholesale/marketing company. This eliminates an additional phase between producer and consumer. It also allows for a closer co-ordination.

Once this system is operating a further co-ordinating/regulating function can be established. Each key phase can select qualified representatives. A fresh vegetable industry organization managed by the representatives would co-ordinate each/all phases of the infrastructure. They can set/monitor standards for quality, arbitrate differences, co-ordinate contract compliance and set reasonable agreed on percent profits for each phase of the infrastructure.

This type of organization through its involvement reduces overall costs to all concerned, ensures supply meets demand, prevents large or small price swings and assists in technology information to the producer. Export markets can also be developed and serviced by this type of representation.

INTEGRATED INFRASTRUCTURE



RECOMMENDATIONS

EXPORT MARKET

Fresh and fresh frozen vegetable export markets are currently being established in Nanhai County through Bao Sian a Joint-Venture Company.

Bao Sian is exporting fresh vegetables to Hong Kong, Macao and Singapore. Fresh frozen vegetables are being exported to Japan, Western Europe and the United States. They are working on established contracts and packaging the vegetables in client identified printed cartons/packaging.

The fact that they have been able to achieve USA approval for their fresh frozen vegetables states the quality of the product is excellent.

As described in the findings of Guangdong Province relating to the overall operations of Bao Sian; their established and future methods of supply for large tract specialized farming, vegetable processing and farmer supplied inputs/technology is definitely the correct approach to exportation.

The key to exporting vegetables is the development of a similar structure as Bao Sian; consistent conformance to quality standards set by the purchasing client, strict quality control at the processing facility, proper utilization of excellent technology, knowledgeable farm management, large tract specialized farming and compliance to all shipment contractual agreements.

There are many foreign companies that are interested in purchasing direct or through the formation of joint-venture companies. These companies have the technology, established market and financial ability to assist their Chinese potential partners in developing export opportunities.

Exporting to non-partner foreign clients is also an excellent opportunity. In either or both situations key to meaningful success is the development of large tract specialized vegetable farming and strict compliance to the issues described above.

Development of the infrastructure system recommended in this report can be the supplier to the export market. Marketing/distribution or wholesale/marketing companies can be the supplier to the processing operation or can export themselves. Establishment of excellent processing capabilities will allow for direct servicing of export opportunities.

CHINA

RURAL SECTOR ADJUSTMENT LOAN

POST-EFFECTIVENESS SUPERVISION MISSION

Rural Enterprise Reforms

by- Nicholas Mahoney (C)

WORLD BANK CHINA RURAL SECTOR ADJUSTMENT LOAN SUPERVISION MISSION
12th - 29th September 1988

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Abbreviations used in this Report

ABC	Agricultural Bank of China
EZO	Experimental zone office
NGE	Non governmental enterprise
NGFA	Non governmental financial association
PRS	Production responsibility system
RCRD	Research Centre for Rural Development, State Council
RRP	Regional reform programme
TVE	Township and village enterprises, collectively or privately owned

1 INTRODUCTION

1.1 Summary

The rural industrial economy continues to grow at a rapid rate - so rapid in fact that the supply of credit to the sector has been reined in to prevent overheating and inflation.

No major breakthroughs are expected in rural industry reforms in the present macro-economic climate, but still the number of reform areas has been increased to 3. There are now RRP's in Fuyang and Wenzhou, as previously, and a new reform area has been established in Zhou Cun, Zhebu city, Shandong province where the experimental focus is to be on shareholding (stock) systems for enterprises currently owned or controlled by community government. The relative priority given by RCRD to experiments in each of these areas and in the other areas in which it is active working is unclear at present.

If TVEs continue to develop as rapidly as they have in this decade, the target to create 100 million off-farm jobs by the turn of the century would easily be reached. It is clear though that continued growth is contingent upon the rapid development of TVE organisation and management, more balanced sectoral development, and improved spatial distribution and factor mobility.

Responsibility for the government's programme for TVE reforms as outlined in the Policy Letter appears to be spread across a number of ministries and agencies. It was difficult during the supervision mission to obtain an overview of the entire programme or any information at all on some of the component parts. Industrial policies for TVEs have not yet been formulated.

RCRD is involved in various experiments to increase exports by TVEs in coastal zones, but there is no formal experimental reform area and no timetable for a national policy or programme.

The national private enterprise law was issued in July and this re-confirmed the legitimacy of privately owned enterprises operating outside of the state sector, independent of local government control. It is not clear how successfully the law has been implemented nationally but in the experimental zone of Fuyang a draft Non Governmental Enterprise law has been prepared to give both private enterprises and township or community owned enterprises an equal status in law. The Fuyang Insolvency ("Bankruptcy") law is also in draft form pending People's Congress approval.

In the Fuyang experimental zone the majority of the 20+ projects are being implemented according to schedule. The industrial zones with their integrated reform objectives have undergone remarkable development in the last 6 months. The projects to remove artificial restrictions on the development of rural markets have

been successful in the pilot areas and these reforms are now spreading rapidly. There are early indications that the number of enterprises, their output and their profit have continued to increase at a significant rate. The EZO has introduced two new enterprise models - both for joint ventures with foreign companies, but the full set of model enterprise charters appears to be spreading rapidly before a full evaluation and revision. RCRD has some doubts about the feasibility of the rapid introduction of 'modern contractual' relationships into rural society in general, although China's reform growth targets would suggest such relationships, embodied in enterprise constitutions and contracts and protected by law and by local courts, are both crucial and inevitable. The implementation of local and particularly national enterprise legislation is imperative.

There are two aspects of the Fuyang RRP which give rise to particular concern. Firstly, the statistical monitoring system is not being implemented as planned - greater use of samples and control groups and adequate resourcing would help resolve the problem. Secondly, non governmental financial associations continue to operate without a secure asset base and with unsatisfactory lending policies. There is the possibility of collapse and loss of depositor confidence. There is also the possibility that the associations will be propped up without solutions being found to their basic problems. Neither outcome would be satisfactory.

1.2 Overview

The general context of the rural industrial reforms is reviewed in section 2. The government's TVE programme, as outlined in the Policy Letter, and its progress in 1988 is the subject of section 3. Section 4 reports on implementation of the projects which make up the Fuyang RRP and highlights some of the major achievements and issues. A detailed update on all the projects is provided in appendices 1 and 2.

2 TVE SECTOR DEVELOPMENT

2.1 Growth and Reform in 1988

The macro economic problems of 1988 have affected perspectives on TVE development and reform. Rapid TVE growth was previously seen as a sign of success, now it indicates overheating and contributes to inflationary pressure on raw material prices, and makes unsustainable demands on energy and transport (See *Put brakes on industry growth*, China Daily, 19/9/88).

Some indication of the rapid rate of growth can be gained from statistics published in the China Daily (although problems with the terminology used to refer to different types of enterprise makes comparison generally difficult) -

- Total industrial output rose by 17.1% in the period January to August 1988 over the same period in 1987
- 40% increase in the output value of township enterprises in the first half of 1988 over the same period in 1987,
- 33% increase in their profits

(China Daily 19/9/1988, 28/9/88)

Overall enterprise reform is seen as crucial for the success of price reforms - until enterprises are responsive to prices, market mechanisms will be ineffectual. TVEs are viewed by some as providing a model of responsible and responsive organisation. A general convergence of enterprise structures may even be under way with both state and local government enterprises being encouraged to adopt stock/equity structures to improve management and control, and private enterprises considering similar structures to clarify ownership rights, ensure independence and raise investment capital.

One thing that is clear is that bank credit for TVEs has been restricted and will probably remain so for some time to come. Credit rationing rather than market interest rates is the favoured policy instrument; loan application procedures have been made more difficult and a ban imposed on the registration of new non governmental financial associations. There appears to be some debate as to the allocation of credit to more developed areas where bank lending is more secure and to the less developed areas where there are labour surpluses.

The current concern with macro-economic issues may not yet have had any discernable impact on the growth of TVEs but the credit squeeze will undoubtedly do so.

It is said that under present conditions, there will be no major breakthroughs in TVE reforms which, like other reform areas, will now proceed on a more gradual basis. At the same time however the scope of TVE experiments is broadening.

2.2 TVE Experimental Reforms

There are now three experimental reforms areas for the development of TVEs and non state enterprises: Fuyang prefecture in Anhue province and Wenzhou in Zhejiang as previously, and also in Zhou Cun, Zhebu city, Shandong province. RCRD is also involved in other TVE experiments in areas not formally included in the national rural enterprise reform programme.

The experimental focus in the newly introduced reform area of Zhou Cun is on shareholding (stock) systems. The emphasis is on enterprises currently owned or controlled by community government. The aims are to evaluate different organisational forms and to identify effective ways to value the contributions of labour and capital. There is a concern that state/local government assets are not to be undervalued or disposed of without adequate compensation.

The overall experimental frame would appear to be spreading as RCRD now refers to 4 distinct models of TVE development :

- Wushi (Jiangsu) - collectively owned TVEs,
- Fuyang (Anhue) - rural private TVEs
- Wenzhou (Zhejian) - private and joint stock TVEs, and
- Shishi (Fujian) - private export orientated TVEs

In 1988, RCRD has become increasingly involved with the development of export orientated TVEs in the coastal regions. Enterprises here are much better placed than those inland to export and generate foreign currency. The concern here is how to futher develop capacity to compete in international markets and remove administrative impediments (see section 3.1.1). It is still being debated whether more developed state industries would not be better placed than newly developed TVEs to be competitive and whether more emphasis should not be given first to meeting the needs of the large domestic market where demand is increasing.

In Fuyang the experiment is concerned with adjustments to the rural economic structure and the creation of off-farm jobs in an area in many ways representative of much of rural inland China. Current debates in this well established experiment surround increasing urbanisation and the transfer of control over and use of agricultural land for industry.

The relative priority being given to the different experiments is unclear.

2.3 Growth Targets to the Year 2000

Following several years of double digit employment growth rates, RCRD is in favour of an annual growth of 7% - 8% which it estimates should achieve the target 100 million new jobs by the year 2000.

RCRD estimates that such a growth in employment would be accompanied by a 20% pa growth in TVE output value. If state industry grew at 10% pa, the output of the two sectors would be approximately equal by the end of the century.

Whether such targets are attained will depend on a number of factors.

The rapid TVE growth rates of this decade were the result in part of the removal of restrictions on non-governmental enterprise, and the impetus provided by the implementation of the PRS in farming and its effects on farmer savings. These effects however cannot be repeated: growth in future will depend instead on the accumulation of industrial capital and better management of assets - both of which in turn are dependent upon the clarification of property rights and enterprise structures.

By the time TVEs account for 50% of industrial output value, there will be some very large enterprises indeed. RCRD estimates the current average size to be 5 employees and Y10,000 fixed assets. Organisation and management will have to be developed very rapidly indeed if such large enterprises are to be viable.

Many TVEs are achieving very high rates of profits currently. Observers though are concerned that a lack of clarity regarding ownership limits the rate of reinvestment. This will become increasingly critical as profit rates decline as markets mature.

TVEs have developed largely in the processing of agricultural materials. Rapid growth cannot continue without diversification into other sectors, including transport and commerce. The spatial distribution of industries will also have to change: away from location at or near the home of the entrepreneur or offices of the local government, with an increasing orientation towards markets, sources of supply or transport as appropriate. This will demand a change in personal as well as factor mobility.

3 GOVERNMENT TVE PROGRAMME AND THE IMPLEMENTATION OF THE POLICY LETTER PLAN TO RATIONALISE THE RURAL ENTERPRISE SYSTEM

Many of the reforms outlined in the policy letter are expected to take place first in pilot programmes in limited localities and, after experience has been gained, to be implemented more generally. The rural enterprise system reforms are at various stages in this process and the overall position is summarised in the following table -

Reform Area	Status of Reform
Export in Coastal Region TVEs	RCRD actively involved in experiments; no specific experimental area; no timetable for national policy.
Programmes to Facilitate Exports	Developments are occurring but no details of specific programmes were made available
Private Enterprise Law	Introduced in July, national implementation unclear. RCRD promoting an experimental Non Governmental Enterprise Law as an alternative for Fuyang in 1989
TVE Law	No progress as yet on national law.
Insolvency Law	Experimental law scheduled for 1989 in Fuyang only
TVE Contract System, Joint Stock Organisations, and Inter Enterprise Investment	Joint Stock experiments in Wenzhou and Zhou Cun; no information on contract system, inter-enterprise investment or national policies
Spark and Training Programmes	Current status of these unclear/uncertain
Financial Systems for TVEs	Experiments in Fuyang continue but no information on any national programmes
Industrial Policies	No policy for TVEs to date
Government Management	Experiment in Fuyang only.

Nationally, control over the rural enterprise system reforms appears to be spread across a number of ministries and other agencies. Which of these (if any) is responsible for overall coordination is unclear.

This section of the report is based largely on two meetings with

RCRD staff. The meetings were difficult to arrange, fairly brief, and there were a number of policy areas with which the RCRD participants in the meetings were not personally acquainted. Coverage here is not as comprehensive as might have been desired and the topics covered will merit fuller coverage in the next supervision mission.

Some of the policy letter reforms are specifically located within the Fuyang Experimental Region and are also covered in section 4 and appendices 1 and 2.

3.1 TVE Exports

3.1.1 Export by Coastal Region TVEs

The reform policy objectives are to encourage TVE exports with policies to

- 1 link producers and agents in importing countries,
- 2 give TVEs greater flexibility in their use of foreign exchange earnings,
- 3 adapt export incentives and import permits (for export manufacture) to local conditions, and
- 4 provide TVEs with financial facilities and services previously only available to public firms.

RCRD has been involved with these issues in the coastal provinces of Fujian, Zhejiang, Jiangsu and Shandong for up to two years now. Areas differ markedly in their development.

The town of Shishi in Fujian is renowned as an example of private and other non-governmental enterprises orientated principally towards export. There the producers are noted for their personal and family ties with overseas importers. There is an established foreign exchange market and people are allowed to hold all foreign currency receipts (subject to an upper limit of US\$4 million per transaction). Elsewhere, and previously in Shishi, foreign currency has to be exchanged for RMB. It is reported that foreign currency is invested in production and commerce whereas RMB was often used to increase consumption.

In Wushi in Jiangsu, an area known for the successful development of local government controlled TVEs, the informal relationships which form the basis of export trade in Shishi are absent. Here the local government has maintained fairly tight control over imports, exports and the use of foreign currency, but has implemented some reforms. To facilitate contacts it organised a mission for 150 foreign companies to visit Wushi. It also arranged for 100 local TVE managers to visit the special economic zone at Shenzhen to meet with potential chinese partners there with whom three-way joint ventures could be formed with foreign companies. To overcome the greater control over foreign trade locally, these same managers were encouraged to buy or to establish warehouses in Shenzhen where it is much easier to obtain customs clearances.

National policy for coastal region TVEs is said to be still under consideration at the level of the Central Party Committee; no detailed timetable update was made available.

3.1.2 Programmes to Facilitate TVE exports and Reforms to the Existing Foreign Trade System

Details of specific programmes were not made available but brief accounts of certain developments may indicate general trends.

In 1988 the government decentralised the management of local import/export corporations, gave them greater profit responsibilities, and improved their financial control procedures. Provisions were also made to allow enterprises to retain a greater proportion of the foreign currency they earned. It is not clear what effect if any these changes have had on TVEs.

In Fuyang, the EZO has produced enterprise charters for two new joint ventures between local and foreign companies.

Most exporting is still controlled by provincial Import and Export Corporations which select enterprises to produce goods for export, and provide them with low interest funds for fixed assets and working capital. In Anhue it is said that while the corporation there continues to work with state enterprises as in the past, it increasingly favours TVEs for new contracts because they are more responsive, their management is better, their delivery is prompter, and because they are easier to negotiate with on prices and terms. (As ever, there is the danger of corruption when the private sector requires scarce resources or services from state monopolies such as the import/export corporations).

3.2 TVE Law and Organisation

3.2.1 Private Enterprise Law

The national Private Enterprise Law came into effect in July 1988 following the amendment to the constitution in April permitting privately owned enterprises. A draft translation is attached as appendix 3.

The private enterprise law defines three types of private enterprise: sole proprietorships and partnerships with unlimited liability, and limited liability companies. The latter are private companies - they cannot offer shares for sale to the general public - in which the number of investors may not exceed 30 people. The law specifies the areas to be covered in the constitution of the limited liability company. The private enterprise is guaranteed independence in operation and freedom from interference from local government bodies. (The law also sets out the obligations of the private enterprise to operate within the law and pay its taxes). The law specifies that debts to third parties must be repaid if the enterprise ceases

production, and it provides protection to employees and gives them the right to organise trade unions. Two restrictions are made over the use of income and profits: managers/managing directors may only be paid a salary up to 10 times the average wage in the enterprise, and 50% of profits must be reinvested.

It is not clear that measures to compel reinvestment will achieve the desired aims - perhaps it would have been enough to protect investors' rights to their investments and capital gains and leave the choice of amount of investment and its application to them. Reinvestment will occur if the conditions are right, and specific provisions of this kind will probably only lead to evasion or the concealment of profits - neither of which are desirable.

The private enterprise law would appear to address most of the major issues that RCRD and others have identified: the legitimacy and independence of private enterprise, protection of investors' property rights, clear organisation, and liabilities to third parties when an enterprise ceases to trade.

RCRD originally planned to draft regulations for implementation of the private enterprise law but decided against this. It feels that sufficient prejudice remains against the concept of private ownership that the very entrepreneurs whom it would like to come forward to register as private owners will be deterred. It reported difficulties in Fuyang where in one town only 1 enterprise came forward to register when attempts were made to implement the law.

RCRD wants private enterprises to be treated together with other kinds of non state enterprise. It is particularly concerned that private enterprises will be subject to higher rates of tax than other non-governmental enterprises. RCRD also takes the view that in practical terms, in their management and market orientation, a convergence of enterprise forms is already well underway and that this demands that the various kinds of enterprise operate under common legislation.

For these reasons it decided not to work with the provisions of the private enterprise law and that it would be more useful at present to experiment with a Non Governmental Enterprise Law in Fuyang (see section 4, and appendices 1 and 4).

Whether or how the private enterprise law is being implemented nationally is unclear.

3.2.2 TVE Law

A national TVE law has already been taken through several drafts by a sub-committee of the People's Congress with inputs from the Ministry of Agriculture and RCRD. A completion date has not yet been announced.

RCRD, while it is in favour of a national unified enterprise law,

argues that it will be some time yet before this comes about. It points not only to the deep-rooted prejudice against private enterprise, but also to the complexity of Chinese rural social relationships. It is currently being argued that the two dominant axes of rural social organisation - the family and locality on the one hand, and the state apparatus on the other - simply do not as yet allow for the free development of the kind of single stranded commercial relationship between property owning individuals which would form the basis of modern enterprise organisation.

3.2.3 Insolvency Law

There is no date at present for the introduction of a new national insolvency law for TVEs. The experimental law is soon to be introduced in Fuyang (see section 4, and appendices 1 and 5).

3.2.4 TVE Contractual Systems, Joint Stock Organisations and Inter Enterprise Investment

Programmes to develop joint stock companies are under way in both the Wenzhou and the Zhou Cun experimental zones (see sections 3.7 and 2.3 respectively). Full details were not made available during the mission.

Strong reservations are being expressed about the system under which township (and state) enterprises are contracted to a manager. There are fears that the short term nature of the contracts does not do enough to ensure the long-term growth and stability of the enterprise and, in particular, that assets are neglected in the pursuit of quick profits. Examples visited do appear to offer the contracting manager the opportunity to make a lifetime's salary in one year (in the form of earnings and profit share) for relatively little or no risk or investment. The contracting system may have helped revitalise uncommercially run enterprises, but it seems likely that it will be modified as joint stock organisations are developed further.

No information on specific reform programmes for contractual systems or inter-enterprise investment was made available.

3.3 The Spark Programme for Technology Transfer

The Spark Programme was launched nationally in 1985 by the State Science and Technology Commission with the aim of providing appropriate technology for the development of TVEs. The programme is run by the Commission with the involvement of the TVE Bureau of the Ministry of Agriculture. Prior to the reforms, the rural population had had very limited exposure to industrial technology and the programme was to introduce technology which was practical and capable of being implemented rapidly in the rural areas.

In 1986, 5,100 Spark projects and programmes were launched, sponsored variously by the Science and Technology Commission, and local governments. The total budget in that year was over Y2

billion, Y430 million from central government and the central bank, the bulk of the remainder coming from local enterprises, and some contributions from local governments.

Examples of Spark programmes and projects cover new demonstration enterprises, provision of technical support, and training of technical and managerial personnel. Participating enterprises may benefit from subsidised loans, tax exemptions and training subsidies. More than 1 million people received training under the programme in 1986.

The targets set for Spark for 1986-1990 were -

- 1 to develop 150 key industries (products)
- 2 to launch 20 demonstration projects for developing technology in mountainous areas
- 3 to establish 10 experimental centres for the development of beaches and islands
- 4 to establish intensive centres for appropriate technology around cities
- 5 to develop 100 types of advanced small production facilities and improve the flow of information to rural areas regarding existing equipment and technology
- 6 to improve the training of technical and managerial personnel and build 51 training centres.

It was not possible during the supervision mission to obtain an up to date briefing on the Spark Programme and it may be that its future is uncertain.

An appraisal of the programme has been undertaken by the World Bank.

3.4 Training

RCRD believes that training should not only improve the skills of the managers and directors of TVEs but also those of the government cadres who are responsible for administering and advising them.

Previously the TVE Bureau of the Ministry of Agriculture sponsored a training programme but it was held to be expensive and without satisfactory results. Teaching materials were unsuitable, and there was a lack of suitably qualified teachers and funds.

There is strong popular demand in rural areas for enterprise training; there are TVE schools such as the school included in the Fuyang RRP (see appendix 1), and there are many individuals (some of whom are TVE school graduates) who provide training. RCRD feels that current training may be generally satisfactory as regards practical skills, but is often inadequate when it comes to the more abstract areas of marketing or enterprise management.

There was a firm plan at the end of 1987 to set up 10 TVE schools

nationally. A number of agencies including RCRD and CATIC are involved in implementing these, but progress appears to have slowed down considerably this year.

3.5 Reforms to the Financial System and Expansion of Financial Services to TVEs

No specific information was made available on reforms to the financial system (apart from developments in Fuyang; see Section 4 and appendix 2). Fuyang is in fact behind other areas as regards the development of non governmental financial associations. ABC is said to be the lead agency here rather than RCRD.

The controls announced this summer to limit the supply of credit and to withhold approval from new non governmental financial associations will undoubtedly have an impact on TVE investment.

3.6 Government Policy and Management

3.6.1 Industrial Policies

The State Planning Commission issued its Views on Restructuring Industry in document number 139 of this year (a draft translation is attached as appendix 6).

Key areas identified for support are agriculture, energy, transport, communications and raw materials where it is very difficult to increase productivity. It states that TVEs, as well as military enterprises, should be encouraged to enter these sectors.

Sectors where productive capacity already exceeds the supply of raw materials such as aluminium and common plastics are identified as areas where action should be taken to restrict the further expansion of productive capacity, even if consumer demand is high.

Growth is to be limited in those sectors where product quality is low and where market demand is weak, sectors such as artificial leather and low quality spirits. The further expansion of industries which are badly located or which use excessive quantities of energy is to be restricted.

The mechanisms to be employed are both administrative and financial - local governments are to withhold permits and banks to withhold credit.

The document says little or nothing about how growth in problem sectors is to be encouraged. It is difficult at this stage to assess its impact on industry in general or on TVEs in particular.

A document dealing specifically with TVEs is said to be in the course of preparation. The Development Institute of RCRD

previously drafted forecasts and plans for various industrial sectors but this work is currently in abeyance.

3.6.2 Improvement to Government Management

Local government at various levels as well as the offices of national ministries all take an interest in TVEs: they formulate policies and collect management and other fees. The overall policy aim is to have independent enterprises operating in a market place, and transform the role of government from that of manager of enterprises into a regulator of markets. The actual picture varies across the country with government offices of all kinds in the more developed regions acting in a less predatory and more coordinated fashion.

Specific experiments are underway in Fuyang and in Wenzhou, and some Fuyang experiments to make the work of government offices more efficient and less restrictive are spreading from the prefecture to the province of Anhue. No information on a national programme was available.

Paragraph 28(f) of the policy letter refers to measures to 'improve governmental support services'. During the supervision mission it was suggested that a more accurate translation would be 'improve governmental management services'.

3.7 Wenzhou RRP

A detailed plan and implementation schedule for the TVE reform experiments in Wenzhou have not been made available; the reform area was not visited on either the appraisal or the supervision mission. Accordingly it is not possible here to give a detailed report on progress or results.

Wenzhou is an area with a long tradition of commerce and its population is familiar with the ways of the market. In this respect it differs from a more typical rural area such as Fuyang. Private enterprise has developed very rapidly in Wenzhou but too many enterprises are said to be operating in the black market. It is an area where lower level cadres have been quick to implement reforms - often going ahead of national developments and even provincial policies - and the first regulations governing TVEs and private enterprises were issued there in 1987. The population of the area is very mobile and entrepreneurs from Wenzhou can be found trading in many other parts of the country - including some who have come to take advantage of the preferential policies in the industrial zones and the market opportunities in Fuyang. Recently there has been a rapid growth of joint stock companies - the number is said to have reached 50,000.

4 REVIEW OF DEVELOPMENTS IN THE FUYANG REGIONAL REFORM PROGRAMME

4.1 Continued Growth of TVEs

Rural industries in Fuyang have continued to grow rapidly in 1988. Employment growth at 19% and profit growth at 65% are particularly high. TVEs now employ 18.4% of the population.

	Jan-July 1988	Change over 1987
Output value all TVEs (Y billion)	1.9	+59%
Industrial output value TVEs (Y billion)	1.2	+61%
Profit (Y million)	182.1	+65%
Taxes (Y million)	24.5	+53%
Number of enterprises	222,000	+30,000 +14%
Employment	860,000	+161,000 +19%

One county in Fuyang estimated increases in the first 6 months of 1988 of 55% in total output value and 100% in profits. The number of TVEs there increased by 14% (1987: 16%) and employment by 28% in the same period.

The rate of growth in Fuyang is above that reported nationally (see section 2.1).

4.2 Review of the Experimental Projects

In general, the set of projects which comprise the Fuyang RRP has been implemented according to schedule. There have been some changes and delays revealed by the EZO's own implementation monitoring, and also some successes. The set of projects has been subject to some change of detail and reevaluation. Some projects are already regarded as having passed the experimental stage and are diffusing rapidly. Those involving infrastructural development have shown remarkably rapid progress over the last 6 months.

The projects were originally classified into 3 groups viz Enterprise Environment, Enterprise Systems, and Regulation of Government Behaviour, although many projects in practice cut across these 3 areas. In August the EZO reviewed progress and reclassified the projects into those which have been completed successfully, those which are under way without serious problems, and those which have run into difficulties.

A detailed project by project update can be found in appendices 1 and 2. Some of the highlights and issues are summarised here.

Reforming the Administration of Markets and Road Tolls

The two projects to reform the administration of markets and road tolls were very successful in the 4 pilot areas. Before the appraisal they were being extended to markets throughout the prefecture and extension is now planned province wide. Effective implementation is not yet complete within the prefecture however, the process takes time and there is considerable resistance in some areas from the government offices whose discretionary powers are to be curbed. It is difficult to plot the success of these projects beyond the pilot stage as there is no systematic monitoring of implementation or impact. It does appear that firm local political commitment is necessary to implement these reforms and outside of the four pilot areas this is something which the EZO may find difficult to foster directly.

Industrial Production Materials Markets

Markets have been established in Fuyang city to deal in cement, steel, vehicles, and one for fertilizer is planned. All these goods are in short supply and have to be purchased by TVEs on the open market or the black market. The project can neither improve the supply of the materials nor have an impact on the prices actually paid by TVEs. What it does set out to do is to bring the trade out into the open where it can be legitimised and at the same time controlled and taxed more effectively.

Industrial Reform Zones

The three industrial zone projects which had started at the time of appraisal have been developing very rapidly and two new projects are underway. These zones should not be confused with industrial parks - although they resemble them physically. Rather they should be seen as integrated reform programmes designed to affect the total environment - physical, social, political, financial, and commercial - in which enterprises operate. In addition to offering new enterprises a site and services,

- they provide preferential terms for power and finance,
- they are attempting to establishing markets in land - or its use rights, and in some cases have already agreed the principles
- they offer opportunities to convert rural to urban citizenship and thus facilitate rural-urban mobility,
- they simplify government administration over enterprises and enhance the independent status of the latter,
- many are conducted in areas where reforms to the administration of markets and road tolls are complete or underway, and
- all are closely associated with non-governmental financial associations.

The interesting question is whether successes in the zones will lead to the general diffusion of new policies, or whether the idea of zones *per se* will spread. Will, for example, all

enterprises have the right to buy and sell land rights in the future or will this privilege only exist within the boundaries of defined zones?

Non Governmental Financial Associations

NGFAs constitute an important, high profile, and politically sensitive project. There are now 6 NGFAs established as experimental projects, 5 of which are associated with industrial reform zones and 1 with the Gu Jing liquor enterprise group. NGFAs have a complex set of objectives

- to mobilise local savings
- to increase the supply of funds for TVEs
- to compete with state banks on deposit interest and services offered
- to change the attitudes of investors and depositors, and that of government at all levels.

Each NGFA when it began raised capital by way of withdrawable stock and deposits. Those which have become established have borrowed heavily from state banks. In one case the ratio of borrowing to combined stocks and deposits is over 4:1. The loans taken are for periods ranging from 3 to 18 months. The NGFAs lend short-term (3 to 6 months) but their loans are concentrated in new enterprises or in enterprises concentrated in one sector. There is therefore a significant risk of default. It appears that enterprises have used short term loans to finance fixed assets and this only increases the risks. In one NGFA, loans were made for periods of 3 to 6 months, while over 50% of its funds came from 3 month borrowing and most of the balance was withdrawable stock or deposits.

Such problems were pointed out at the time of appraisal.

The EZO has monitored the implementation of these projects but does not set operating standards or monitor performance particularly carefully. At appraisal and during the supervision mission, summary accounts provided by the EZO differed significantly from those collected in the field. The EZO has increasingly been decentralising the management of projects to local leading groups but in the case of the NGFAs this seems to be a questionable practice. The NGFAs have not yet been successful in attracting local people as stockholders or depositors on a necessary scale. If one of the NGFAs were to collapse, investor confidence would take a very sharp knock indeed. Making more loan capital available to TVEs in the short term is an important objective but it has to be balanced against developing long term investor confidence. Current practice suggests that a balance has not been struck. Most enterprises in Fuyang have been set up without loans from NGFAs and, if the latter were to restrict lending while they developed their institutions and their equity base, the impact on TVE growth would probably be insignificant. The long-term gains for the NGFAs however could be enormous. In the long term, the success of

the NGFAs would increase the supply of funds to TVEs.

The EZO could usefully intervene here to set clear operating standards, to monitor performance and to exercise a degree of control.

The EZO appears to believe that the solution to the problem is to establish a 'Fuyang CATIC' and, with funds borrowed from CATIC itself, provide more long term loans to the NGFAs than are currently available. However, it has to be asked whether by doing so the EZO is helping to pilot a model for NGFA development which is replicable. Such a move may well satisfy the 'enterprise lobby' but will it inspire other areas which may not have access to long-term funds to finance their own NGFAs?

It is noteworthy that the rates of interest charged on loans - although higher than the state banks - hardly reflects the scarcity cost of capital. They are low too in relation to the rate of return on capital achieved by many enterprises.

All of these questions may be academic: this summer the central government gave instructions that approvals for all new NGFAs should be withheld.

Enterprise Charters and Enterprise Law

Since the appraisal, the EZO has added two new model charters to the existing set of 8. Enterprises have continued to adopt the charters spontaneously - in Fuyang and nationwide, and the provincial government has decided to popularise them throughout Anhue.

There seems little doubt that the charters give enterprises a legitimacy that in present circumstances they otherwise would not have. What is disappointing is that the charters are spreading apparently without revision. There were weaknesses in the original set, some of which have been addressed in the latest two charters. It would have been desirable if improvements had been made to them all before they were widely adopted.

The link between the charters and the development of enterprise law is not at all clear. The EZO, under the guidance of RCRD, has decided to experiment with a Non Governmental Enterprise (NGE) Law in one city. The law has been drafted as an alternative to the national Private Enterprise law in order to bring privately and collectively owned enterprises together under one legal umbrella. The draft NGE law will undoubtedly be a major step forward but it does not seem to be based on an evaluation of the operation or the strengths and weaknesses of the model charters, and appears to have weaknesses in its provisions for enterprise organisation.

The insolvency law has not yet been piloted but, like the NGE law, should be implemented in one area late this year or early next. It will be particularly important to see if, when the law

is implemented, there is any change in attitude towards insolvent enterprises.

Firstly, will insolvent enterprises still be allowed to continue in operation to preserve employment even though this is being achieved at the creditors' expense?

Secondly, will ABC and other banks come to recognise that, in the reformed economy, lending carries inherent risks? Will they agree to write off debts once they have proved unrecoverable? Will they be flexible and allow enterprises to be refloated? Will they revise their own procedures to minimise their risks in the future?

Thirdly, will procedures develop to sell insolvent enterprises at a price which reflects a market valuation (of their assets or their earning potential) - even if this value is less than the outstanding debts - or will creditors continue to block such moves in the hope that one day a government department will repay them in full?

The insolvency project has implications and ramifications that go well beyond the adoption of the draft law by the People's Congress.

Government Administration

Two projects set out to reform government administrative practices. The Joint Government Agencies Office was set up as a pilot to improve registration procedures. The provincial government has now recommended its general adoption throughout Anhue.

The Small and Medium Enterprise Bureau project had more complex objectives - various government agencies were to collaborate and coordinate a wide range of activities, the current administrative distinctions between rural and urban enterprises were to be replaced by a more useful classification based on industrial sector; and staff were to be appointed on the basis of merit. This project is physically established but it has proved difficult to foster genuine collaboration between the various agencies and joint projects have made little headway.

Statistics System

The ambitious plans to monitor the performance of TVEs operating under various conditions throughout the reform area have not progressed in 1988. The EZO does not have the resources to see the project through, even partially.

Collection of statistics on enterprise performance would appear to be an essential component of a reform programme which is experimental. It is not clear how without them the success of the reforms is to be measured. The statistical bureau will continue to collect basic data on the number of enterprises, their

employment, profit and output, but it will be difficult to determine the impact of specific reform projects in various parts of the prefecture.

4.3 EZO Views on the State of the Reforms

The EZO has expressed a number of concerns about the reform programme in general and its own functions.

The EZO is at the sharp end when it comes to changing the attitudes and behaviour of government offices. Many projects challenge the administrative status quo and the personal or institutional interests of government officials. The transfer of land for example from agricultural to industrial use and the accompanying transfer of control to industrialists has met with a great deal of opposition from province, prefecture, and local government departments.

It is clear that many reform projects work because they have political support which can break down entrenched opposition, but it is equally clear that if projects are transplanted to areas in which political backing is weaker, progress is slower. The EZO takes the view that political reform lags behind economic reform nationally.

The EZO feels a certain responsibility for the enterprises which it is promoting and the people who invest in them. Many have operational problems - shortage of supplies, management, etc. It would like to be able to offer practical support when asked but has to concentrate on policy matters.

The key problem at present appears to be a lack of trained personnel and a lack of funds in relation to the size of the task. Much project implementation work has been devolved to leading groups in various counties. RCRD has trained 8 people from such county groups this year but the EZO feels that while training in the basic theories of the reforms is useful, more technical training is what is required.

Devolution has meant that the EZO has become increasingly out of touch with the details of the various projects. This must have a consequence eventually for its effectiveness in developing policy.

4.4 The Experimental Zone Office

The EZO has a staff complement of 7 but this is down on 1987. In that year the province provided an additional 3 staff and RCRD had up to 16 staff working in the zone compared with 3 this year. With more than 30 projects spread over the 9 counties and 2 million population, the EZO itself can now only pay close attention to those projects it regards as key. Annual funding is said to be about half of that necessary and RCRD has suggested that the EZO should become more self-reliant. The EZO itself

feels strongly that it is underfinanced and understaffed given the tasks in hand.

Staff in the EZO and at project level are not appointed by competitive selection and therefore skills and commitment are bound to vary. RCRD officers say they have tried to insist that appointments are made on merit.

The Fuyang experiment has so many component parts covering such a broad range of issues that resource constraints (budgetary, staff, skills) in the EZO are a cause for concern. The areas most likely to suffer are monitoring and evaluation, control over sensitive projects, and influence over the diffusion of successful reform experiments.

4.5 Monitoring the Experiment

The implementation of reform projects is generally monitored effectively against the clear plans that are drawn up in advance.

Monitoring the impact of projects has become somewhat problematic. In pilot areas the impact of projects such as the reform of the market administrative system has proved relatively easy to monitor. The local leading groups generally collect key indicators. The impact of the more complex projects, such as industrial reform zones or enterprise charters has not been monitored. The aim of such projects stated simply is to have more enterprises working more efficiently and employing more people. To measure impact, basic data on the performance of enterprises in the project area has to be collected and compared with data from a control group. Until the plans for a statistical system are revived it looks as if this is not going to happen.

In the case of the NGFAs, it would be desirable if monitoring were linked directly to some form of control. In these projects, the basic data are available locally, but the EZO does not keep itself up to date. Clear norms have not been set for operational indicators and so no action is possible under the circumstances.

It is not clear how complex projects are to be revised and amended before they are developed outside of their pilot areas if comprehensive monitoring and evaluation is not taking place.

Monitoring appears most problematic when it comes to assessing the effective diffusion of projects which have been taken up by the prefecture or the province. It is not clear what offices collect data or who is responsible for processing and evaluating it.

The Fuyang EZO is operating under resource constraints at the present and the devolution of responsibility for projects to county leading groups can only have exacerbated monitoring problems. RCRD has suggested more formal procedures for project implementation and monitoring in Fuyang so perhaps judgement should be suspended until the first progress report is prepared.

In any case this topic should certainly be raised again in the next supervision mission.

4.6 Reform Objectives, Maturing Markets and Developing Enterprises

Despite all the problems of the supply of raw materials, sometimes predatory local governments, and unclear legal status, many new enterprises are remarkably successful and their owners make an enviable return on their investment. It is clear that there are many under-exploited market opportunities. In some sectors where enterprise development has been underway for some time however, the signs of maturing markets appear: declining margins, increased competition, inflation in raw material costs which does not keep pace with inflation in the prices of finished goods, etc.

Mature markets bring new challenges. Enterprises have to develop more sophisticated competitive strategies to survive. Management skills must improve. Assets must be used more efficiently. What is being done to prepare managers for challenges such as these? Is sufficient priority being given to training?

Some enterprises have responded to increasing competition by moving into higher quality product lines, often by becoming more capital intensive. Given the employment generation objectives which are integral to the reforms, this response raises interesting questions about the rate at which new employment will be created in established industrial sectors and how a balance is to be struck between profitability and job creation.

Other enterprises respond to increasing competition by going ceasing to trade, or even going bankrupt. As long as creditors and employees are relatively well protected, everything should be done to facilitate bankruptcy. Excessive intervention to support unprofitable enterprises and subsidise employment has to be avoided if the market is to work efficiently.

The growth of mature enterprises also raises the question of the availability of investment capital. There are numerous experiments under way at present to develop joint stock companies. Such companies may well be a useful way to clarify ownership and control, but it will be interesting to see whether this new form is used simply to re-classify existing investments, or whether it will give new investors the confidence to risk their savings to finance enterprise growth.

Some enterprises in Fuyang are already at a stage at which an injection of venture capital would make all the difference. It is important that in such cases government offices responsible for enterprise administration take a flexible approach. Enterprises will need to be able to transform their constitution as they develop. Private enterprises will need to become limited companies. Private limited companies will need to become public limited companies. Enterprise mergers and takeovers, arranged for

reasons of commercial expediency, rather than because one enterprise is bankrupt, will need to occur. To facilitate this, government departments will need to display a responsiveness that they have not been used to in the past.

Appendix 1

The Fuyang Experimental Projects - Detailed Update

The Fuyang Experimental Projects - Detailed Update

This appendix provides an update on all the projects included in the Fuyang reform programme (with the exception of the NGFA project [project B1.3] which is covered in appendix 2). Since the appraisal mission, three new industrial zone projects have been added, new NGFAs have been established, two new enterprise charters and five charters for entrepreneurs' associations have been drafted, an experiment to develop and pilot a non governmental enterprise law has been taken on, and a series of books have been published rather than the one reported previously. One planned project to develop a rabbit meat producers association has been dropped, and the statistics project is in abeyance. A number of projects have been taken up outside of the zone.

(The reference numbers in brackets after each project refer to the appendix to annex 1 of working paper number 5 of the Red Cover Appraisal report volume II).

Putting the Markets and Road Tolls in Order (A1.1 and A1.2)

These two projects established to remove the excessive number of fees and tolls, to organise and regularise market administration and tax collection, and to stimulate market trade were extended from four trial areas to the prefecture's 892 markets before March 1988 and have subsequently been extended to the whole of Anhue province. In the pilot areas, regulations for government offices have been clarified, the number of offices involved cut back radically, personnel have been reorganised, and firm action has been taken against traders who evade taxation. But even in the pilot areas these projects were the object of some opposition from vested interests and strong local leading groups had to be established to see them through. The EZO is of the opinion that, with extension to the whole province, follow up action is required to train personnel, to spread and legitimise the offices supervising the markets, and to fully implement the new systems and codes of conduct.

What is not at all clear is what overview the EZO has over the process of diffusion and its impact, nor whether full implementation is readily achievable without the strong political backing given in the pilot areas.

As for the impact of these reforms, in the case of the Borzhou

Specialised Traditional Medicine Market, the results appear quite spectacular -

	October 1987 as Reform commenced	Sept 1988
number of stalls	600-800	1,700
number of traders per day	<10,000	20,000 - 30,000
value transactions per day	Y20,000 - 30,000	Y100,000 - 150,000
fees and taxes officially collected per month	Y20,000	Y50,000

In Mengcheng market the number of traders grew by 50% and tax collected by 160% following the implementation of the reform.

These projects are regarded as one of the EZO's greatest achievements.

Commercialisation of Town Centre Streets (A1.7)

The aim of this project located in Borzhou city was previously understood to involve the commercialisation of four city centre streets through increasing rentals to reflect the scarcity value of commercial sites. Two months into the project though, it appears that the project is one in which the city government applies zoning regulations - while at the same time offering preferential policies - and owners and tenants have been encouraged to raise the funds to implement city plans for reconstruction and redevelopment. The city of Borzhou is already very commercialised with an estimated 50% of all city centre streets already occupied, at least in part, by traders and shops. It appears that rentals will rise in the four streets selected as a consequence of the compulsory zoning policy, rather than act as a spur to commercialisation.

Industrial Zones

The industrial zones in Mengcheng and Tiehe (A1.4, A1.5) were described in the Appraisal mission report. Both were then at the late planning stage and are now part complete. Two new zones are now planned or underway, both in Gwo Yang. *The Industrial and Commercial Development Zone (A1.B)* is now regarded by the EZO as part of this set, and brings the total to 5. All of these projects are held to be progressing satisfactorily.

It has become clear that the zones are far from being simple rural industrial parks. Rather, with their package of preferential policies, their attempts to create markets in land, the change of status from rural to urban citizenship which is involved, the modifications to government enterprise administrative procedures, together with their proximity to areas which piloted the market reforms and their association with non-governmental financial associations, they represent highly

integrated reform packages designed to readjust the market and administrative environment for new businesses. In some cases the zones are an integral part of county governments' overall 5 year planning.

It is probable that further industrial zones will be at a planning stage by the time of the next supervision, although it is not clear if by then such zones will still fall under the purview of the EZD.

The rapid rate of implementation of these zonal projects and an impression of their scale can be seen from the following summary of developments to date in Mengcheng and Tiehe.

	Mengcheng	Tiehe
Area (mu)	108	610
Target no. enterprises	150	
Target no. employees	3,000	
Target investment (Y million)		100 - 150
Target output value (Y million pa)		100 - 200
Applications received	85	152
Applications accepted and factories under construction or completed	19	23
Enterprises operating	13	7

In Tiehe, provisional plans have been made for the development of the area surrounding the zone to accommodate enterprises servicing the enterprises within the zone and their employees.

In Mengcheng the land transfer issue has not yet been resolved. In Tiehe, although it is still maintained that land cannot be bought and sold, it has been decided that an enterprise within the zone can

- 1) transfer its use-rights to land it occupies, and
- 2) sell its buildings

and do so in both cases at a negotiated price.

The Gwo Yang Yimen Comprehensive Zone was not reported at the time of appraisal as approval was not given until March 26th. The aim here is to take an entire district and conduct a number of economic and political reform experiments simultaneously. The project is to include both collective and private enterprises operating in both manufacturing and commerce. The seven components of the project are -

- 1) To decentralise functions currently undertaken by the county government regarding finance and personnel to the district
- 2) to develop an industrial and commercial zone in one

area of the district

- 3) to develop exports (based on vegetables and smoked beef) with the help of preferential loans, fertilizer, and technical assistance
- 4) to reform the housing system
- 5) to reform the financial system
- 6) to develop the township and ecological [?] agriculture
- 7) to change the relationship between local government and TVEs.

To date applications have been received from 45 enterprises, 32 of which have been accepted and 4 of which have already gone into business.

The project planned at the time of appraisal to undertake *Research into the Relationship between Local Government and TVEs (C2.1)* has not yet been implemented, but the Gwo Yang Yimen Comprehensive Zone has been designated as the site for this.

During this supervision mission a detailed briefing on this new project was not possible but it would certainly be worthwhile during the next.

Gwo Yang Cheng Dong Economic Development Zone is located within the Gwo Yang Yimen Comprehensive Zone, this industrial area in most respects resembles the original Mengcheng and Tiehe zone models, although the sponsors emphasise the aim of locating enterprises with different forms of ownership (state, collective and private) together on the same site. It is planned to be significantly larger than the other two zones however - 4,700 mu when complete, and 1,000 mu in the first stage. The target for stage 1 is 120 enterprises; to date applications have been accepted from 41 - 75% of which are private, and the rest state, community and village government owned.

The development of stage 1 of the industrial zone is part of the county 5 year plan to reverse the current ratio of agricultural to industrial output from 60:40 to 40:60. Using the local plan's analysis of current and projected output values but assuming no significant growth in agricultural productivity, industrial development in the zone itself - representing just 0.05% of the total land area in the county - is forecast to take the industrial:agricultural output value ratio to 52:48.

It is interesting to note that the anticipated 62% increase in county industrial output value, and the 25% increase in total county output value, is accompanied by new off farm employment for only 4% of the rural population. Such a rise is however consistent with the national target of 100 million new rural jobs by the end of the century.

Zone	Agric use		Industrial Use	
Area (mu)	1,000		1,000	
Employment	2,439	[1]	30,000	[2]
Output Value (Y)	221,684	[1]	175,000,000	[2]
Annual Profit (Y)	175,000	[2]	17,500,000	[2]
Initial Investment				
Infrastructure			2,500,000	[2]
Enterprises			38,400,000	[3]

County	1988		1988 + zone 1993		
Output (Y million)					
Agriculture	421	60%	421	48%	
Industry	281	40%	456	52%	+62%
Total	702		877		+25%
Employment (thousands)					
Agriculture	779	74%	749	71%	-4%
Urban and TVEs	279	26%	309	29%	+11%
Total	1,058		1,058		

Notes

- 1 - average for county
- 2 - zone plan estimate
- 3 - average for first batch of enterprises

The forecast makes certain naive assumptions -

- no population increase
- all additional urban+TVE employment comes from displaced agricultural labour within county
- no inflation
- no growth of TVEs outside of zone

but given the fairly gross assumptions regarding future output and employment in new enterprises in the zone made in the county plan there would be little value in being more sophisticated.

Jeishou Gwang Wu Industrial and Commercial Development Zone (A1.8) has the particular aim of encouraging the development of commerce in the general commodity and specialised plastics market in the town and, simultaneously, the development of related processing and manufacturing industry. It has a similar package of incentives and policy reforms to the other zonal projects. Within the overall zone area there is a specific industrial zone.

In the 12 months which included the implementation of the project in 1988 the number of sellers in the market has increased by 60% to 320, the number of commodities by 24% to 2,600 and the value of sales by 50%. The number of households engaged in the collection of waste plastics has gone up by 39% to 178.

Employment in commerce and industry has increased by 50%. Sixteen new industrial enterprises have been established within the general zone area - there being virtually no industry in the town previously - and in the specific industrial zone 78 enterprises have applied for sites of which 30 have been accepted and 2 are already in production. Fifty-five are expected in total

The market and road toll reforms are at a pre-implentation stage in the market and no firm date exists for implementation itself.

The EZO's plans to replicate this combined market reform/industrial development project have not progressed since the time of the appraisal.

Labour Export System (A1.6)

Labour migration from the county in which this project is located amounted to 100,000 in 1987, and forecasts for 1988 and 1989 are 150,000 and 300,000 respectively. No further information was available during the supervision mission.

Gu Jing Enterprise Group (A1.3)

Near Borzhou city the famous Gu Jing spirit is produced by 1 state factory and more than 100 TVEs. The aims of this project were (1) to improve the quality of production of the TVEs by means of technical assistance from the state factory (2) to eradicate illegal use of trademarks and to collaborate on supply and marketing and (3) to develop the group into a single economic entity through voluntary association. At the time of appraisal it was not clear how the aims of this project reconciled with the more general reform objectives of promoting market competition, not least between TVEs and state enterprises.

In this year technicians from the state factory have held 50 days training for 150 TVE staff, they have provided direct technical assistance on site, and TVE staff have had placements in the state factory.

The problem of trademarks appears to have been resolved - though exactly how is not clear.

Joint purchasing of raw materials has not been an area of collaboration - partly because supplies were readily available in the open market recently.

Joint sales have involved the state factory purchasing 1,600 tons from TVEs in 1988; this is equal to 13% of its forecast annual output/throughput. Two of the larger TVEs, with an annual output of 600 and 1800 tons p.a. sold 15% and 40% respectively of their total output to the state factory. Together they account for over 50% of the state factory purchases while making up only 2% of the population of TVEs in the group. One factor here appears to be the state factory's limited capacity to sell increased volumes in the market place; another is the ability of those TVEs with

better quality products to make their own direct sales at higher prices than the state factory will pay. This is slightly offset by the shorter credit period taken by the state factory than by other customers.

It is argued locally that the aim of ultimate association between all the enterprises is not so much a matter of restricting local competition as enabling all the enterprises to be more competitive nationally. At a local level there are several crucial issues

- 1 has the state enterprise the marketing capacity to handle group sales effectively?
- 2 are there market niches better exploited by TVEs selling on their own?
- 3 can the state factory can achieve its ambitions to improve its quality and diversify its range so that it can move up market and further into exports, leaving the TVEs to fill the gap it would like to leave for lower quality product?
- 4 do the TVEs themselves want to move up market?

It is not clear that the project design addresses such issues of competitive strategy.

At a policy level, the local debate on the merits of increased collaboration among the firms raises the long term issues of -

- 1 the freedom of enterprises to arrange takeovers or mergers; at present it appears that such arrangements are usually considered only for insolvent enterprises
- 2 the state controls needed to prevent unfair restrictions on competition and the formation of cartels and monopolies.

These two issues could usefully be placed on the experimental reform agenda.

Industrial Production Materials Markets (A2.1)

This project was only at the preparation stage at the time of the appraisal mission but already industrial materials markets have been established for cement, steel, and vehicles, and one for fertilizer is planned.

The aim is to address the problem of materials which are in short supply and which local TVEs currently purchase on the open market, the grey market and the black market. Local government and state companies, as well as enterprises and individuals, are active in the trade in these materials, and the exploitation of the differential between plan or ex-factory prices and the market prices by these companies has been dubbed 'official profiteering' in the chinese press and elsewhere (see China Daily: *Official swindling* [16/09/88]; *Gains recovered in speculative scandal* [17/09/88]; *Top factory falls prey to profiteers* [17/09/88]).

The steel and vehicles markets already have fixed sites, and a site for the cement market is under construction. Investments in the steel market amount to Y30,000 for fixed assets and Y300,000 for working capital. So far this year sales through the market amounted to Y1.6 million yielding Y46,000 in profits taxes and fees paid to local government.

Given the small volume handled by these markets, they have not yet had an impact on either supply or prices, but their value is seen to be that of bringing the grey market out into the open - legitimising the trade in these materials, making it susceptible to open official regulation and facilitating the collection of fees and taxes by local government.

Enterprise Charters (B1.1)

This is another project regarded as a significant achievement by the EZO; but although new models have been added, and the existing models are about to be popularised through the province and are spreading to other areas, the project appears to have lost direction, and to have become dislocated from the development of enterprise law. There is a real danger that it will be drawn to a conclusion before important lessons have been learned and the charters amended and upgraded in the light of these. Diffusion before monitoring and revision appears to be a reversal in the logical order of the experiment.

The EZO takes the view that with the adoption of the charters by an estimated 60% of all new enterprises formed recently in the prefecture, much has been done to clarify the internal relations between the parties involved, to improve rational management, and to increase the possibility of capital accumulation by insulating enterprises and their profits from the claims of family members. The project timetable has conclusions being drawn by the end of this year.

One of the key functions of the charters appears to remain that of giving enterprises a legitimacy given the absence of enterprise law and the less than full public acceptance of private ownership. Whether or not they achieve the other objects of rationalising management or increasing capital accumulation it seems impossible to judge. The performance of a representative sample of enterprises with the charters would have to be compared with that of a control sample for this to be established. This has not been done.

Since March, two new forms of model enterprise charter for joint ventures between local TVEs and foreign firms have been added bringing the grand total of enterprise charters to 10.

Both new charters were drawn up for a successful TVE in Fuyang city which was establishing joint ventures - one with a Phillipine company to be based in Fuyang and one with a Hong Kong company to be based in Shenzheng. The first of these is the most

comprehensive charter in the whole set of 10 and covers -

- name, location and activity
- liability of investors
- details of registration
- registered and subscribed capital
- transfer and withdrawal of capital
- board of directors
- audit
- accounting
- distribution of profit, and
- winding up

and, in addition

- conditions of employment for manager and employees
- administrative, organisational and sales plans, and
- contract terms between the parties.

The charter has a finite term of 7 years.

It would appear logical and useful if the first of the above lists (or, better still, the list in the national private enterprise law [see section 3.2.1]) became the standard for all model charters, and that the other items - or items appropriate to particular enterprises - were added at the discretion of individual enterprises. Revisions to the models along these lines could be made before they spread to other areas.

Non-governmental Enterprise Authorised to Wholesale Medicine (B1.2)

The aim here was to allow a TVE to compete in the medicine wholesale market, previously monopolised by state owned wholesalers. The TVE in question actually began wholesaling in 1987 (1 year before it was taken on as a project). Since its activities have been officially recognised it has benefited by doubling its sales, increasing its workforce by a third, and by having a legal business.

It is not clear whether the entry of this one enterprise into the wholesale market, a market in which the state monopoly remains the major force, has done much to reduce prices or stimulate competition - although the TVE certainly claims to be price competitive. While there is only the state wholesaler as competition and while the customers are local government institutions, there is the possibility that savings could be shared between the TVE and the individual buyers rather than the purchasers they represent.

System for Insolvency and Revival of Enterprises and The Non Governmental Enterprise Law (B2.1)

Insolvency

The bankruptcy law is at a draft stage pending approval by the provincial People's Congress for implementation in one county where enterprises which have ceased trading have been selected for trials. The draft was prepared with assistance from university law departments.

Problems encountered in the formulation of the law were the identification of evidence which would be acceptable to the People's Court; opposition from ABC which will not readily write off debts long after it is clear that the borrower cannot repay - presumably in the expectation that some government office will take responsibility; and the absence of other systems which would have facilitated bankruptcy proceedings - developed enterprise financial systems, enterprise constitutions, and established means of auctioning assets.

The reluctance to see debts written off is a core problem.

It has proved difficult to sell defunct enterprises. This appears to be because the creditors will not accept a sale at the best market price but insist that the purchaser takes over all liabilities along with any assets.

RCRD has also expressed some concern about the writing off of debts arguing that as almost all TVEs which were started up to a few years ago were entirely debt financed those responsible for the enterprises would benefit without having to take any responsibility. It is not clear though that such an argument has the same force now: the issue seems to rest with ABC which eventually will have to accept that loans to private enterprises carry a risk and that it must develop its own procedures to minimise its exposure to such risks.

The scale of the problem was presented in a report on insolvent enterprises drawn up by the prefectural branch of ABC. At the end of 1987 25% of all loans to TVEs were simply overdue, a further 13% were classified as doubtful and a further 9% were said to be unrecoverable. Over 16% of enterprises with outstanding loans had actually ceased trading.

The draft law draws heavily on the national Enterprise Bankruptcy Law applying to state enterprises which was adopted in December 1986. The main points can be summarised as follows -

- the law applies to all non governmental enterprises
- when an enterprise cannot return its due debts a process of revitalisation or bankruptcy can take place
- there may be a voluntary declaration of insolvency by the enterprise, or a creditor owed more than one third of the total debts may apply to the court

- If the enterprise and its creditors agree, they may decide upon revitalization rather than immediate winding up; the agreement can involve deferments or reductions in debts;
- Enterprises under revitalisation are supervised by a creditors committee.
- Creditors priority
 - wages
 - taxes
 - debts
 (though the text appears to be ambiguous as to whether this is an absolute priority or whether creditors receive a proportionate share of available assets).

A translation of the draft insolvency law is attached as appendix 5.

It will be interesting and important to see if with the implementation of the new law only those enterprises which have actually ceased trading are declared bankrupt or if the more rigorous definition of inability to pay debts as they fall due is applied. The underlying issue here is whether priority continues to be given to maintaining employment in a technically insolvent enterprise, or whether the balance will tip in favour of creditors.

The EZO hopes the law will be applied in such a way as to encourage revitalisation - by employing a new manager with a new contract, or by takeovers or mergers - and that winding up will be the last resort.

In addition to its work on the insolvency law itself, the EZO has been involved in some experiments (outside the reform project proper) to improve procedures for loan guarantees.

Non Governmental Enterprise Law

The drafting and trial of a Non-Governmental Enterprises Law has been taken on as a project by the EZO. The text of the law has already been drafted and a trial site selected in Borzhou city. The EZO and several government offices are organising a survey of the legal needs of 10 selected enterprises prior to submission of the draft to Borzhou People's Congress. The intention is to implement the draft in November, amend it in December, and put it to the provincial People's Congress early in 1989 for implementation province wide.

The draft non governmental enterprise law resembles the national private enterprise law (section 3.2.1) in many respects, but there are important differences -

- A non governmental enterprise is defined as one established with private investment and whose property belongs to private people; it includes enterprises in which there are joint investments of private individuals and state or local government

- It puts the onus to comply with deadlines in registration and other procedures on the government departments rather than on the enterprise
- It provides more detailed guidance for organisation and management and more detailed protection for the rights of the investor and the enterprise
- It provides a less comprehensive list of contents for the charter of a limited liability enterprise
- It does not make any stipulations about the proportion of profits which should be reinvested, and
- It proposes an order in which creditors should be paid which appears to favour banks over trade creditors, but is as ambiguous as both the bankruptcy laws as to the priority of creditors.

A translation of the draft text of the law is included as appendix 4.

Rabbit Meat Producers' Association (B2.2)

This project has been dropped from the experimental programme although the county government sponsoring it has gone ahead with a project to improve the organisation of rabbit meat production and processing.

TVE Entrepreneurs' Associations (B2.3)

One association was underway at the time of appraisal and now there are five for which model charters have been written.

It will be interesting to see whether such associations develop to become a powerful force representing the interests of private enterprises. If they prove popular, they will bring together groups of people with more practical experience in running enterprises than can presently be found in the agencies which are supporting enterprise development. Perhaps this experience can be tapped.

Joint Government Agencies Office (C1.1)

The joint agencies office project sets out to speed up the process of enterprise registration and to reduce possibilities for corruption by bringing all the necessary agencies together in one office open to the public. The project had been piloted in Fuyang city by the time of appraisal, and the provincial government has now proposed that the arrangement be adopted throughout the province. So far two counties have established a physical office while in some others government officials assemble twice a month.

Small and Medium Enterprise Bureau (C1.2)

This office was set up in one town and brought together officers from three government agencies (TVEs, Private Enterprises, Industrial and Commercial) to work with both rural and urban

enterprises under the leadership of an elected manager. At the time of appraisal administrative difficulties were mentioned and it appears that the agency hierarchies are still not enthusiastic about the project. The agencies are represented in one office but have not yet clarified their functions. Attempts to appoint staff on the basis of open competition have proved difficult. Broader plans to deal with enterprises on the basis of their trade classification rather than on their urban or rural location as at present, and to establish rural-urban commercial markets have both proved difficult to implement.

Book: Guidelines for Establishing TVEs (C1.3)

The guide to setting up TVEs and to the regulations governing their operation was published nationally on schedule.

The EZO has also published a series of books under the general title "To Establish a New Order for the Socialist Market Economy". The topic of volume 2 was model charters; volume 5 covered draft legislation and related issues.

Research on Government and TVEs (C2.1)

This project has not yet begun. It has been decided that it should be implemented from October 1988 as part of the Gwo Yang comprehensive economic development zone project.

Improved Statistical System (C2.2)

The EZO's plans for an improved TVE statistical system were ambitious though comprehensive. The aim was not only to improve routine collection for all enterprises, but also to use sample surveys to monitor the performance of enterprises operating under different conditions.

The statistical system was to provide the data on which conclusions could be drawn, not only about the performance of TVEs, but also about the success of the whole reform experiment.

Little has been achieved so far however, principally because the system requires skilled staff and funding, and neither have been made available. In August main indicators were collected from 8 enterprises using the model charters and from a sample of 165 enterprises in 5 industrial groups.

The EZO now argues that, even if it were to collect enterprise statistics, there are so many exogenous variables affecting their performance that the exercise would be of limited value. It is not clear however why if control groups were used this should be a problem.

The EZO has no specific plans to take this project further until and unless it obtains assistance from RCRD and the Statistical Bureau. It was suggested during the supervision mission that universities or colleges might arrange projects for their

students along lines of enquiry useful to the EZO, but the head of the office was not certain that this would be possible or useful.

The EZO feels that it is difficult to measure the qualitative impact of the reforms - it argues that objectives include a change in the attitudes of government offices in many cases and that these are not readily quantifiable. It is important here though to distinguish between ultimate aims and intermediary objectives. The ultimate aim is to have more enterprises operating more efficiently; intermediate objectives include changing the attitude of government departments which stand in the way of this. It is possible to quantify the former, even if quantifying the latter is difficult, and the use of control groups would again be useful. Admittedly the use of control groups increases the size of the task, and the problem of exogenous variables remains. But until people and resources are deployed to tackle these problems head on appropriate solutions are not going to emerge and conclusions will be very difficult to substantiate.

An absence of sound statistical data will make it difficult to measure the impact of reform projects and could well devalue the whole experiment. This is a cause for concern.

TVE Training Centre (C2.3)

The EZO has not taken its plan to sponsor the Fuyang TVE School further but it is still anxious to see an investment made in the school, even though RCRD is not. Meanwhile, the school appears to continue to thrive with fee paying pupils and teachers whose contract responsibility system goes so far as to specify the grades their pupils must achieve if they are to continue in their jobs!

Appendix 2

Fuyang Non Governmental Financial Associations
Detailed Update

Fuyang Non Governmental Financial Associations Detailed Update

There are now six NGFAs set up as experimental projects in Fuyang (one of which is not yet fully operational). Five of these are associated with industrial reform zones and 1 with an enterprise group.

- 1 Zhangji Financial Services Corporation, Borzhou, Gu Jing Liquor enterprise group
- 2 Teiho Economic Development Zone Financial Services Corporation
- 3 Shang Jian Financial Services Corporation, Mengcheng, Shang Jian Industrial Zone
- 4 Gwo Yang Yimen Financial Corporation, Gwo Yang, Gwo Yang Yimen Comprehensive Zone
- 5 Gwo Yang Cheng Dong Financial Services Corporation, Gwo Yang Cheng Dong Economic Development Zone
- 6 Gwang Wu Industrial and Commercial Zone Financial Corporation, Jeisho

The Fuyang 'CATIC' is still at a planning stage. It is not clear whether Zhihe Stock Financial Society (Red Cover Appraisal Report Paper 7 p.23 refers to this as 'Quehe') in Gwo Yang is regarded as one of the Fuyang experimental projects. No information was obtained on the Borzhou investment corporation mentioned at the time of appraisal.

The EZO has identified 6 common characteristics of the NGFAs -

- 1 they lend mainly to TVEs
- 2 they issue 'stock' to TVEs, peasants, industrial and commercial workers
- 3 directors are elected democratically by shareholders, and managers are responsible to the board
- 4 employees are employed in open competitive recruitment
- 5 there is no governmental or individual interference (though the NGFAs accept assistance from state bodies, and
- 6 profit is distributed taking into account interests of both stockholders and borrowers.

A further characteristic is that they all aim to offer a better service and more competitive interest rates to depositors than do the state banks.

According to the EZO, the NGFAs share 10 problems -

- 1 state banks will not lend to TVEs which have deposits with NGFAs
- 2 peasants lack confidence in NGFAs
- 3 NGFAs have formally adopted a stock system, but stocks are in practice withdrawable and therefore represent debt rather than equity
- 4 local state banks are reluctant to give guarantees for NGFAs borrowing from other banks

- 5 NGFAs borrow in practice only because people have
 'connections' and can obtain loans through the 'back door'
 6 borrowed funds greatly exceed self owned funds
 7 there is a concentration of lending to single industrial
 sectors
 8 NGFAs require technical assistance, but this is not
 forthcoming from the state; supervision of NGFAs is
 ineffectual
 9 NGFA employees require training, and
 10 there is insufficient security for both lending and
 borrowing.

The EZO does however feel that the NGFAs have increased the flow of funds to TVEs.

Meetings were held with managers/leading groups of all 6 NGFAs during the supervision mission. This was fortunate as the EZO did not have accurate up to date figures. In all cases figures were obtained for stock, deposits, borrowing and lending, but up to date balance sheets with details of all assets and liabilities including reserves were not made available on this occasion. The data are summarised in the table below.

	Stock	Deposits	Borrowing	Total Funds	Lending
	Y million				
	%				
Borzhou	2.29 16%	0.45 3%	11.3 81%	14.04 100%	13.6
Tiehe	0.38 9%	1.36 32%	2.5 59%	4.24 100%	4.0
Shang Jian	0.136 19%	0.072 10%	0.5 71%	0.708 100%	0.395
Gwo Yang Yimen	0.113 26%	0.317 74%		0.43 100%	0.328
Gwo Yang Cheng Dong	0.135 7%	1.1 60%	0.6 33%	1.835 100%	0.7
Gwang Wu	0.36 100%			0.36 100%	
TOTALS	3.414 16%	3.299 15%	14.9 69%	21.595 100%	19.023

Borzhou Zhang Ji Financial Services Corporation (Red Cover paper 7 p22 "Zhangzhi Financial Service Society"

This NGFA was set up to lend to enterprises in the Gu Jing Liquor Group and began operations in 1986. To attract and keep stockholders it has paid a dividend of 2% in addition to interest at 12%. Interest is paid in the form of additional stocks.

The association has had problems with overdue loans - they currently amount to 9% but a number have been rescheduled. The high level of overdue loans said to be due to the seasonal nature of the liquor industry but it also transpires that the enterprises are having difficulties repaying because loans made for periods of 3, 6 and 12 months were used to purchase fixed assets. It appears that the terms of the loans were not matched to the real needs of the enterprises or this problem could have been foreseen. The association is said to be trying to diversify its lending to enterprises in other industries.

The NGFA borrowed at first with a guarantee from a local bank, but because the loan was returned on time, the current borrowing is not guaranteed.

Teiho Economic Development Zone Financial Services Corporation

In this NGFA, 74% of the stockholding and 16% of the deposits are from enterprises in the industrial zone.

The funds currently borrowed from other banks have a 3 months term. They are guaranteed by a local state bank but there is a real possibility that the guarantee will not be extended when the NGFA comes to borrow again. This is a problem as loans to enterprises in the zone have been made on 3 to 6 month terms.

Interest on both loans and deposits are higher than those paid/charged by ABC.

	NGFA % pa	ABC % pa
demand deposit	4.4	2.9
industrial loan	17.5	9

Interest is paid on stocks at 11% while dividends are paid at 15% of net profit.

Shang Jian Financial Services Corporation, Mengcheng, Shang Jian Industrial Zone

This NGFA received approved in April and began operations in September 1988.

Although it has been in operation for only 1 month, Y82,000 of the Y477,000 loans it has made have already been repaid.

Loans are made for terms of 1 - 3 months; 67% are to enterprises within the industrial zone.

It has borrowed funds from local government departments for a term of 9 months. Y100,000 of the borrowed funds (20%) came from land transfer fees paid by industrial enterprises in the zone for the right to use agricultural land for industrial purposes.

The NGFA borrows at 8.2% and pays 3.7% on demand deposits and 8.7% on stock and time deposits. The interest charged on loans varies as follows -

Loans	within zone	outside zone
repaid before term	15.4%	19.6%
repaid on time	19.6%	23.9%
overdue loans	23.9%	28.3%

Loans are made only for working capital - the association says it has learnt a lesson from Zhang Ji NGFA in Borzhou.

Gwo Yang Yimen Financial Corporation, Gwo Yang, Gwo Yang Yimen Comprehensive Zone

This association was established in April this year but was only approved in July after the EZO intervened with the Central Bank after the provincial bank had expressed reservations.

Loans are made to both TVEs (35%) and specialised industrial households (65%).

Gwo Yang Cheng Dong Financial Services Corporation, Gwo Yang Cheng Dong Economic Development Zone

No information other than figures for funds and loans summarised in the table above was obtained.

Gwang Wu Industrial and Commercial Zone Financial Corporation, Jeishou

This NGFA is not yet operational as it is waiting for approval.

It distinguishes between withdrawable stock (40% total) and 3 year stock which carries a higher dividend. In practice though it expects the 3 year also to be withdrawable (just like term deposits are). The idea of non-withdrawability is said to be unacceptable to stockholders.

Fuyang CATIC

Plans to establish a local financial trust/investment corporation in Fuyang have been thwarted by national rulings prohibiting further registration of such enterprises. At present the plans

which RCRD and the EZO have to lend CATIC funds to an independent financial organisation in Fuyang are dependent on the EZO's efforts to establish a new branch of an independent provincial company (which is mainly involved in foreign trade) in Fuyang. The stated aim of this branch will be to provide "comprehensive services to facilitate the readjustment of the rural industrial structure". It is hoped that the provision of independent financial services throughout the prefecture will be possible under this umbrella.

Appendix 3

The National Private Enterprise Law
Draft Translation

Interim Regulations for Private Enterprises in the People's Republic of China

Draft Translation

Chapter I General Principles

- 1 In order to make the socialist planned commodity economy prosperous these regulations are formulated to encourage and guide the healthy development of private enterprises, to protect the legitimate rights and benefits of private enterprises, and to strengthen the supervision and management over private enterprises.
- 2 The term "private enterprise" is used in these regulations to refer to economic organizations whose property belongs to private persons, whose purpose is to seek profits, and which employ 8 or more people.
- 3 The private economy complements the socialist public economy. The state protects the rights and benefits of private enterprises. Private enterprises must operate according to state laws, regulations and policies.
- 4 Employees of private enterprises can organize trade unions according to the law. The legitimate rights and benefits of such employees are protected by state laws.
- 5 Private enterprises can organize private enterprise associations.

Chapter II Types of Private Enterprises

- 6 Private enterprises are of the following types -
 - sole proprietorship
 - partnership
 - limited liability company.
- 7 "Sole proprietorships" refers to enterprises established with the investment of a single person. The investor of the sole proprietorship has unlimited liabilities for the debts of the enterprise.
- 8 "Partnership enterprise" refers to an enterprise set up by two or more persons according to an agreement. The partners invest and operate the enterprise jointly and will share profits and losses. The Partnership Enterprise should have a written agreement. The partners have unlimited liabilities for the debts of the enterprise.
- 9 "Limited Liability Company" refers to an enterprise in which the investors have responsibility for the debts of the company in proportion to the amount of their investment and in which the all the assets of the enterprise are available

to cover its debts. Limited Liability Companies should meet the following standards -

- 1 the phrase 'ltd co' should appear in the name of the company
- 2 The company should have a company charter which meets the provisions of these regulations
- 3 the number of investors is between 2 and 30
- 4 the registered funds should be legally verified
- 5 an investor may only transfer his investment with the consent of all the other investors unless there are 3 or more investors when the transfer of investment may be made with the agreement of at least half of the investors.
- 6 The company cannot reduce its registered capital
- 7 the company is not allowed to issue stocks to the general public.

If the Limited Liability Company has more than 30 investors it must apply under the provisions of this article to the industrial and commercial administrative bureau and may only be registered with its consent.

- 10 The limited liability company has a legal person status according to law.

Chapter III CLOSING AND WINDING UP OF PRIVATE ENTERPRISES

- 11 The following people can apply to open a private enterprise -
 - 1 village people in the rural areas
 - 2 people waiting for jobs in 23 cities and townships
 - 3 individual industrial and commercial households
 - 4 people who have retired or who have resigned [their jobs]
 - 5 people retired according to state law
- 12 Private enterprises can operate in industry, construction, transportation, commerce, restaurant services, repairs, technological consultancy, etc. within the scope of state laws, regulations and policies. Private enterprises are not allowed to engage in military industry or finance and may not produce any products prohibited by the state.
- 13 Private enterprises which apply for permission to open should meet the following conditions -
 - 1 they must have capital and a number of employees which are compatible with the planned scale of operations
 - 2 they must have a fixed location for their operation and the necessary facilities
 - 3 they must have a scope of operation which is in accordance with the scope provided in state laws regulations and policies

- 14 The charter of the Limited Liability Company should include the following -
- 1 the name and address of the company
 - 2 the principles and scope of operation
 - 3 registered capital and the investment of individual investors
 - 4 the names and addresses and the details of the rights and duties of investors
 - 5 the organisational system of the enterprise
 - 6 the conditions for the winding up the company
 - 7 the conditions for the transfer of investments by investors
 - 8 the way in which profits and losses will be shared
 - 9 the procedures to amend the charter
 - 10 other items that should be provided for.
- 15 [words missing in original] . . . private enterprises applying for permission to open must produce the certificates necessary for registration at the local industrial and commercial administrative bureau. The enterprise can start operation only after it has acquired the operational licence.
- 16 The private enterprise should reregister at the local industrial and commercial administrative bureau on the occasion of separation merger or transfer, or if it changes its location, or if it makes any changes in its scope of operation.
- 17 If the private enterprise stops production temporarily it should apply to the industrial and commercial administrative bureau 30 days in advance of stopping operation and it should cancel its registration after the termination is verified. If the private enterprise stops production it should settle its accounts and return its debts.
- 18 If the private enterprise becomes bankrupt it should clear up the bankruptcy and return its debts. The specific measures to be followed will be provided in other regulations.
- 19 The private enterprise which has the status of a legal person should change or cancel its registration according to the provisions in the Regulations for the Management of Enterprise Legal Person Registration of the PRC.

Chapter IV RIGHTS AND DUTIES OF THE PRIVATE ENTERPRISE

- 20 The investors of the private enterprise have the rights of ownership over their own property according to law. The property can be inherited according to law.

- 21 The private enterprise enjoys the following operational rights -
- 1 the exclusive right to the use of its approved and registered name within its area of operation
 - 2 the right to independent operation within the registered area/scope of operation
 - 3 the right to decide to set up departments, to employ or to dismiss employees;
 - 4 the right to decide on the wage system and the distribution of profits of the enterprise
 - 5 the right to decide on the price of commodities and the fees charged for services within the state's price management provisions;
 - 6 the right to sign contracts
 - 7 the right to apply for patents and registered trade marks
- 22 According to state laws and regulations the private enterprise can set up sino-foreign joint capital ventures or sino-foreign co-operative ventures with foreign companies enterprises and other foreign organisations or persons. Private enterprises can also undertake labour only contracts, sub-contracts, assembling, and pay over a share of the output [of a venture] in return for the right to use technology.
- 23 The private enterprise has the following duties in its production and operation -
- 1 to observe state laws regulations and policies
 - 2 to hand in tax according to law
 - 3 to accept the supervision and management of relevant state departments
- 24 According to state regulations the private enterprise should open an account in a bank or in another relevant organisation. Those enterprises which meet the appropriate provisions may apply for loans.
- 25 Except as provided in state laws and regulations no government office or department may ask a private enterprise for funds materials or labour. The private enterprise may refuse to pay any charges illegally levied. The industrial and commercial administrative bureaux have the right to stop illegal charges [being levied].
- 26 Neither the operational licence of the private enterprise nor the legal person operational licence of the private enterprise may be suspended or cancelled except by the industrial and commercial administrative bureaux following legal procedures.

Chapter V LABOUR MANAGEMENT IN PRIVATE ENTERPRISES

- 27 When employing people the private enterprise must sign a written labour contract with the employee which designates the rights and duties of both parties according to the principles of equal voluntary and consensual negotiation. The labour contracts of the Private Enterprise should be kept in the archives at the local labour administrative bureau.
- 28 The labour contract should include the following items
- 1 the quantity and quality of labour
 - 2 the term of the contract
 - 3 labour conditions
 - 4 payment of insurance and the welfare of labour
 - 5 labour discipline
 - 6 consequences of the violation of labour contract
 - 7 other items
- 29 Labour contracts in private enterprises should be handled in accordance with the Interim Regulations on Labour Contracts of State Run Enterprises.
- 30 Private enterprises must observe the regulations of the state pertaining to labour protection and establish necessary regulations and systems to provide adequate security and health facilities in order to insure the security and health of employees. If the workers' duties are a threat to their health and safety the private enterprise should buy insurance from the insurance company according to relevant state regulations. If the private enterprise has the capacity it should buy social insurance for the employees.
- 31 Private enterprises will adopt the 8 hr per day 6 days per week working system.
- 32 Private enterprises may not employ people who are under 16 years of age.
- 33 Trade unions of private enterprises have the right to sign collective contracts with the enterprise on behalf of the employees. The trade union has the right to protect the legitimate rights and benefits of the employees and to support the production and operation of the enterprise.

Chapter VI FINANCE AND TAX OF THE PRIVATE ENTERPRISES

- 34 The private enterprise must register at the local tax bureau within 30 days of acquiring legal person status or its operational licence.
- 35 Private enterprises must observe relevant state regulations for finance and accounting and the regulations of the tax

bureaux. The private enterprise should establish a complete financial and accounting system and appoint financial and accounting staff, establish accounting books, formulate financial reports, strictly carry out its tax duties and accept the supervision of the tax bureaux.

- 36 The salary of the director (manager or chairman of the board of directors) of the private enterprise may be set at a level up to ten times the average salary of the enterprise.
- 37 Income tax of private enterprises will [be levied] according to relevant regulations and the Interim Regulations of the Private Enterprise Income Tax of the PRC.
- 38 The private enterprise must devote 50% at least of its profits after tax to the expansion of production. If for extraordinary reasons the proportion is below 50% the enterprise must have the permission of the tax bureau. The production development fund of the private enterprise can be used to expand production, to invest in other enterprises, to return loans or to make up for the losses of the enterprise. If the fund is put to any other use the enterprise must have the permission of the tax bureau.
- 39 The investors of the private enterprise should hand in progressive income tax on their salary and their share of the distribution of after tax profits.

Chapter VII SUPERVISION AND PUNISHMENT

- 40 The industrial and commercial administrative bureau should strengthen its supervision and management over private enterprises, protect their legal operation, and inspect and punish illegal operations. The relevant responsible bureaux should follow the state regulations and give guidance and help as well as manage the production and operational activities of private enterprises.
- 41 If a private enterprise commits any of the following actions
 - 1 make false statements in applying for registration, or begin operation without verification and registration;
 - 2 operate beyond the scope of operation specified and approved at the time of registration, or fail to change its registration, re-register or cancel its registration according to the regulations
 - 3 forge change lease or rent transfer sell or make photocopies of the operation licence without permission.
 - 4 engage in illegal operations

the industrial and commercial administrative bureau may, according to the gravity of its offence, give it a warning or a fine, or confiscate its illegal income, or order it to cease production, or revoke its operational licence.

If the private enterprise with a legal person status violates the registration management regulations it will be punished according to the Enterprise Legal Person Registration Management Regulations of the PRC.

- 42 If a private enterprise commits one of the following actions it may be warned or fined by the labour administrative bureau according to the gravity of the offence -
- 1 engage in production and operation in a manner which is not in accordance with the state regulations of labour protection
 - 2 employ child labour
 - 3 encroach on the legitimate rights and benefits of the employees
- 43 If a private enterprise violates article 38 they will be warned or fined by the tax department according to the gravity of the offence.
- 44 If a private enterprise does not agree with the punishment handed out by the management bureaux under article 41 and 42 it should appeal to a higher department within 15 days after it is informed of the punishment. The higher department should reply within 30 days after it has received the appeal. If the enterprise still does not agree it can appeal to the People's Court within 30 days after it has received the notice from the higher office. If the term for re-appealing to the higher department or the appeal to the court expires the punishment decision will stand.
- 45 If a private enterprise violates state laws and regulations pertaining to tax, resources, industrial and commercial administration, prices, finance, measurements, quality, hygiene, environmental protection, it should be punished by the relevant bureaux.
- 46 If management personnel [of government offices] violate the provisions in these regulations, abuse their power, or try to seek personal benefits from their office, accept bribes or encroach on the legitimate rights and benefits of private enterprises, they should be punished administratively or economically by the relevant responsible bureaux according to the gravity of the offence. If management personnel violate criminal law they shall shoulder criminal responsibilities.

Chapter VII APPENDIX

- 47 These regulations will be explained by the State Industrial and Commercial Administrative Bureau. The means of implementation will be formulated jointly by the State Industrial and Commercial Administrative Bureau and other relevant departments.

48 These regulations will be implemented from July 1st 1988.

Note: The Regulations were adopted by the 7th conference of the standing committee of the State Council on June 3rd 1988.

Appendix 4

The Fuyang Draft Non Governmental Enterprise Law
Draft Translation

**Foward to the Non Governmental Enterprise Regulations
Draft Translation**

1 Guiding Principles for Formulation

Non governmental enterprises have grown up differently in different regions. They need a national law but we shall start with an experiment in order to to gain experience. The aim is to clarify property rights to help enterprises compete in the market. Because of a general lack of personnel trained in law there are detailed sections in the text of this draft intended to facilitate its implementation. The draft is based on investigations and incorporates elements from foreign laws.

2 Definition of Non Governmental Enterprises (NGEs)

NGEs are defined as economic organisations which have been established with private investment and whose property belongs to private persons who have the purpose of making profits and who engage in commercial economic activites in the name of the enterprise.

BORZHOU NON GOVERNMENTAL ENTERPRISE REGULATIONS (local)
Draft Translation

GENERAL PRINCIPLES

- 1 These regulations are formulated to promote the healthy development of non governmental enterprises (NGEs), to clarify their internal and external relations, to protect the legitimate rights and benefits of the NGEs and to lead the NGEs toward regularisation.
- 2 The NGEs referred to in these regulations are those economic organisations which are established with private investment and whose property belongs to the private persons and with an employment of 8 people at least and who engage in commodity economic activities with the purpose to make profits. If the employment is under 8 but the enterprise meets all other standards in the above and if the entrepreneur is willing to be registered as a NGE this enterprise is also considered as an NGE.
- 3 If the enterprise established with private investment has become a collectively owned enterprise through affiliation to a government department, so long as its property right is not transferred it is considered a NGE and the regulations apply to it.
- 4 If an enterprise is established with the joint investment of a state owned enterprise, a collectively owned enterprise, village and township governments and private persons but it does not become a state owned enterprise or a collectively owned enterprise because of this then these regulations apply to it.
- 5 If a state owned enterprise or a collectively owned enterprise is contracted to a private person then during the term of the leasing or contract it is not considered an NGE and the regulations do not apply to it. But if the two parties to the contract voluntarily observe these regulations they should be excepted from this provision. If when the term of the contract expires according to the agreement the property right of the enterprise belongs to the private person this enterprise becomes an NGE with effect from the day of its reregistration and these regulations apply to it.
- 6 NGEs are an important component of the socialist economy of our country. The government should protect their legitimate rights and benefits. When the legitimate rights and benefits of NGEs are encroached upon relevant government departments should help to eliminate the encroachment
- 7 The regulations will only apply to the administrative region of Borzhou city. If there is any inconsistency between these regulations and relevant laws and regulations or policies of

superior departments consultations should be held between relevant departments and an understanding should be reached; on such a basis the administrative region should give priority to the application of these regulations

II THE REGISTRATION OF ENTERPRISES

- 8 The organisation responsible for the registration of the enterprises is the county industrial and commercial administrative bureau.
- 9 Any citizen can apply to the enterprise registration bureau to set up a NGE according to the relevant laws and regulations of our country
- 10 A private person who applies to set up an NGE should meet the following requirements -
 - 1 he should have funds machinery and technology which is compatible to the scale of the planned enterprise
 - 2 he should have a fixed operating location
 - 3 he should operate within the scope formulated [in the registration document] or provided in national laws
- 11 The applicant can start his business only after registration and obtaining a licence. Those who start business without registration should become registered within 15 days after receipt of the warning notice from the enterprise registration organisation. Those who violate this will be fined Y200 - Y1000 according to the gravity of the offence and will be forced to stop the business.
- 12 After the establishment of the parent factory, if any branch factory with independent accounts and with independent operation is set up, the parent factory should register the setting up of this branch factory at the local enterprise registration organisation within 2 weeks. If the parent and the branch factory are under the jurisdiction of different enterprise registration organisations the parent factory should register the setting up of a branch factory at the local enterprise registration organisation of the branch factory within 3 weeks.
- 13 If the parent or the branch factory transfers to another location then within 3 weeks at the original site and 4 weeks at the new site it should register its transfer of site at the original enterprise registration organisation.
- 14 The separation or merger or transfer and any changes of an enterprise's scope of operation should be reregistered at the original enterprise registration organisation within 3 weeks.
- 15 If there is a temporary termination of production the enterprise should register this at the original enterprise

registraion organisation (ERO) 1 month in advance. The application for the temporary termination of production should include

- 1 the reasons for termination
- 2 the duration
- 3 the results of winding up the enterprise [the accounts?]

- 16 If during the temporary termination of production the enterprise again engages in operation it will not be considered as having terminated its production from the day of the termination.
- 17 When the enterprise is wound up it should cancel its registration at the original ERO within 15 days.
- 18 If the enterprise does not register or go through the registration procedures in articles 12 -15, and 17 it will be fined Y100 - Y500 according to the gravity of the offense.
- 19 The ERO cannot refuse an application for registration from anyone who has met the requirements. If the applicant does not agree with the decision of the ERO it can appeal to the superior Industrial and Commercial Administrative Bureau within 15 days. If the superiod ICAB does not give a categorical reply within 30 days it will be considered as accepting the appeal of the applicant. If the applicant does not agree with the decision of the ICAB it can appeal to the county people's court within 15 days

III ENTERPRISE BEHAVIOUR

- 20 The entrepreneur can name the enterprise with his own name or other names. Within the same ERO [area] others cannot use the already registered name to register or to operate in the same trade. If the enterprise is not organised as a company it should not use the word 'company' in its name.
- 21 The enterprise can apply to the relevant organisations for patents and registered trade marks according to the provisions of the patent law and the trade mark law of the PRC.
- 22 The enterprise can sign economic contracts with other economic entities according to the provisions of the economic contract law of the PRC.
- 23 The enterprise should open bank accounts in the designated bank or other financial institutions. It should do its best to put its financial transactions through the bank.
- 24 The enterprise should set up books of account, balance sheet, and profit and loss account according to the

provisions of the relevant accounting laws in our country.

- 25 The enterprise can decide on the number of management personnel, technicians and workers that it wants to employ or dismiss and the manner in which these are done.
- 26 When the enterprise employs management personnel, technicians and workers it should adhere to the principle of equal and voluntary consensus to sign labour contracts. The labour contract should include the following -
 - 1 the requirements and the quality and quantity of the labour of the employee
 - 2 the term of the contract
 - 3 working conditions
 - 4 rewards and welfare
 - 5 discipline
 - 6 responsibility for [consequences of] the violation of contract
 - 7 others
- 27 If a labour dispute happens in an NGEs it should be handled according to the Temporary Regulations for the Resolution of Labour Disputes in State Owned Enterprises
- 28 The NGE should buy life insurance for the workers who engage in industries or kinds of work which are detrimental to health or dangerous. The enterprises with the capacity to buy insurance of pensions for the employees should do so.
- 29 NGEs are not allowed to employ workers who are less than 14 years old.
- 30 The wage system and the distribution of profit will be decided by the enterprise itself. The part of the net profit of the enterprise that is used for personal consumption or dividends should not be more than 30%. Any part of the profit which is used for expansion of production will be subject to a 20% tax rebate.
- 31 The entrepreneur can make his own decisions on the disposal of his property. He can give, sell, leave as inheritance, or mortgage it either partially or totally. The entrepreneur can also form partnerships with others and can lease the enterprise or contract it to others.
- 32 If the entrepreneur leaves the property of the enterprise as inheritance or gives it as a present he has to pay inheritance and gift tax according to relevant regulations.
- 33 The bankruptcy of the NGE will be handled according to the provisions in the [state] enterprise bankruptcy law of the PRC.

IV SOLE PROPRIETORSHIP ENTERPRISES

- 34 Sole proprietorship enterprises are enterprises set up with personal investment and whose capital and assets belong to the private person. If the enterprise is set up jointly with the investment of family members it is considered as a sole proprietorship enterprise unless there is a partnership agreement among the family members. The enterprise obtained by a private person through various forms of property right transfer is also considered as a sole proprietorship.
- 35 The registration documents of the SP enterprise should include the following items -
- 1 the name and address
 - 2 the name and address of the entrepreneur
 - 3 the principles and scope of operation
 - 4 the amount of capital and how it is to be used
[or] the value of investment and the standards of its valuation
- 36 The owner of the SP enterprise can operate and manage the enterprise himself. He can also employ others to manage it.
- 37 The owner of the SPE cannot dismantle the enterprise at his own will before he has returned all the debts of the enterprise. The exception is if the creditor of the enterprise does not apply for bankruptcy proceedings.
- 38 The owner of the SPE shoulders unlimited responsibilities [for the liabilities of the enterprise]

V PARTNERSHIP ENTERPRISES

- 39 PEs are the enterprises jointly set up with the investment of 2 or more natural persons and are managed jointly by the partners. The property of the enterprise should belong to the partners.
- 40 The enterprise obtained by 2 or more natural persons by various forms of property right transfer is also considered a PE
- 41 The partners of a PE should not be more than 20. The partner of 1 PE cannot simultaneously be the partner of another PE.
- 42 When applying for registration the PE must show its partnership agreement. The partnership agreement should include the following -
- 1 names and addresses of the partners
 - 2 the investment, form and valuation
 - 3 the name and authority of the person responsible for the partnership
 - 4 the form of distribution of profit and losses

- 43 The PE can engage in economic activities within the scope of law. It has the right to sue and be sued in the name of the enterprise
- 44 All partners have equal status except the person responsible for the partnership. The actions taken by the person responsible for the partnership within his authorities will be considered as the action taken by the PE.
- 45 The authorities belonging to the person responsible for the PE cannot be exercised by other partners, otherwise the losses incurred would be shouldered by the partner doing so
- 46 The partners have the right to supervise the actions of the person responsible for the partnership. If the partners have voiced doubt about the behaviour of the person responsible for the partnership the person responsible should immediately stop his action and put the issue to be decided by all the partners.
- 47 Within the duration of the partnership any partner will not be permitted to transfer his stocks to a third party without the consent of all the other partners, with the exception that if the transfer happens among partners.
- 48 If any partner wants to withdraw he must inform all the other partners 1 month in advance and his withdrawal must be agreed by all the other partners. After the drawing up of accounts of the enterprise the withdrawing partner can take back his share. The physical assets, patents etc that the withdrawing partner originally invested in the enterprise can only be withdrawn in the form of cash
- 49 If a partner dies or becomes incapable of taking action he will be deemed to have withdrawn from the partnership, with the exception that if in the agreement an heir is named the heir can take his place.
- 50 As for the distribution of profit and losses of the PE, if there is an agreement, the distribution should be in accordance to the agreement. If there is no agreement it should be distributed in proportion to the partners' investments
- 51 If the partners have reached agreement only on either the distribution of profit or the distribution of loss, this proportion would be considered valid in regard of the distribution of whichever of these an agreement was not made.
- 52 The partners of the enterprise shoulder unlimited liability. The creditor of the PE has the right to ask for the payment of debt from any of the partners. [Even] If there is a provision in the partnership agreement that says one of the

partners does not shoulder responsibility for the loss beyond the amount of his investment he cannot be exempted from this unlimited liability.

53 After the clearing up of the debts of the PE the partner has the right to ask for compensation from other partners if he has paid more than he is responsible for.

54 In the following circumstances the PE can be wound up

- 1 with the unanimous agreement of all the partners
- 2 if the enterprise is declared bankrupt

55 During the time of application of bankruptcy the partnership enterprise cannot be dismantled because of the unanimous agreement among all the partners

56 Before dismantling of the PE it must complete the clearing up of the enterprise. Before the clearing up is completed any partner will not be permitted to require partnership property analysis [or to distribute partnership assets]

57 The clearing up of the PE should include the following items

- 1 the winding up of all the operational activities
- 2 collection of debts due to the PE
- 3 pay all the debts of the enterprise
- 4 return the investment of the partners
- 5 distribution of the remaining property

58 The payment of debts should be conducted in the following order

- 1 the salary of employees and labour insurance fee
- 2 tax due
- 3 bank loans
- 4 other debts

59 The person in charge of the clearing up of the enterprise should be all the partners. The partners can also invite other people to replace them for this task. The supervisor of the clearing up should be an appointed person from the county industrial and commercial administrative bureau

IV ANONYMOUS PARTNERSHIP ENTERPRISE

60 Anonymous PEs are established jointly with investment of named partners and anonymous partners. The named partner must be a natural person. The number can be 1 or more but less than 20. The Anonymous partner can be a natural person other enterprises with legal person status or township or village government

61 The total investment of the anonymous partner should not be

more than 30% of the total investment in the enterprise

62 The daily operation and management of the APE should be carried out by the named partners . The anonymous partner does not participate in the operational activities of the enterprise but at the end of each operational year he has the right to inspect the balance sheet of the enterprise and its operational and property situation.

63 The named partners shoulder unlimited liabilities for the enterprise . The Anonymous partners will share losses and profits according to the proportion of his investment

64 With the agreement of all the named partners the anonymous partners can transfer their stocks partially or totally to others or withdraw from the partnership

65 After the withdrawal of all the anonymous partners and with the unanimous agreement of all the named partners the APE can change into an individual partnership enterprise. This change should be registered at the original enterprise registration department.

66 With the consent of 30% or more of the anonymous partners a bankruptcy [can be] put forward against the anonymous partnership enterprise according to the enterprise bankruptcy law of the PRC.

67 Articles 41 and 45-53 in these regulations are applicable to the named partners of the APE.

68 In terms of the legal status of the APE article 43 applies.

69 The registration clearing up and dismantling of AP enterprises should be carried out according to provisions pertaining to individual partnership enterprises.

VII LIMITED LIABILITY ENTERPRISES

70 The number of founders of the LLE should be 5 or more

71 Before the registration of the enterprise the founders must formulate the founding charter of the enterprise. The enterprise charter should include the following provisions

- 1 name and address of enterprise
- 2 the aim and scope of operation
- 3 the total value of stocks, the total value of every kind of stock and the form of the stock
- 4 the way of subscribing stock
- 5 the authorities of the board of directors
- 6 the way of amendment to the enterprise charter
- 7 the way the enterprise puts out bulletins [notices for formation and bankruptcy]
- 8 the name and address of the sponsor

- 72 The stocks of the LLE should be divided into 2 parts namely pure stock and stock in the form of term bonds/securities. Those who hold pure stock are stockholders on the board of directors; those who hold stocks in the form of bonds are not. The number of stockholders on the board cannot be more than 30
- 73 Without the consent of the board, the stockholders on the board cannot transfer their stocks to 3rd person with the exception of transfer among board members
- 74 A stockholder on the board cannot withdraw his/her stocks from the enterprise if the enterprise is being wound up but the liabilities have not been settled, and otherwise without the consent of the board.
- 75 If stockholder on the board loses his ability to act or dies with the consent of the board of directors his hier can inherit his stocks
- 76 The stocks in the form of bonds can be inherited or freely transferred to 3rd parties. Such transfers should be conducted according the proper procedures
- 77 Before the total amount of accumulated dividends and interest on bonds that should be paid to the bondholders has reached the level of the total amount of original value of stock and the bank interest which would have accrued on the bonds, bond holders have the right to apply to withdraw their bonds. When withdrawing the bonds the enterprise will deduct the dividends and stock interest that the bondholder has already received and return all the money paid for the bonds and also pay interest according to the time deposit interest rate provided by the People Bank of China.
- 78 When the total amount of accumulated dividends and interest payable on bonds has reached the level of the total amount of original value and the bank interest that would have accrued on it this, the bond holder does not have the right to apply to withdraw his stocks. At this moment the bonds are converted into pure stocks
- 79 The stockholders who subscribed pure stocks through the manner provided in article 78 can become the stockholder on the board if he meets the standards for a stockholder on the board and if the number of stockholders on the board is less than 30
- 80 The board of directors is composed of all the stockholders on the board of directors. The major issues in the enterprise will be decided with 2/3 of the affirmative votes of the board.
- 81 The board should elect a chair or executive director who

will be responsible for the day to day work of the board. There should be provisions in the charter pertaining to the authorities of the chair

- 82 The meeting of the board should be held monthly. It should be called by the chair. Interim meetings can be held at the request of 1/3 of the directors
- 83 The stockholders not on the board should send a representative to be present at the meeting
- 84 Every decision of the board should be placed on record. The meeting records should record the discussion of the major issues, the main points of the decisions and the results of the vote and be signed by all the directors present
- 85 The board can recruit the manager of the enterprise to be in charge of the operation and management of the enterprise. A director can also be the manager
- 86 The director should be loyal to the enterprise, adhere to the laws of the state, the charter of the enterprise and the decisions of the board
- 87 Any director is not allowed to engage in the trade within the operational scope of the enterprise in the name of the enterprise for himself or for a third person. Otherwise the board of directors can see such trade as invalid and the losses will be shouldered by the person who caused this.
- 88 The stockholder conference of the limited liability enterprise should be composed of all the stockholders. The pure stockholders have the right to vote and the bondholders do not have the right to vote
- 89 The stockholders conference should be held annually and be called by the board. An interim stockholder conference can be called if the board thinks it is necessary or with the vote of 1/3 or more of the stockholders
- 90 The quorum of the stockholder conference is 2/3 of the stockholders who have the right to vote. The decisions at the stockholders conference will be passed with 50% or more of the affirmative votes
- 91 The authorities of the stockholders conference should include -
 - 1 to discuss and adopt the working report of the board and the development plan of the enterprise
 - 2 to inspect the financial situation of the enterprise
 - 3 to discuss and make decisions on the major issues in the enterprise
 - 4 to make amendments to and adopt the charter of the

enterprise

- 92 Every decision of the stockholders conference should be placed on record. The record should record the discussion of the issues, the major points of the decision and the results of the vote and be signed by the chair of the conference and the directors present at the meeting
- 93 The limited liability enterprise can be dismantled in the following circumstances
- 1 with the affirmative votes of 2/3 of the stockholders who have the right to vote
 - 2 with the approval of 3/4 of the main body directors [1]
 - 3 When the original term of the enterprise provided in the charter expires
 - 4 if the enterprise is declared bankrupt
- [NOTE [1] Main body directors = directors holding a majority of voting stock.]
- 94 Before the enterprise is dismantled it must complete the clearing up of the enterprise according to relevant provisions in article 57 and 58
- 95 The persons responsible for the clearing up of the enterprise should be composed of the members of the board. They can also be appointed by the board or the stockholders conference. The supervisor of the clearing up should be an appointed person from the industrial and commercial administrative bureau
- 96 When the people responsible for the clearing up have been chosen the creditors and debtors of the enterprise should be informed 1 month in advance [of the commencement of the clearing up process]
- 97 The people responsible for the clearing up should brief the stockholders conference about the process of their work at any time. The results of the clearing up should be handed to the stockholders conference for approval and recognition
- 98 All the stockholders of the limited liability enterprise should have limited property responsibility for the enterprise. The profits and losses of the enterprise should be distributed among the stockholders according to the proportions of their stocks
- 99 Limited liability enterprises can sue and be sued in the name of an independent enterprise

VIII APPENDIX

- 100 These regulations will come into effect on a date to be decided.

Appendix 5

The Fuyang Draft Insolvency Law
Draft Translation

JEISHOU COUNTY NON GOVERNMENTAL ENTERPRISES
REVITALIZATION AND BANKRUPTCY REGULATIONS
Trial stage

Draft Translation

- 1 These regulations are formulated in order to improve the performance of non governmental enterprises, strengthen the economic responsibility system, and protect the legal rights and benefits of creditors and debtors.
- 2 These regulations apply to all kinds of enterprises whose property belongs to non governmental entities ("enterprises").
- 3 When enterprises are not able to return their due debts they can be revitalised or go bankrupt according to these regulations.
- 4 The enterprise can apply for revitalisation or declare bankruptcy through a creditor who is owed at least one third of the total debts of the enterprise. If the enterprise applies for revitalisation or declares bankruptcy voluntarily it should provide relevant accounts and a list of creditors.
- 5 The local People's Court will be responsible for the jurisdiction of the case of revitalisation and bankruptcy in its locality.
- 6 If the People's Court accepts the case of revitalisation or bankruptcy which is brought by the creditor it should inform the debtor within 30 days and publish a notice and if the court accepts a case brought by the debtor it should inform the already known creditors within 30 days and publish a notice and in the notice there should be stated the time of the first creditors' meeting.
- 7 Within a month after the creditor has received the notice he should notify the court of the amount owned to him and those who do not receive a notice should do so within 3 months after the bulletin is posted. If after this period of time creditors have not done so this will be regarded as a voluntary renoucement of rights.
- 8 The creditors committee will comprise all creditors and the chair of the committee will be appointed by the court from among the major creditors. All the members of the creditors committee enjoy a vote with the exception of those creditors whose debt is the subject of a property guarantee and who have not given up their right to priority in the returning of the debt to them.
- 9 The debtor should be present at the creditors conference and

answer the questions of the creditors

- 10 The first creditors meeting will be called by the court and should be convened within the first month after the filing of the amounts of debts with the court. Other creditors committees or conferences will be convened when the People's Court or the creditors committee think it is necessary and can also be convened at the request of the winding up group or at the request of creditors who hold more than one quarter of the total debts which do not have a property guarantee. The creditors committee can appoint a working group to take charge of relevant issues between meetings
- 11 The authority of the creditors committee includes the verification of debts and decisions on the revitalisation programme or the bankruptcy winding up programme of the enterprise. When they make decisions on the winding up or the revitalisation programme the committee should inform the administrative office of the enterprise (if the enterprise has one) to participate in the meeting.
- 12 The decisions made at the creditors committee will be valid with more than one half of the affirmative votes of the participating creditors at the meeting together with the affirmative vote of those who hold more than one half of the total debts without property guarantee. The decisions of the creditors committee then applies to all creditors.
- 13 The creditors committee can reach a revitalisation agreement with the enterprise the content of which can include the delaying of the debts, the reduction of part of the debts, and the changing of the manager. If the enterprise under revitalisation has an administrative office the revitalisation should be sponsored by the administrative office.
- 14 The term for the revitalisation of the enterprise generally should not be more than 1 year. In special cases it can last 2 years at most.
- 15 During the revitalisation the enterprise should accept the supervision of the creditors committee and should hand in regular reports about the revitalisation to the creditors committee.
- 16 Under the following circumstances and with the decision of the court the enterprise should stop its revitalisation and declare bankruptcy and go through winding up procedures -
 - 1 if the enterprise refuses to carry out the revitalisation agreement;
 - 2 if the financial status of the enterprise continues to deteriorate and the creditors committee applies for the termination of the revitalisation;

- 17 If the term of revitalisation expires and the enterprise is still unable to return its debts according to the revitalisation agreement then the enterprise should go through winding up procedures.
- 18 If the debtor has found a guarantee and within the 6 months after its application for bankruptcy the debtor has returned all its debts then the enterprise will not be declared bankrupt.
- 19 Winding up of the enterprise will be sponsored by the winding up group appointed by the court. The winding up group should be established within 15 days after the court declares the enterprise bankrupt. Its responsibility is to take over the bankrupt enterprise and to preserve, clear up, value, dispose and distribute the property of the enterprise. The winding up group is responsible to the court.
- 20 Bankrupt property will comprise the following -
 - 1 all the property that the enterprise has when it was declared bankrupt;
 - 2 the property that the enterprise acquired between the period from the declaration of bankruptcy to the termination of the bankruptcy process;
 - 3 other property rights within the control of the enterprise;
 - 4 other property belonging to any unlimited liabilities debtor between the period when he declared bankruptcy to the termination of the process except the basic or necessary living and production materials.
- 21 When the court has taken over the case of revitalisation and bankruptcy the debt that is partially returned by the debtor to some of the creditors is invalid/prohibited [?]
- 22 From six months before the court accepts a case of revitalisation or bankruptcy to the day when the bankruptcy clearing up is declared the following actions of the debtor are prohibited -
 - 1 to hide or privately distribute or to transfer property free of charge
 - 2 to sell its property at an abnormally low price
 - 3 to provide property guarantees to the debts that originally did not have such guarantee
 - 4 to return debts which are not due
 - 5 to give up its own rights as a creditor.

The winding up group has the right to chase back these assets and the property recovered will be part of the bankrupt property.

- 23 With the bankrupt property the enterprise should first pay the bankruptcy fees and then make its payments in the

following order -

- 1 the salaries of employees, and the labour insurance fee
- 2 the taxes of the enterprise
- 3 the debts

If the bankrupt property cannot cover all the 3 items then those 3 items will be paid according to a proportion. The creditors who enjoy a property guarantee should enjoy priority in getting the payment for the debt in the proportions paid to creditors.

- 24 When the distribution of bankrupt property finishes then the winding up group will apply to the court for the termination of the bankruptcy process. After the termination of the process those debts which have not been repaid will not be repayable.
- 25 If the enterprise has taken any action listed under article 22 and this has been discovered within 1 year after the termination of the bankruptcy process its property will be chased back by the court and it will return the debts according to article 23, and if the enterprise violates the law then it will shoulder legal responsibilities.
- 26 After the termination of the bankruptcy process the winding up group will cancel the registration at the original office.
- 27 The person directly responsible for the bankruptcy of the enterprise cannot continue to have major responsibility for any enterprise and cannot set up any enterprise within 3 years after the termination of the bankruptcy process. Administrative departments can note the bankruptcy on the records of the person directly responsible and can punish them administratively. If the person responsible has violated the law then he should shoulder legal responsibilities.
- 28 These regulation will come into effect as a trial from April 9 1988.
- 29 The regulations will be explained by the Standing Committee of the Peoples Congress of Jeishou County.

Appendix

Reference to relevant articles in civil law of PRC -

Art 45 : the legal person status of the enterprise will be ended according to the following

- 1 if the enterprise is cancelled according to the law
- 2 if the enterprise is dismantled
- 3 if the enterprise declares bankruptcy under law

4 other

.....

Art 49: if the legal representative of the enterprise does any of the following actions the legal person should shoulder responsibilities and the legal representative can be administratively punished or fined or if he commits crime should shoulder legal responsibility -

.....

3 to embezzle capital, hide property in order to escape payment

4 after dismantling or cancelling or declaration of bankruptcy the enterprise disposes of its property according to its own will.

Appendix 6

State Planning Commission Document 139 of 1988
Views on Restructuring Industry

Draft Translation

STATE PLANNING COMMITTEE
document 139 of 1988
VIEWS ON RESTRUCTURING INDUSTRY AND THE STRUCTURE OF PRODUCTS

Draft Translation

Addressed to the planning committees/commissions at provincial level, autonomous zones, municipalities under the central government and cities under provincial administration which are specially listed on plans. Relevant departments of the state council and agencies directly under the State Council

Introduction

The rational restructuring of industry determines to a considerable degree future economic development and future economic efficiency. One important shift in the functioning of planning management is to formulate and implement industrial policies so as to stimulate rational structures. This task has already attracted attention from various parties concerned. The rationalisation of industrial structure is a long term task but we should start now.

The present restructuring of industry should have as a goal the economic development strategy determined by the 13th Party congress. It should take as guidance the 7th 5 year plan and the annual plans. It should take as the foundation the present structures of industries and should take as reference the market situation both abroad and at home. In accordance with these principles the state planning commission has met with relevant agencies to analyse the industries and products that are problematic and has distinguished various situations and has presented views to support, restrict or prohibit so that through discussion all parties concerned will reach consensus to further formulate specific policies so as to take coordinated measures to go in the same direction and to achieve coordinated actions. These views are stated as follows so that all the agencies addressed can make further studies and organise implementation.

1 VIEWS ON KEY SUPPORT TO INDUSTRIES AND PRODUCTS

Agriculture, the energy industry, transport and communications, and the raw material industry are conspicuous weak links in which increases in productivity are relatively difficult to achieve. Therefore they are key areas to be supported. Light industry, textiles, machinery products, electronic products and products for export (see annex for details), all of which are in short supply, cannot enjoy further increases in production for various reasons. Some because of energy or raw material shortages, some because of transport difficulties, some because of a lack of production capacity. Different situations should be identified so that appropriate measures can be adopted to promote development.

Attention can be given to encourage military enterprises and TVEs to produce such products.

In the past much research has been done to identify those key industries and products which should be supported, much attention has also been given to such support. Supportive policies and measures have also been formulated. In future, examinations should be made to monitor the implementation of these policies and measures in various circumstances; the measures should then be further supplemented and perfected to enable these industries and products to adapt or adjust to market demand promptly.

2 INDUSTRIES AND PRODUCTS THE DEVELOPMENT OF WHICH IS TO BE RESTRICTED

1 The further expansion of productive capacity should be restricted in those industries in which the capacity to process raw materials is greater than the supply of these raw materials (even though final demand in the market for the products exceeds productive capacity) and in which this problem is unlikely to be alleviated.

These industries mainly include aluminium products, common plastic products, woolen textiles, assembly lines for refridgerators and colour TVs, washing machines (excluding enterprises in coastal areas importing raw materials and exporting products) and [the construction of] restaurants, opera halls, and grand office buildings. In dealing with such industries/products, firstly

- no new approval should be made for the start of construction.
- Those already approved as a project but in which work has not started should be firmly cancelled
- On those which work is started but not completed, a change of use should be made.

Secondly banks should not provide funds

- for those projects outside the Plan that once built and completed and put into operation will have no guaranteed supply of energy or raw materials,
- or for those construction projects that are planned to be executed using their own capital.

Thirdly, those projects in which construction continues in violation of regulations should be stopped and those concerned held accountable.

Fourthly, those construction projects that would build new or renovate or unnecessarily improve offices, opera halls, tourist restaurants, should be wound up.

2 In those industries or products that have low levels of

technology, that have weak market demand, that have surplus productive capacity, integrated and comprehensive means should be used to raise the quality of the products, move enterprises into quality lines (for higher incomes), or convert to other products.

Such industries include very common artificial leather, low quality liquor, watches for men using mechanical mechanism, unfamous sewing machines, unfamous bicycles, low quality fans, low level recorders, low level computers, multipurpose machinery, and special purpose machinery produced at low technology level.

Dealing with such industries/products,

- firstly industrial and commercial department should draw up a list of products for restriction,

- secondly, banks should meet responsible departments of such enterprises to work out together the average turnover period of working capital and a quota/ceiling should be calculated for maximum stockholding. Those who exceed such ceiling the bank can take the initiative to raise loan interest rate, even to cease making loans.

- Thirdly, government departments at all levels should stop giving subsidies to the products that have weak market demand and the products that are virtually at end of their life cycle. These government departments should guide the enterprises in their conversion to other purposes.

3 Very firm restrictions or restructuring policies should be adopted for those industries or enterprises that have undesirable locations, that have undertaken construction mindlessly, gone into production without a plan, and which have poor technology and/or consume unnecessary amounts of raw materials, or which pollute the environment, or which have low social or economic efficiency.

Dealing with such industries/products,

- 1 the government departments responsible should formulate and promulgate as soon as possible economic and technical criteria for enterprises of various size.

- 2 for those construction projects that do not conform with stipulated or standard criteria, approval should not be given to the start of work. Banks should not give loans; for those projects already in operation, renovation or restructuring should be required and a deadline set for this. For those that do not complete such renovation or repairs by the deadline, administrative and economic sanctions should be used to stop production.

- 3 The production departments and supply and marketing departments should have a tight grip over the production equipment so as to prevent the proliferation of equipment which is no longer economically useful.
- 4 For those products that, although they enjoy great demand, but which nevertheless are not suitable to China's present level of consumption and industrial structure, a variety of means should be adopted to restrict a wild development, to restrict them in a planned way, and to give adequate guidance to the consumption of such products.

These products mainly include ring-top canned drinks, air-conditioners, and video tape recorders. In dealing with such products, firstly, the purposeless expansion of their production capacity should be restricted, in the case of projects already submitted for approval - approval should be made strictly in accordance with the seventh 5 year plan. No approval should be given to any project which has not been included in the plan. Secondly administrative and economic means should be taken to restrict their production and consumption. Thirdly, trade departments and customs departments should issue licences for import of raw materials in accordance with the plan of the responsible agencies of the relevant trade. Fourthly for those enterprises which have already built their own production capacity, encouragement should be given for those enterprises to become export enterprises so that they achieve foreign exchange self sufficiency so that they can import in order to foster export.

The various special economic zones should propose restructuring plans that are suitable to their own characteristics in accordance with the development ideas of the central government and their local circumstances so that the construction and development of special economic zones will conform better with the rationalisation of industrial structures.

In order to guarantee the smooth progress of restructuring of industry and products the State Planning Commission will organise relevant departments to elaborate and adjust the following industrial policies -

- (1) to increase input into agriculture and to encourage industries to support agriculture
- (2) to optimise local industrial structures
- (3) to assist assimilation, absorption and innovative introduction of imported/new technology
- (4) to support TVEs to engage in exporting products produced by labour intensive operations and also policy to give guidance to TVE development
- (5) to stipulate rational ceilings for storage and to implement differential loan interest rates;

(6) to encourage co-ordination between complementary industrial sub sectors to carry out rational mobility of factors of production and to promote horizontal connections between enterprises

(7) to encourage military enterprises to produce civilian products

(8) to implement differential interest rates for loans for fixed assets in accordance with the requirements of industrial restructuring .

The State planning commission will also organise relevant departments to coordinate the following specific policies -

1) to continue to improve the development of electricity power industry

2) to alleviate the very intensively used rail routes and to achieve the potential of road and water transport

3) to accelerate the development of 'short line' metal products

There are other numerous specific policies which this document hopes that the various localities and departments at various levels will actively compile and report on. It is also hoped that these localities will make policy suggestions that they believe are needed to be formulated organised and coordinated by the state.

Formulating and implementing industrial policies is a very complex task. It involves the particular interests of all parties and therefore requires close coordination of all the localities and departments involved so that the task of restructuring industries and products can be carried out smoothly.

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Annex: Catalogue of the industries and products that are to be restructured at present.

1 Industries and products that will be given key support

1.1 agriculture - grain, cotton, meat, eggs, poultry, oil seeds, sugar crops, sericulture, vegetables, quality tobacco

1.2 forestry - dry and fresh fruits, fast growing wood,

1.3 coal mining and coal washing, - raw coal

1.4 oil and natural gas exploration - crude oil, natural gas

1.5 ferrous mining and extraction - pig iron ores

1.6 non ferrous metal mining and extraction - non ferrous ores

1.7 salt mining - sea salt, well salt and mined salt

1.8 food beverage and tobacco industries - sugar and beet and starch sugars [] citric acid and other [natural] food additives good quality liquor and cigarettes

1.9 garment industry - garments (above average level)

1.10 timber processing and bamboo, palm products, straw products and [] products industries

1.11 paper making and paper products industries - pulp, paper

- produced by machines, paper board
- 1.12 electric power, steam and hot water supply - electricity power generation and supply, steam and hot water production and supply
- 1.13 petroleum processing industry - primary, secondary and 'deep' processing
- 1.14 charcoal making, coal gas and coal products industries - charcoal production (machine charcoal) coal gas production and supply of carbonised products
- 1.15 chemical industry - chemical mining, basic chemical, chemical fertilizer, organic chemicals, dyes, and refined chemical products, chemical pesticide and herbicides, synthesised [], synthetic rubber, synthetic fibres, synthesised single and multiple fibres [], and other synthetic materials, [], [], [=fibres], timber products (resin) and [glue], [glue]
- 1.16 chemical fibre industry . . .
- 1.17 plastic products
- 1.18 building material and other non metal mining products and large and small scale cement, new wall paints, waterproof material, floating glass making, charcoal element products, non metal mining products basic building for export
- 1.19 ferrous metal smelting and rolling
- 1.20 non ferrous metal smelting and rolling
- 1.21 machinery industry
- 1.22 transport industry equipment (high level absorption of new technology)
- 1.23 electronic machinery and apparatus manufacture
- 1.24 electronics and communication manufacture (supporting high level import substitution/localisation)
- 1.25 public utility industry - gas water etc

2 INDUSTRIES AND PRODUCTS TO BE DEVELOPED IN CONTROLLED WAY

2.1 Those products whose processing capacity greatly exceeds raw material supply and which will do so for some time and the products for which processing capacity greatly exceeds demand will be restricted from further expansion of productive capacity and mainly include -

- food beverage and tobacco
- textiles (special products)
- chemical industry (special products)
- petroleum processing (special energy consumers) (special restriction on remote areas, small or low technology refineries)
- plastic products
- building material and other non metal extractive industries (eg small cement plants < 20,000 tons, small glass,...)
- ferrous metal processing (small, poor in technology)
- non ferrous metal processing (small, poor processing)
- metal products industries (eg ring pull cans, bulk freight containers)
- machinery industry (ordinary metal cutting, medium and big tractors, movie machinery, certain office equipment,

transport equipment - steam locomotives
electric (washing machine, domestic fridge, luxury domestic electronics)

2.2 The restriction on the amount of production has to be imposed on those products with weak demand, low quality, not selling well. These include

food beverage and tobacco- low quality liquor, small cigarette plants
Textile industry - small cotton mills
education and sports articles - manual organ
chemical industry - black and white film materials
plastic industry - ordinary artificial leather
machinery - large mechanical watches, non famous sewingmachines
transport industry - non famous motorcycles
electric machiney and apparatus - low quality electric fans
electronics and communciations - radios, low quality recorders, small calculators (except import substitutes)

2.3 Products for which there are explicit provisions from relevant state departments for abandonment - provisions for prohibition, technology low, energy high, polluting, low economic or social efficiency.

2.4 The industries and products that are to be controlled from the point of view of achieving economies of scale. These are industries and products that are planned by state, including

automobiles
silicon chips/intergrated circuits
optical fibre communication equipment
programme control phones
phone exchange equipment
cathode ray tube for colour TVs
compressors for fridges

Appendix 7

Updated Policy Reform Matrix

Recent Actions

C. 1988 (May-Sep)

- Private Enterprise law implemented in July
- New regional reform site announced at Zhou Cun, Shandong
- Control over bank credit to TVEs introduced

Intended Actions

A. 1988 (May-Dec) - 1989

[continued] . . .

- Reform the financial system and expand financial services to TVEs
- Encourage inter-enterprise investment, joint stock arrangements and other ownership forms
- Formulate industrial policies and adjust the industrial structure of TVEs

Appendix 8

Meetings and Field Visits During the Supervision Mission

BEIJING

Presentation and Discussion

Du Reng, Director Development Institute, RCRD

Meetings

Hu Zhuangjun, Deputy Director for Industry and Enterprise, Development Institute, RCRD

Ran Mingquan, Deputy Director for Fuyang EZO within RCRD

Bi Mingjian, RMC

FUYANG

Briefings

Sun Kongwen, Director EZO, and EZO staff

Field Visits

Vehicle Repair Workshop

Joint venture clothing enterprise

TVE Training School

TIEHE

Industrial Zone,

NGFA,

Plastic Fibres enterprise

JEISHOU

Gwang Wu Industrial and Commercial Zone,

NGFA,

Plastic Balloon Factory

Shu Gwang Food Processing Factory

BORZHOU

Traditional Medicine Market

Medicine Wholesaling TVE

NGFA

Two liquor TVEs and State liquor factory

Project team for commercialising town centre streets

GWO YANG

Industrial zone and NGFAs

MENGCHENG

Mining tools factory

Industrial zone and NGFA

Mill, Plastic recycling, Fuel blocks, and Shoe enterprises

Appendix 9

Corrected Appendix to Annex 1 of Working Paper 5 of
Red Cover Volume II

NOTE The appendix to annex 1 of working paper 5 as reproduced in the Red Cover volume II omitted projects B1.1 to B2.2. The section omitted is attached here.

PROJECT		YEAR		1987				1988				1989			
No.	Name/stage	Quarter		1	2	3	4	1	2	3	4	1	2	3	4
B1.1 CHARTERS FOR ENTERPRISES															
	approval					x									
	implement					x									
	investigate extension									x					
	extend														no date set

PROJECT		YEAR		1987				1988				1989			
No.	Name/stage	Quarter		1	2	3	4	1	2	3	4	1	2	3	4
B1.2 NON GOVERNMENT ENTERPRISE TO WHOLESALE MEDICINE															
	report on selected enterprises					x									
	authorisation					x									
	begin									?					
	evaluate												x		
	extend														x

PROJECT		YEAR		1987				1988				1989			
No.	Name/stage	Quarter		1	2	3	4	1	2	3	4	1	2	3	4
B1.3 FINANCIAL SERVICES INSTITUTIONS															
project (a)															
	approval					x									
	start					x									
	evaluate						x								
project (b)															
	approval					x									
project (c)															
	approval									x					
project s (d) - (f)															
	approval by												x		
	extionsion														?

PROJECT		YEAR		1987				1988				1989			
No.	Name/stage	Quarter		1	2	3	4	1	2	3	4	1	2	3	4
B2.1 INSOLVENCY AND REVIVAL OF ENTERPRISES															
	approval						x								
	begin investigations									x					
	report										x				
	monitor												x		

PROJECT		YEAR		1987				1988				1989			
No.	Name/stage	Quarter		1	2	3	4	1	2	3	4	1	2	3	4
B2.2 RABBIT MEAT PRODUCERS' ASSOCIATION															
	begin investigations										x				

CHINA

RURAL SECTOR ADJUSTMENT LOAN

POST-EFFECTIVENESS SUPERVISION MISSION

Rural Investment and Finance

by- Ramesh Deshpande (AS3AG)

RURAL SECTOR ADJUSTMENT LOAN

RURAL INVESTMENT AND FINANCE

1. Introduction. Reform of the rural investment and finance system is one of the main features of the Government's new (second phase) reform program. Its main objective is to increase the efficiency of government investments, establish new financial channels, improve rural financial institutions' operational policies and procedures, and promote expansion and diversification of rural financial services

2. During the recent RSAL supervision, the mission reviewed with the Research Center for Rural Development (RCRD), the major developments in the reform of the rural investment and finance system, with reference to the government proposals outlined in paras. 30-33 of the policy letter (see, Annex 4 to MOP). Specifically, the topics reviewed included: the role and functions of the recently established sectoral investment corporations; the performance of Guanghan (Sichuan) and Fuyang (Anhui) regional reform programs in rural finance; and the progress in the operations of the China Agribusiness Trust and Investment Corporation (CATIC).

3. Concurrently, on September 16, the mission made a presentation on the current issues in rural finance to the RCRD staff in Beijing. Later, on September 24-25, the mission participated in the Rural Reform Workers Conference at Meitan (Guizhou), and made a brief presentation on land banking concepts and institutions. Land banking is being introduced on an experimental basis in Meitan county as a part of the ongoing regional reform program in Land Management System. At the wrap-up meeting held on September 28, the mission discussed, among other matters, its main findings and the follow-up actions needed on RSAL proposals concerning rural investment and finance. The mission also later discussed with RCRD staff, the question whether the Bank should conduct a sector work in rural investment and finance, to assist in the government's ongoing reform effort in these areas. RCRD staff seemed to be keenly interested in this proposal, subject to modalities to be worked out during the next supervision. The mission's main findings and recommendations are summarized below.

Rural Investment.

4. Reorganization of Key Ministries. 1/ In late 1987, the State Council proposed for approval by the National People's Congress, a reorganization of key ministries of the Central Government and establishment of sectoral investment corporations, to improve the efficiency of the state investment system. These proposals were approved in April 1988. The Government has since completed much of the proposed reorganization. It has merged the State Economic Commission (SEC) and the State Planning Commission into an expanded State Planning Commission (SPC) and established six State Investment Corporations(SICs), one each in energy, communications, manufactured products, raw materials, agriculture, and forestry. The key objectives of the state investment reform are: to effectively separate the state investment budget (and its accounting and management) from the recurrent budget, both previously administered by the Ministry of Finance; and to increasingly shift the responsibilities for financing of public expenditure to China's local enterprises and communities. Broadly, the Government investment budget will be divided into two parts: revenue generating (commercial) and non-revenue generating investments. The newly established SICs would undertake the revenue generating projects, while nonrevenue generating projects would be handled by the line agencies (ministries and bureaus). SICs would enjoy considerable autonomy in decision-making on individual investments. As for resources, in addition to budgetary funds, SICs would issue bonds and borrow funds from the local banks, and bilateral and multilateral agencies. SICs would use three main mechanisms for financing projects: loans to project entities, investments in stocks and shares issued by enterprises, and direct investments.

5. State Investment Corporations. One of the important institutional objectives of SICs is to ensure improved cost recovery of government investments, which in the past had been generally poor. Depending upon the financing mechanism used, SICs would recover the investment costs through loan repayments (principal and interest), dividends on shares and equity, and profits remitted by enterprises. SICs would repay government budgetary loans from the funds so generated, subject to the overall cash flow of the projects financed. It is intended that once the government loans are repaid, SICs would formally transfer the ownership of these projects to the Government as "state properties". However, in this arrangement, the state would allow SICs to retain a part of their annual profits/dividends as government contributions to their equity and working capital. SICs would use these funds for financing commercial investment. Government also proposes to set up a Fund for capital construction, from the loans repaid by SICs and recycle these resources for financing new investments (Source: China Daily, Sept.11, 1988). Financial management of SIC is still a evolving subject and some of the concepts outlined above might undergo changes as the SICs commence their operations.

1/ Includes comments provided by Messrs. R. Burcroff (AS3AG) and J. Goering (RMC) and the minutes of their meeting with SPC and agriculture and forestry corporations.

6. Although SICs would enjoy considerable autonomy in investment decision-making, the line agencies would continue to play an important role in defining their investment priorities and review of larger investments. The SICs have generally established their investment priorities for 1989 and 1990, in which agriculture is expected to receive high overall priority. (The proportion of agricultural investment in total capital construction investment for 1987 increased to 4.8% from 1986's 3%). Within agriculture, the government proposes to give priority to water resource development, construction of important grain-base areas, and windbreak or shelter projects to contain soil erosion in North China. It remains to be seen how these priorities would get reflected in actual resource allocation, especially in the context of the currently difficult macroeconomic environment, characterized by government effort to contain inflationary pressures. There are also competing claims for larger resource allocation by different ministries. Following the mandate given by the Third Plenary Session of the 13th Central Committee of the Communist Party of China (CPC) (September 28-30, 1988), the Government is initiating a series of measures to slow down the burgeoning industrial growth, scale back the overextended capital construction, exercise further controls over the expanding money supply and the amount of credit available, and hasten the reform of enterprises. Against this background, how agriculture would be treated in terms of priorities and resources, remains to be seen. This should be one of the major concern of the next RSAL supervision.

7. For revenue generating projects that would fall within SIC operations, the review and approval procedures are expected to be divided into three main categories--thresholds to be defined-- with decreasing state involvement as the project costs become smaller.

(i) For very large projects requiring the State Council approval, and those within SPC's discretionary authority, the SPC will review and vet the project establishment report, project feasibility study, and project construction report;

(ii) For the State-financed projects, if the project cost is below the State Council and SPC's thresholds, the line ministries (for non-revenue generating projects) and SICs (for revenue generating projects) can independently approve the feasibility studies. SPC approval will, however, be needed for the project establishment and construction reports. The same principles will be applied to locally financed projects beneath SIC/SPC thresholds. However, all thresholds are likely to be differentiated by sector.

(iii) Two other thresholds will be applied to smaller investments by SICs.

(a) one for a limited number of very small projects which the SICs can review and approve without referring to higher authorities, and

(b) one which is smaller than the SPC thresholds, but higher than SICs' independent review/approval authority, where

relevant documentation must be referred to concerned line ministries prior to the approval of a project.

8. Project approval procedures, and the policy and operational jurisdictions of line ministries and SICs are still being worked out and many details remain to be decided. SPC and SICs are in the process of developing proposals for training of their staff in investment appraisal. The next RSAL supervision mission should discuss with SPC and SICs (dealing with agriculture and forestry) to explore whether the Bank can support this effort through the likely RSAL II or any other suitable mechanism.

9. Agriculture and Forestry Corporations. All the six sectoral SICs would play an important role in China's rural development, but of more direct relevance to the Bank's lending to agriculture and forestry will be the State Agricultural Investment Corporation (SAIC) and the State Investment Corporation for Forestry (SICF). Currently, the main channels for Bank Group funds are the line ministries, and national and provincial bureaus, provincial Agricultural Development Corporations (ADCs) and the Agricultural Bank of China (ABC). For the forestry projects, the Forestry Ministry and the provincial bureaus are main channels. Both SAIC and SICF have expressed their intention to approach the Bank Group for resources. This has important implications to both the Bank's future lending to agriculture and forestry, and the institutional arrangements for their implementation since both SAIC and SICF could possibly implement the projects on their own or supplement the existing institutional arrangements. An early involvement by the Bank to assist SAIC and SICF in defining their institutional goals and strategies, and preparing an organizational and management framework for project implementation seems essential. One way to provide such assistance could be to include this task in the likely RSAL II operation (para. 8).

10. The State Agricultural Investment Corporation. SAIC has been registered with an initial capital of Y400 million of which \$20 million will be in foreign exchange. It would operate as an independent economic entity responsible to the State Council on policy matters but operationally to the Ministry of Agriculture and SPC. About 80% of SAIC's operating funds in early years are expected to come from the capital construction funds formerly earmarked for MOA. SAIC, as noted, has been authorized to raise additional funds through bank borrowings and bond issues. Contrary to the earlier government proposal, SAIC is not expected to receive any resources from the new land conversion tax. SAIC is exploring alternate sources of funds, including possible Bank Group assistance (para. 9)

11. The State Investment Corporation of Forestry. SICF has been established with a registered capital of Y400 million and \$20 million. It seems that SICF would focus on wood processing and furniture making investments: to quote SICF's President Mr. Wang Lixin, "we must not limit our business to planting and felling trees...we must broaden our business scope to include profitable wood processing industries such as paper and furniture making and extracting chemicals". During 1989, SICF plans to establish four major forestry regions (?) in the Northeast and construct four factories for making wood panels, and paper and pulp.

12. Proposed Follow-up. The next RSAL supervision should focus on the following: (a) review the steps taken by the government to make the SAIC and SICF operational, and by SAIC and SICF to develop business plans, resource mobilization arrangements, and organizational and management systems for project appraisal and implementation; (b) further discuss with SPC, line ministries, SAIC and SICF, jurisdictional questions mainly to clarify the Bank's role in regard to financing investment projects handled by different agencies; (c) ascertain the likely nature of provincial governments' participation in SAIC and SICF operations, whether SAIC and SICF would establish provincial and lower level branches, and the likely relationship between SAIC and SICF, and the provincial Agricultural Development Corporations; and (d) explore how the Bank should assist the government in defining the role, operational policies, resource mobilization and investment strategies, and institutional development of SAIC and SICF. This review would also help to identify SAIC's and SICF's investment programs suitable for Bank assistance and the core issues and institutional strategies in rural sector investment planning which should be addressed through the likely RSAL II.

Regional Reform Programs in Rural Finance

13. Since the RSAL appraisal in February-March 1988, the regional reform programs (RRPs) in rural finance have made good progress; however, further initiatives are currently constrained by the difficult money and credit situation. The financial sector is going through a painful adjustment process, in response to the severe credit curbs imposed by the People's Bank of China (PBC), and the upward revisions in interest rates on deposits and loans effective September 1, 1988. These measures (aimed as they were at containing the inflationary pressures in the economy, encouraging financial savings, and depressing excessive loan demand), have placed the banks under considerable pressure to adjust their loan portfolio in terms of both yield and maturities, and handle resulting liquidity problems on a priority basis. Recent interest rates adjustment involves indexing of rates on deposits for three years and more, which is not backed by indexing of interest rates on loans. Indexing of interest rates on deposits was intended mainly to halt a run on the banks during August 1988, attributed to the people's expectation of a sharp hike in prices of consumer goods and durables. The banks are still unclear how the likely increases in interest costs of deposits adjusted for inflation should be met. The banks expect that possibly, the Ministry of Finance would come forward with a subsidy scheme to compensate the banks, which would be a major setback to the process of interest rate reform pursued by the government during the past few years. Ideally, adjustment in deposit rates must be matched by adjustments in lending rates. Against this background of uncertainty and concern, the reform of the financial sector has generally slowed down, and as for the reforms that have been introduced, the impact would be much less than anticipated. At this time, PBC is taking a cautious approach to further diffusion of the financial sector reforms, and has, in fact, placed an embargo on establishing new investment and trust companies and nongovernmental financial intermediaries.

14. Proposed Initiatives under RSAL. Government's policy letter

to the Bank (Annex 4 to MOP) mentioned that during 1988 and 1989, it would take the following actions under RSAL: (i) make CATIC operational and begin financing of the reform-oriented investment projects, mainly in the coastal region; (ii) introduce reform of the specialized banks and RCCs in several regions based upon monitoring of performance under the Guanghan (Sichuan) RRP; and (iii) establish and revise, as necessary, trial regulations to facilitate an orderly expansion of nongovernmental financial associations (NGFAs). During 1988, the Government also intended to initiate a general review of rural financial market policies and formulate guidelines for strengthening the ongoing reform processes. Results of this review were expected to become available by the end of 1989 (paras. 30-33 of the policy letter). The progress in, and the government plans for implementation of the above programs are reviewed below.

15. China Agribusiness Trust and Investment Corporation (CATIC). CATIC was established in 1987, as a nonbanking financial institution (a joint stock company) with the primary objective of acting as a catalyst in financing reform-oriented projects, in collaboration with local and overseas financial and nonfinancial agencies (for details see, paras. 5.19-5.25 and 6.2 of the Working Paper No. 7 in the Loan Implementation Volume). The rationale for CATIC which is multifold, remains substantially unchanged but specific initiatives which CATIC intended to take in the sphere of the financial sector reform are likely to be delayed in view of the current uncertainties in the financial sector (para. 13).

16. The main activities envisaged for CATIC include the following: CATIC should (i) complement the services provided by the existing rural financial institutions, with emphasis on expanding longer term finance and technical assistance; (ii) provide support services to enterprises for more efficient procurement and marketing of goods and services; (iii) demonstrate new systems in enterprise ownership, organization and management, technology applications, product marketing, financing of fixed assets and working capital, funds management, and cost recovery; (iv) assist in the development of rural trust and investment corporations and nongovernmental financial associations; and (v) offer longer term loan funds through refinancing, rediscounting, equity participation and joint ventures. CATIC was to begin to tap resources previously held by communes (now being reconstituted as cooperative foundations) for the limited purpose of managing their funds.

17. During the supervision, the mission reviewed the progress made by CATIC to become operational. The mission's findings and conclusions are as follows.

(i) Institutional and Business Development. CATIC has made a rapid progress both in regard to developing its organization and business. It has hired some 100 well-qualified staff and established three service departments (Planning and Finance; Personnel and General Administration; and External Affairs) and several departments for business operations including: Banking, Domestic Business (Investments), Overseas Business, World Bank Loan Office, Real estate, Information Center, and Research and Consultancy Department. CATIC has also established a subsidiary, "CATIC Trading Company" to undertake

marketing of key commodities and a South China Corporation (in Guangdong) for investments in enterprises. CATIC has acquired a controlling interest in Hebei Flying Dragon Company (engaged in broiler production) and would soon begin, through its real estate department, to undertake projects for developing commercial and industrial estates for subsequent sale to enterprises. CATIC has bought a well-known Huader Foodstuffs Corporation in Beijing (74% ownership) which was established in 1984 to utilize food processing equipment imported from France. CATIC is in the process of establishing the "Beijing Breeding Company" to produce GP poultry stocks, a joint venture in which U.S. (Avian Farms International Ltd.) and Thailand parties are expected to participate. CATIC is negotiating the acquisition of Sanjian Food Stuffs Co. which specializes in soybean protein production. Negotiations are also underway to take over majority stocks in Guangxian State Farm in Jiangxi province and possibly YaYa Enterprise in Beijing), with the aim of establishing a powerful Meat, Chicken and Soybean Protein Group, with a capability to influence the market in these commodities. CATIC is also planning to enter amino acids production to support the local feed industry.

(ii) Financial Aspects. During the first six months of its operations, CATIC has invested about Y750 million (\$200 million) in various projects, and made a profit of Y40 million. CATIC resources include initial equity of Y200 million and \$10 million, trust deposits of Y300 million, interbank borrowings of Y100 million and short-term loans from PBC of Y50 million. CATIC's lending target for CY88 is Y 1 billion. Recent government reorganization has helped CATIC to mobilize large resources in a relatively short period. Some of the newly-created autonomous agencies do not have the trained staff to manage their funds on a day-to-day basis and CATIC is filling this gap by providing integrated financial services to these agencies. Some of the government ministries have also turned to CATIC to seek support for management of their funds on a loan basis; for example, CATIC now manages the Government's Technical Renovation Funds for energy development. In the past, most ministries used to disburse budgetary funds to different projects without cost-recovery requirements and interest obligations, i.e. generally on a grant basis. CATIC does not carry any risk on investments made out of trust funds designated for specific purposes, but it does assume risks if the trust funds are not designated and investment decisions are the responsibility of CATIC.

(iii) CATIC's role as a promoter of rural financial intermediation. According to its institutional objectives (para. 15), CATIC is expected to serve as a lead or promotional agency (not a regulatory agency which is the People's Bank role), for rural investment and trust corporations and nongovernmental financial associations and support their development. Any major initiatives in these spheres in the near future are, however, unlikely due to currently difficult money and credit situation (para. 13). As noted, the People's Bank has placed a ban on setting up new financial institutions (para. 13) and clearly CATIC cannot proceed with introducing new institutions or even any major reforms in the existing institutions' operations, which have been asked to reduce their investments and improve liquidity. So far, CATIC has participated in the establishment of two investment and trust companies, one in Zhangzhou (Fujian) and the other in Fushan (Guangdong). Provincial

governments seem to welcome CATIC's leadership role in organizing investment and trust corporations, possibly because this gives the local institutions an access to broader financial markets. This aspect of CATIC operations must be constructively used and it is important, however, that the People's Bank formally recognizes CATIC's leadership (promotional) role in development of rural investment and trust companies and nongovernmental financial associations. It is unclear whether this has been done and what coordination arrangements at the policy level exist between CATIC and the People's Bank. This issue needs to be pursued further with the PBC and CATIC. In the interim, CATIC proposes to route its assistance through the provincial governments for projects selected and appraised by CATIC. CATIC would possibly retain the option of converting its loans to provincial governments into equity so that in later years, it could through equity participation, support the development of investment and trust companies and through them, influence the performance of individual enterprises financed. CATIC is also planning to establish a rural credit service company in Guangdong and a cooperative credit association in Beijing.

(iv) Leasing and Foreign Exchange Business. So far, CATIC's activities have concentrated on lending, acquisition of some major companies and commodity trading. CATIC proposes to diversify by financing leasing operations and the first operation of its kind would be to lease out imported deep sea fishing boats. CATIC is also going to deal in foreign securities and exchange.

(v) RSAL Counterpart Funds. CATIC's main role under the RSAL has been to coordinate the procurement of fertilizers and other materials. CATIC provides planning and administrative support to the procurement agencies through its recently established World Bank Loan Office. Originally, the Government intended to entrust the counterpart funds of the Bank Loan/IDA Credit to CATIC for investments in reform-oriented projects. CATIC was also planning to use these funds to complement the resources of local financial intermediaries. Some rethinking on this subject is underway within the Government and it seems that, because of serious budgetary constraints, CATIC would now receive only a part of the counterpart funds. Whether the reduced funds availability will dilute the CATIC's reform-oriented role and activities remains to be seen.

18. Mission's evaluation. CATIC has set for itself an ambitious agenda requiring management expertise of a high order (see, initial evaluation, para. 5.25 of the Working Paper No. 7, Loan Implementation Volume). In the first six months of its existence, CATIC has indeed made a remarkable progress in building a core organization to handle its diverse activities and has developed a loan portfolio of Y750 million by mobilizing large trust deposits. While it was outside the supervision mission's scope to evaluate the quality of CATIC's loan portfolio, it is clear that CATIC's current preoccupation is to develop profit centers to make its operations financially sustainable. For the progress so far achieved, much credit goes to CATIC's dynamic management allowing, of course, for the success that goes with high level contacts which CATIC enjoys in the government and political circles. It is this combined political and financial strength, coupled with strong reform orientation of its management

that should help CATIC to steer its way through the currently difficult macroeconomic environment and keep on track to fulfill its intended role in the reform of the rural investment and financial system. The next RSAL supervision should focus on evaluating the CATIC's emerging business strategies and operations against this background.

19. Guanghan (Sichuan) Regional Reform Program. The mission visited Guanghan county to review the progress in implementing the Regional Reform Program (RRP) in rural finance. The main focus of the Guanghan RRP is to revitalize the official banking system by introducing a package of inter-related measures that would promote competition among banks, encourage market orientation, facilitate diversification of services, improve portfolio management, upgrade internal organization, and reward staff for good performance (for details, see paras. 5.2-5.4 of Working Paper No. 7 in Loan Implementation Volume). Recently established nongovernmental financial institution and an investment and trust company also participate in the RRP.

20. Reform of the financial system in Guanghan was initiated in 1986 but it became operational only after the inclusion of this package in RRP in 1987. During the past about two years, much progress has been made in RRP implementation. Specialized banks' branches now enjoy considerable autonomy in their business operations. The branches recruit staff on the basis of qualifying tests and interviews in contrast with the earlier practice of government labor bureaus nominating the staff. Local bank branches and sub-branches have entered into contractual arrangements with their respective upper level branches setting targets for deposit mobilization, lending, loan collection, profits to be remitted to higher level branches and profits to be retained at the branches. These contracts also spell out the criteria/indicators to link wages and rewards to staff performance and productivity. The branches have also entered into contracts with individual staff to assess their performance in relation to the quantitative and qualitative indicators defined in the contracts. There has been a noticeable improvement at all branches in deposit mobilization, lending operations, and profitability and, by and large, the staff received about 20% of their regular wages as bonus. The RRP banks performance during 1988 can, however, be realistically assessed early next year (during February 89 supervision), when the year-end data (for 1988) are expected to become available.

21. Inflation Distorts RRP banks 1988 Results. RRP branches' 1988 results are likely to be considerably distorted in relation to the targets set in their contracts with higher level branches and the staff, due to the following: (i) severe curbs on lending imposed by the People's Bank, as a part of its general restrictive credit policy; (ii) deposit targets prescribed by the higher level branches far exceed those agreed under the contracts; and (iii) interest rate increases on deposits and loans effective September 1, 1988 which, coupled with the lending restrictions and increased deposit targets, are likely to reduce the overall profitability of the branches in relation to the targets agreed in the contracts. Further, the contracts did not provide for separating the effects of exogenous factors, such as heavy withdrawals in deposits witnessed in August

1988 as a result of public fears about price increases, and the impact of inflation on deposits, loans and transaction costs. Most RRP branch managers, therefore, suggested that their contractual obligations and targets should be assessed flexibly. There was a concern that if the modalities for wage increases in the contracts were not interpreted flexibly, some staff may derive higher benefits for deposit targets which could be easily achieved due to increasing money supply (rather than by real improvements in productivity), while the staff concerned with lending operations might not qualify for any bonus in view of the People's Bank restrictions and funds constraints. Overall, the contract system's effectiveness in achieving performance improvements is currently tempered by high inflation and low margins on financial intermediation and severe credit constraints. Care must be taken to ensure that the contracts are not interpreted rigidly, affecting the staff morale and performance. At the same time, the Guanghan RRP is set to test the design and efficacy of the contract system in banking industry. Use of quantitative targets, without appropriate weightages for both indogenous and exogenous factors that influence the banking industry can be both misleading and hazardous. The Guanghan RRP provides an excellent opportunity to handle this issue through its M & E system (para. 31 below), which will be reviewed during the next RSAL supervision when initial M & E results are expected to become available.

22. Improvements Needed in RRP Design. Guanghan RRP can be strengthened and improved in many ways as noted below. These comments are based on the mission's discussions with the participating banks and the SRO in Guanghan.

(i)Commercialization of Specialized Banks. RRP is being implemented county-wide and its main focus is to allow the banks' county level offices to operate as "independent accounting entities". All banks except the Industrial and Commercial Bank of China (ICBC) has introduced this concept in Guanghan. ICBC could not make its county level branch an independent accounting entity because unlike other banks, in ICBC, the basic accounting unit is a prefecture-level branch and not a county branch. This has limited the Guanghan ICBC's effort to adopt RRP practices. The Guanghan System Reform Office has asked the Sichuan provincial ICBC to regard its county level branch as an independent accounting entity for purposes of RRP, but the issue remains undecided at the provincial ICBC. RCRD should take up this issue with the national ICBC.

(ii)Modalities for calculation of wages. Staff wages and bonus in all RRP branches except the Agricultural Bank of China (ABC), are linked to gross profit (i.e. difference between interest received and interest paid) and not to net profit (i.e. after taking into account the operational costs). This practice has a potential to allow wage increases without commensurate improvement in overall staff productivity or efficiency in branch operations. ABC, Guanghan has linked staff wages and rewards to more broad-based indicators including performance in deposit mobilization, lending and profits. However, RRP branches believe that none of these models can be effectively used because of the currently skewed interest rate structure and lending regulations which restrict the profitability of bank operations. A careful evaluation of the staff rewards system

will, therefore, be necessary very soon, which the SRO proposes to do as a part of the ongoing M & E exercise (para. 31 below). The next RSAL supervision will follow up on this aspect.

(iii) Lack of Increases in Credit Funds. Credit funds contributed by the Government to the specialized banks (which are like equity) at the time of their establishment several years ago, have remained substantially at the original levels. In the past, the profits earned by the banks were remitted to the Government, which permitted no increase in the credit (equity) funds. One of the important objectives of the Guanghan RRP is to allow the participating banks to retain a portion of the profits earned and use such retained profits as loanable funds, to increase profitability of banking operations and make provisions for any bad debts. However, the amounts that could be retained by the branches in terms of the RRP contracts are still very small (a certain percentage of incremental profits) and will increase the credit funds nominally. Further, RRP branches still remit the entire profits earned during a year to the supervising branches and receive their share in the profit only after the audit is completed, which usually involves long delays. RRP branches, on the other hand, wish to retain their part of the profits at source (subject to audit and adjustment in due course) so that these funds could be used for lending, without disruption and long wait, for greater profitability.

(iv) County Credit Plan Administration. Consistent with the national pattern, the local branch of the People's Bank administers the county credit plan as per the limits set for individual banks/branches for loans to their clients, and loans by PBC to the branches to supplement their resources or liquidity needs. These limits are set at the beginning of the year and there is little flexibility in increasing the amounts earmarked except for temporary needs. This may be in line with severe macro level restrictions on credit expansion but at the county level, the rigidity in credit plan administration seems to badly hurt the local economy. For example, credit limits not used by some branches, are not transferred to others, even when the funds needed to meet this demand are locally available to PBC (i.e. without resorting to borrowings from higher level PBC branches) and the overall credit disbursed in the county is below the aggregate amount set in the Plan. Such rigid management of the credit plan causes unnecessary hardship to the local community and affects enterprise performance. Also, PBC's credit plan administration often does not respond to the seasonal variations in the demand for and supply of funds at individual branches serving different clientele or sectors (such as agriculture by ABC, and industry and commerce by ICBC), leading to inefficient use of both local bank and PBC funds, besides causing artificial scarcity of resources. Local credit plan ceilings need to be broken down in monthly, quarterly or seasonal targets. Integration of the credit plan management with the local financial markets is critical for efficient use of local resources and PBC funds and should be introduced in Guanghan, to increase the effectiveness of the RRP. The RRP could then provide valuable learning experience in credit plan management for replication on a wider scale.

(v) Interest Rate Structure. The RRP banks have the flexibility of charging the interest rates on loans at +/- 20% of the

prescribed rates. However, this limited flexibility is hardly effective in practice because either the borrowing enterprises are unable to pay interest at higher rates due to their difficult financial condition or liquidity problems, or they just resist to pay higher interest using local political connexions. The RRP branches consider that the current interest rate structure is hardly effective as a tool for regulating demand for and supply of credit, and more so in the context of high inflation in recent months. RRP banks strongly asked for further liberalization of interest rates.

(vi) Proliferation of Financial Institutions. With the expansion in the banking system in Guanghan, on an average, there is one bank office for every 2,000 persons. Some banks in RRP indicated that there was a saturation of bank offices, and that the number should not be increased to keep the overheads low and discourage unhealthy competition. Clearly, bank decisions to open new offices or close the existing offices should be determined by their own assessment of the business potential and profitability. The mission, however, noted that this perceived proliferation of branches in Guanghan was because most branches provided similar services. Even the recently established Investment and Trust Corporation which by definition should mobilize longer term resources and extend longer term loans, was currently undertaking only commercial banking (i.e., deposit-taking and short-term lending). While this Investment and Trust Corporation has been in existence only for only about six months, and not much progress in investment banking was expected from it in a short period, it is important that the Guanghan RRP pays greater attention to diversification of services, including introduction of newer instruments of deposit mobilization and longer term lending.

(vii) Settlement Procedures. Introduction of a clearing house service has been by far the most important feature of the Guanghan RRP. In the past, the time involved in settlement of claims by enterprises and banks was much longer involving inefficient use of scarce working capital and payment of higher interest rate charges by the enterprises. Between January 1987 and June 1988, the Guanghan clearing house operated for 885 days and settled 273,000 transactions involving a total amount of about Y 4 billion, and net payments of Y 1.2 billion. For ABC alone, the accelerated settlement increased the working funds by about Y 0.8 million. However, several improvements can be made in the clearing operations. Currently, the settlement of claims is done under the auspices of the People's Bank but without using deposit accounts of the banks to settle the claims. Consequently, the RRP banks often undertake the settlement of claims under the same roof, but on a bilateral (face-to-face) basis if a participating bank is short of liquidity. Indirectly the system provides interest-free accommodation to the bank which is short of liquidity, and also contributes to delays in making payments to the enterprises who end up in paying higher interest charges to their banks. RRP banks suggested that all checks/bills due for settlement must be presented to the People's Bank (and not to individual banks), and that the People's Bank must settle the claims through deposit accounts of the concerned banks, if necessary by granting temporary overdrafts subject to the limits set by the current credit discipline and the individual bank's borrowing capacity. This will enhance the

efficiency of the clearing arrangements.

(viii) Staffing & Recruitment The Guanghan RRP authorizes the participating branches to select candidates for vacant positions, based on written tests and interviews to assess their suitability. The branches can also fire the newly selected staff if not found suitable during the probation period. This is an important improvement over the past arrangements when the higher level branches or labor offices nominated the staff, which did not strictly ensure that the candidates' skills matched with the job requirements. The RRP branches are also authorized to realign the staff within individual branches, according to tasks and staff capability. However, the RRP branches still do not have the powers to increase or reduce the number of positions as may be warranted by their business needs. At some of the RRP branches, there is excess staff which cannot be fired or reassigned under the existing regulations. The result is that these branches are constrained to achieve per capita staff profitability and performance as envisaged by the RRP contract system. Further, not infrequently, RRP branches are asked to open new units/sections to handle policy loans or activities directed by the higher level branches, leading to higher administrative costs and reduced profitability. As the reforms are extended on a wider scale to commercialize the banking operations, these issues must be handled squarely and perhaps a beginning should be made through the Guanghan RRP.

23. Overview of Guanghan RRP. The Guanghan RRP is currently not equipped to handle some of the issues noted above which are systemic in nature--especially those pertaining to credit plan management, interest rate structure, settlement of clearing claims through deposit accounts with PBC, and increasing/reducing staff positions. RCRD must consider whether the Guanghan RRP should be expanded to address these issues to enhance the impact of the RRP itself and to learn more from this important effort. In spite of these constraints, the Guanghan RRP has provided valuable experience for reforming the banking system on a wider scale by focusing on issues in internal organization and management of the banks/branches as well as interbank relations. Experience gained in Guanghan RRP has already been used by the Agricultural Bank of China (ABC) which has adopted, effective July 1, 1988, a contractual responsibility system in its nationwide branch network. The ABC HQ has entered into a contract with the Ministry of Finance incorporating a number of features of the Guanghan experiment, especially the incentive system which enables the branches to retain part of the the profits for business development and productivity improvement. Other specialized banks are also expected to adopt the contractual responsibility system as the current monetary and credit situation improves.

24. Fuyang RRP. The Fuyang RRP focuses on using informal, nongovernmental, financial institutions as a vehicle for expanding money market and imparting dynamism and flexibility into local financial markets. The main objectives of the RRP is to study if organizing nongovernmental associations (NGFAs) could be an approach to provide a legal framework for burgeoning informal financial intermediation and for integrating them with the formal financial institutions (see, paras. 5.5-5.18 of the working paper no. 7 of the

Loan Implementation Volume). At appraisal, the mission had reviewed three models in nongovernmental institutions and noted that while the experiment had the potential to pave the way for a more systematic development of NGFAs, these models had some weaknesses, especially lack of clarity about stockholders' responsibility, absence of sound financial standards, and lack of explicit arrangements to protect the interest of depositors in the event of bankruptcy. It seemed that the People's Bank carried the risk of bailing out these institutions and meeting the depositors' claims in the event of their failure. After the recent run on the banks (para.13), the People's Bank is cautious in issuing licenses to new NGFAs. However, at the policy level, it is important to address broader issues in NGFA development--including NGFA ownership, stockholders' responsibility for losses, and introducing rules and regulations and financial standards for NGFA operations. Referring to para. 32 of the policy letter, the mission suggested to RCRD during the supervision, to appoint a Task Force comprising PBC, ICBC, ABC, CATIC and representatives from the Fuyang Project Office responsible for monitoring the reform project, to prepare draft NGFA rules for formal approval by People's Bank. The Bank has already indicated to RCRD its willingness to provide technical assistance for this purpose through RSAL supervisions. It, however, seems that RCRD would like the Bank to undertake this task through a sector work in rural finance (paras. 28-29 below).

25. Land Banking. As a part of the second phase reform, the Government has begun the reform of the land management system (see, Working Paper No.4 of the Loan Implementation Volume). In 1988, the National People's Congress approved an amendment to the Constitution legalizing the transfer of land use rights. Experimentation and revision of household contracts has been underway since 1984 in a rather diffused fashion, through the medium of contracts prepared by the many thousands of economic cooperatives in the country. The Meitan (Guizhou) Regional Reform Program which is a part of the Government's ongoing effort to evolve strategies for national reform of the land management system, focuses on two main components: (i) reform of the land contract, including introduction of an explicit charge for land use and the imposition of requirements of good husbandry; and (ii) introduction of a market in the use rights conferred under such contracts. One of the proposals of the Meitan RRP included the establishment on a trial basis, a county land bank with 4-5 districts or township branches, with two integrated functions of encouraging private investments in land improvement and providing longer term credit to finance land improvement (and related investments) against the collateral of land use rights. Following this proposal, the county government has recently established the " Meitan Land Finance Company" (MLFC) to function as the proposed land bank.

26. MLFC will be owned by stockholders. It will raise equity from local governments, farmer households, village cooperative organizations, CATIC, and ABC. MLFC has been registered as an independent company under the supervision of the People's Bank. It will support land improvement, transfer of land use rights, and land consolidation for the purposes of increasing land use efficiency. As a guideline, the MLFC proposes to deploy about 40% of its funds in short-term loans to earn profits through greater recycling of funds, and about 60% in long-term loans.

27. MLFC model is new to China and much work needs to be done in defining concepts and design for introducing land banking institutions on a wider scale. There are broader, systemic, issues involved, which must be addressed before MLFC model could be extended to other areas: these include the need for evolving an acceptable basis for valuation of land use rights, instruments for raising long term resources, prospects of and mechanisms for developing a long-term capital market in rural China, and the institutional arrangements for land banking including the role of long-established institutions like ABC, and RCCs. Both ABC and RCCs have a wide network of rural branches for lending to a broad-based, rural investment programs including land improvement against the collateral of land-use rights. In the MLFC model, much reliance has been placed on raising resources from the government than from the market which is currently very narrow, but must be developed for successful land banking. As regards the valuation of land-use rights, different concepts are being tested in Meitan including: (i) a once-and-for-all compensation for land improvements made by an existing holder from his resources; (ii) capitalization of rent, based on the potential returns from the land, payable during the lease period and (iii) the market value determined by auction of land-use rights. Land "ownership" would continue to vest in village governments which will have powers to repossess the land in certain situations. Difficulties exist in evolving an acceptable basis for valuing land-use rights. A separate paper on issues in land banking in China will be prepared by the mission for a discussion with RCRD, possibly during the next supervision of RSAL.

28. Rural Investment and Finance Review. To support the ongoing efforts in the reform of the rural investment and financial markets, the Government intended to initiate a review of rural financial market policies and prepare guidelines for future reform (para. 33 of the policy letter). The results of the review, which was scheduled to be completed during 1989, were expected to facilitate formulation of nationwide policies. During the appraisal of RSAL, the mission had suggested that RCRD should organize this review during 1988 in collaboration with the Bank, and associate other agencies including the People's Bank, ABC, ICBC, CATIC, RCCs, UCCs and the Ministry of Finance (see, paras. 6.5-6.7 of Working Paper No. 7 in Loan Implementation Volume). Not much action has been taken by RCRD so far to initiative the proposed review.

29. During the supervision, the mission reviewed with RCRD its plans for carrying out the rural investment and finance review. It seemed that RCRD would not be institutionally ready to carry out this review in the near future due to lack of experienced staff and lack of funds. The RCRD staff informally suggested to the mission that the Bank should consider carrying out this review as a sector work during CY1989, and that RCRD would form a counterpart team of local consultants (cost to be paid by the Bank) to support this task. The Terms of Reference suggested in para. 6.7 of the Working Paper NO.7 were broadly acceptable to RCRD. The mission would prepare a proposal for the Bank management approval to the proposed sector work and, if approved, finalize the details during the next supervision of RSAL.

Monitoring and Evaluation of RRP's

rates for different types of loans.

34. M & E will be based on semi-annual reports from the specialized banks and annual reports from nonbanking financial companies. RRP's social and macro effects will be assessed annually based on statistical information compiled by the local statistical office, supplemented by necessary sample surveys. The specialized branches would report to SRO directly, RCCs through Joint RCC at the county level, and Investment and Trust companies, urban credit cooperatives, nongovernmental financial companies through the Planning Department of the People's Bank. The reporting formats will be available for review during the next supervision.

35. The M & E organization and design for the Guanghan RRP is expected to focus both on quantitative and qualitative assessment of the financial performance and staff productivity improvements. Possibly, a systematic attempt would be made to separate the effects of inflation and macro-level policy directives on the performance of RRP branches and to assess whether the staff incentive systems being used by different branches is functioning rationally and effectively.

36. NGFA Experiments. The progress of the three experimental NGFAs will be monitored by Fuyang SRO (which needs to be strengthened) with reference to financial indicators, such as increases in deposits, loans and profits and qualitative indicators such as increases in the deposit and loan accounts and recycling of resources. The M & E would also review the progress made in refining "stocks and ownership" concepts, and introduction of financial standards in banking operations of NGFAs. RCRD has not yet set up a task force to prepare the draft rules and regulations for NGFAs and this task may now have to be handled during 1989, possibly through the proposed Bank sector work in rural finance (para. 29).

37. CATIC. At appraisal, it was contemplated that CATIC would report to RCRD semi-annually, during 1988 and 1989, the progress made in capitalization, defining/diversifying the sources of funds and activities; projects selected for financing; key financial ratios; and business plans. Now that the World Bank Loan Office has been set up in CATIC itself, this information should be compiled by this office internally and included in the progress report. As regards CATIC's role as a catalyst in reform-oriented projects and development of nongovernmental financial institutions, monitoring should take into account developments in macro-economic and financial sector situation, and should be essentially issue-oriented. Much of the analysis should be done during the RSAL supervisions.

38. Review of Rural Investment and Finance. The question whether the proposed review should be undertaken as a sector work will be discussed within the Bank and RCRD during November 1988. Subject to the management decision on the subject, the monitoring plan for the review will be set up during the next RSAL supervision in February 1989.

39. Developments and issues in regard to state investment corporations (SAIC and SCIF) and government policies in agricultural/rural sector investments (paras. 6 and 12) will be

reviewed mainly through RSAL supervisions and the Bank's economic and sector work.

Beijing,
October 23, 1988

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30. To monitor the impact of the three financial sector RRP's, the following arrangements have been developed by RCRD. Detailed reporting formats are being finalized by the local Systems Reform Office (SRO), and will be included in the first progress report to the Bank, due in January 1989.

31. Guanghan (Sichuan) Experiment. Proposed monitoring and evaluation arrangements for the Guanghan experiment are generally satisfactory. The systems reforms office (SRO) in Guanghan county government will be the principal agency responsible to monitor the RRP. The SRO would operate under the guidance of a provincial leading group chaired by the local RCRD director, a deputy governor of the province, a deputy director of the People's Bank, a senior researcher of RCRD, and the mayor of the local county government. SRO would be responsible to liaise with the banks participating in the RRP, and receive support from the local statistical office to collect statistical information for the purposes of monitoring and evaluation. SRO's cost would be met by contributions from the participating banks, RCRD and the county government. RCRD has nominated a research worker to support SRO in its analytical work on RRP. SRO has plans to invite banking experts from within China to Guanghan, to interact with SRO and the local banking community in assessment of the RRP and make recommendations for its improvement. Using the M & E results, the provincial leading group will be responsible to make recommendations to the national government and the State Council (through RCRD), which will formulate approaches for diffusion of the reforms nationwide.

32. The methodology proposed for M & E of Guanghan RRP is broadly as follows. The banks participating in the RRP have been classified into four categories: specialized banks and insurance companies; nonbank financial investment and trust companies, and urban credit cooperatives (UCCs); rural credit cooperatives (RCCs); and nongovernmental financial institutions and cooperative funds (former commune funds). The mission noted that UCCs are banking institutions and should be separated from the nonbanking category. The consensus at the mission discussion was that the RRP institutions should be classified into following four categories: state-owned specialized banks, nonbanking state-owned financial institutions, collective institutions, and credit organizations which do not provide public services, such as cooperative funds. SRO will review these suggestions and make suitable changes in the classification of the RRP branches.

33. M & E indicators will fall in three broad categories with several subtopics as follows: (i) Overall Monetary Indicators (no. of accounting units, no. of employees, capital funds, fixed asset procurement, risk insurance, and self-sufficiency in resources); (ii) Six Financial Indicators (increase in deposits, increase in various types of loans, variations in cost of deposits and loans of Y10,000, variations in the operational expenditure with reference to deposits and loans of Y10,000; and resource utilization efficiency based on the cost of funds, operational costs, return on loan portfolio, net and gross interest margins, and growth in profits); (iii) Quantitative Indicators. Error rate in accounting, errors rate in cash transactions, error rate in deposit accounts, overall personnel attendance, error rate in various types of reports, and overdue loan

CHINA

RURAL SECTOR ADJUSTMENT LOAN

POST-EFFECTIVENESS SUPERVISION MISSION

Reform of Marketing Organisations and Institutions

by- Martin C. Evans (C)

CHINAREFORM OF MARKETING ORGANIZATIONS AND INSTITUTIONS

10. Experimental reform of marketing organizations and institutions are being carried out in three localities: Shangzhi, Heilongjiang; Yutian, Hebei and Liquan, Shaanxi. All are officially-designated Experimental Areas (EAs). The supervision mission did not visit any of these areas and was not able to follow up on what progress had been made there with the reform programs. However, some information was obtained about Shangzhi which is reported below. The mission was also informed that encouraging results were being observed in the Yutian RRP where new cooperatives established by townships and villages had been successful in achieving economies of scale in purchasing agricultural inputs.

The Shangzhi RRP

11. In May of this year 1988 a production union was established among farmer organizations at the provincial level--the Heilongjiang Union of Berry Producers, with the head of RCRD in Heilongjiang as chairman. This union provided a forum for berry producers and the berry processing companies to discuss pricing and to agree on formulae in an effort to avoid the large price fluctuations of earlier years. (Thus the agreed price for this season is Y 0.80/jin compared with Y 0.15 in 1987 and over Y 2.0 in earlier years). Berry producers associations have now been established in 26 counties in the province, modelled on the original one in Bei'an Village. However, pricing agreements between producers and processors were only operative this year in three producing areas where there were locally established processing facilities. In the other areas, it appears that prices paid for raw berries were on average lower.

12. In July, RCRD sent questionnaires to all township leaders, the great majority of whom were concerned with specialized cooperatives. The response indicated that progress was not as good as had been expected: only 30% of the cooperatives were actively providing services to farmers; the other 60-70% had apparently been established but were unable to provide much support to producers because of lack of machinery, equipment, etc. Problems have also arisen with the farmers' cooperative foundations (informal cooperative credit institutions) in Shangzhi because of the large proportion of total capital (Y 26 M out of Y 33 M) which represents virtually unrecoverable loans owed to the former production teams. Confusion over asset ownership under the new institutions, conservative attitudes on the part of cadres unused to commercial management and lack of accounting expertise are cited as complicating factors.

13. Model charters to assist in the formation of farmers' voluntary organizations do exist and their use is actively promoted by RCRD. So far they have been only partially successful in resolving differences between diverse interest groups. (A draft of cooperative regulations for nationwide application--see para. 25 of the Statement of Rural Reform Policies -- has been completed with RCRD assistance but awaits discussion).

14. Three training seminars on farmers organizations have been held so far this year. The first, in January, was attended by over 50 township and village leaders, representatives of farmer organizations, managers of specialized joint development companies and government officials. Stress was laid on need to develop the private sector, the desirability of extending the role of townships in organizing farmers into specialized production/marketing associations and the need to increase the scale of agricultural operations. The second seminar in April involved 50 trainees from among township leaders and EZO staff. The theme was the environment and conditions required to foster the growth of specialized cooperatives. The aim of the third training session in June, attended by 190 county and township leaders, heads of all major government departments at county level and representatives of farmers organizations, was to "sensitize" participants to the need to change old ways of thinking and embrace the new institutional concepts.

CHINA

RURAL SECTOR ADJUSTMENT LOAN

POST-EFFECTIVENESS SUPERVISION MISSION

RSAL Monitoring and Evaluation Arrangements

by- Martin C. Evans (C) and Alan Piazza (AS3AG)

RSAL MONITORING AND EVALUATION ARRANGEMENTS

A. National Level Monitoring

The Focus of Recent Activity

1. Overall responsibility for tracking and monitoring the myriad components of the rural reform program rests with RCRD. It has a watching brief to observe and analyze, throughout the country, the progress of reforms--both those which have been mandated as national policy and those which represent initiatives sanctioned for "testing" at the regional level in the first instance. In its monitoring role, the RCRD reports to the Leading Group for Rural Reform (LGRR) of the State Council.

2. In recent months, much of the RCRD's attention has been focused on issues of macro-economic policy, many of which are directly related to the diffusion of reforms in the rural sector. Booming industrial growth (17% p.a. in the first half of 1988), in part due to the continuing rapid expansion of TVEs, is putting great pressure on raw material and food supplies. While the problem with shortages of manufactured inputs (including important inputs to agriculture such as agro-chemicals and plastic sheeting) is largely bound up with the general problem of reforming the organization and management of State-owned enterprises, the inadequate agricultural response also reflects insufficient public and private investment in agriculture and its supporting infrastructure and services in recent years. With prices and markets for most food commodities wholly or partially de-controlled and with the money supply more than doubling in the last twelve months, inflation has accelerated considerably. Containing the general rise in prices is considered by Government to be an urgent priority.

3. Since last year, local governments (cities and townships) have been encouraged to work out their own approaches to limiting the financial burden of subsidizing food supplies for urban and industrial consumers. RCRD has been monitoring the various methods adopted. In January of this year, for example, Yulin City, Guangxi Province decided to increase both the buying (from producers) and the selling (to consumers) prices of non-staple foods (meat, eggs, sugar, vegetables) to maintain farmers' confidence and signal to consumers that they would also have to pay for part of the increased costs of production and distribution (consumers were assisted by a special supplement to their monthly incomes). Data received by RCRD showed that, within three months of these measures being put into effect, meat consumption per capita had already fallen substantially.

4. The Central Government began popularizing this approach among provincial authorities in May, with two main objectives in mind:

- (a) to achieve a universal shift from variable subsidies to subsidies for fixed quantities of produce only (these to be set at the discretion of the local government; for example it is at present 2 jin/capita/month in Beijing but twice as high as this in some traditionally meat-consuming areas); and
- (b) to replace "hidden" subsidies on food by overt subsidies so that the general public is aware of exactly how much assistance is being given to whom in this respect. State retail outlets also now display two price lists, corresponding to subsidized prices for produce partly available under rationing and "free" market prices.

Practice varies widely from place to place, reflecting local circumstances of demand, supply and income levels and the authorities' differing perceptions of the risks attendant on large-scale subsidy reduction. For example, RCRD calculates that the "hidden" subsidy on meat (i.e., difference between the local government's contract price and the free market price faced by producers) is about Y 0.30-0.40/jin in southern China compared with Y 0.40-0.50 in the north. Guangdong Province grain marketing was completely decontrolled earlier this year, while in Shaanxi Province the rationing of urban grain supplies at subsidized prices was eliminated for the lower grades. These experiments in free marketing resulted in large inflows of grain from neighboring provinces, to the consternation of the local authorities there.

5. The above are examples of local response to opportunities for changes in economic management created by declarations of policy adjustment at the national level. The other type of reform diffusion being tracked by RCRD is the uptake of particular localized experiment designs by other administrative units. Since appraisal, additional new Experimental Areas (EAs) have been officially incorporated in the rural reform program and RCRD is now establishing monitoring and evaluation systems for these. This expansion of the regional reform portfolio is intended to broaden the scope of policy experimentation and give it a more balanced geographical distribution. Some of the new regional reform programs (RRPs) reflect Central Government's decision to establish policy testing in new areas of activity (such as poverty alleviation, animal husbandry), others represent the formal recognition of initiatives which had already been taken by local governments.^{2/} None of them appears to be a close replica of any of the RRP's which existed at the time of appraisal though they may fall into the same broad category (e.g., land management system reform, forest management reform); instead they each have some unique features. There are now 19 official EAs in 15 provinces.

^{2/} For example, the Pingdu land management system reform has been operating on an "informal" basis since 1984, but it was only incorporated in the official program this year; the Shunyi land management system reform was again only formally recognized by the State Council this year--at the County's request.

Training in Monitoring and Evaluation

6. Since the time of the appraisal mission, RCRD has held two workshops in RRP design and management for local leaders and RCRD staff from the EAs. Two training courses were also mounted, each of two weeks' duration. The first, held in May, catered for 64 trainees from 16 EAs and covered such topics as the design of policy research studies as well as monitoring and evaluation. The second course, held in July, was confined to 12 trainees from 12 provinces, all researchers from RCRD provincial offices or in local government. The course was mainly concerned with research methodology and the design and execution of surveys and field investigations. The participants spent four days in the Shunyi EA working in small groups on such subjects as the behavior and performance of government agencies, employment in TVEs, the diversity of financing sources and investment patterns among administrative units, and the institutional structures which were evolving in agriculture.

Reporting

7. RCRD prepares periodic reports for the LGRR analyzing and assessing progress with rural reform throughout the country. RCRD itself should receive regular reports from each of its offices in the EAs on the progress of specific RRP. So far, a common format has not been laid down for these reports, it being left to the individual Experimental Zone Offices (EZOs) to decide how best to present their findings.

B. Monitoring the Regional Reform Programs

Progress with Establishing Monitoring and Evaluation Systems for the RRP

8. At the time of appraisal the design of monitoring and evaluation (M&E) systems for the individual RRP was still largely being conceptualized. Since then, working papers or provisional guidelines on M&E have been prepared by the EZOs concerned for the RRP in Meitan County (land management system), Guanghuan County (rural financial institutions), Shangzhi (cooperatives and marketing organization), and Xinxiang and Yulin (grain system RRP). Action is being taken to staff and finance what are specifically identified as M&E activities in these five areas, while special efforts are being made to collect data on, and report the effects of, land consolidation in Southern Jiangsu in a systematic manner. The Meitan, Southern Jiangsu, Xinxiang and Yulin EZOs have included some instruction on M&E principles and procedures in their general training of local leaders, officials and cadres for RRP implementation. The mission made visits to Meitan, Xinxiang, Yulin and Guanghan. The M&E situation there is reported in more detail below. Specifics of the Meitan, Xinxiang, Yulin and Shangzhi monitoring systems are appended to this report.

9. Monitoring and evaluation does not appear to have progressed very far in the Fuyang RRP (rural industry). Staff shortages in the EZO have led to the abandonment of plans to carry out some important enterprise surveys (the sample of 440 currently supervised enterprises, the sample of 50 enterprises using model charters and the survey of 5 enterprise groups in various industrial zones--see LIV I-WP 5). There appears to have been little or no effort made so far to monitor the effectiveness of Prefecture-wide changes in key policies or administrative actions taken as part of the RRP.

For example, the actual impact of new regulations/procedures to reduce "interference" by cadres in the operation of free wholesale/retail markets has not been checked systematically. Again, there appears to have been no follow-up on the large number of applications for model enterprise charters received by the Industry and Enterprise Office in response to the publicity about them. It is not known, therefore, to what extent these charters are actually being used as a basis for enterprise design or even just as evidence of official "permission" to carry on business. The result is that some of the important "inputs" to the RRP have not been monitored which will make it difficult later on to determine cause-and-effect in the policy reform process.

M&E Arrangements for the Meitan RRP

10. Organization. In August of this year, a Land System Building Monitoring and Evaluation Research Group was established under the auspices of the EA Leading Group. Organized by the provincial office of the State Statistical Bureau (SSB), the M&E group is led jointly by the SSB Deputy Director and the Head of the Rural Economic Sampling Survey Team (RESST). The group is responsible for organizing and coordinating M&E activities in Meitan County and other counties of Guizhou Province which introduce elements of land management system reform. Agencies participating in this work at the county level include the SSB, the Planning Office, the Agricultural Bureau and the Land Management Bureau.

11. Staffing and Finance. Monitoring data will be collected by two main groups of people--the statistical staff of SSB at county, district, township and village level, and the RESST. Recruitment of full-time professional statisticians, one for each location at each SSB level, was completed by the end of October, so that a complete monitoring network has been set up. It is also intended that this should serve as an "early-warning" system to alert the EZO to impending problems with the RRP implementation. A sub-set of the monitoring personnel will be selected (some at random, others according to the "strategic" importance of their particular geographical location) to keep a close watch on farmers' behavior as the RRP progresses. In this way it is hoped to be able to detect incipient problems, indicated by such phenomena as upsurges in land disputes, excessive land fragmentation, decline in agricultural input use, and so on and allow enough time for the EZO to respond before the situation becomes too serious. The "early-warning" personnel will be paid extra for these duties.

12. The (re)organization of the RESST to undertake new monitoring work and related staff recruitment had not begun at the time of the mission's visit, but again it was understood that the RESST would be fully operational by late October. Four members of the RESST will be appointed at county level, another four will be appointed to posts in four districts and another 47 people will occupy part-time positions at township level. The subject of the RESST's first survey has yet to be decided.

13. Meitan County SSB will be allocated two additional micro-computers for the M&E work and the RESST will be given instruments for assessing soil fertility and other equipment from RCRD's EZO budget. RCRD will also pay for staff training. Financing of other incremental M&E costs (i.e., most of it) has not yet been finalized, but allocations are expected from the regular budgets of Meitan County's SSB and RESST supplemented by further direct allocations from the County treasury (Finance Department).

14. Data Collection and Processing. In August this year, a team of five from the Provincial SSB, including the Deputy Director, visited Meitan for one week and carried out field investigations as part of the process of designing an M&E system for the RRP. The working paper on M&E which resulted from this work is reproduced as Appendix 1. Six major categories of required information are identified: (a) the general socio-economic situation in the County: population, labor force, land use, etc.; (b) land exchanges and production conditions: use rights, transfers, tenancies, land development, land quality changes, etc.; (c) responses and attitudes: behavior and understanding of the reform by cadres and farmers, commercial awareness, etc.; (d) economic benefits: output, income, productivity, incidence of poverty,^{3/} etc.; (e) social benefits: social welfare, literacy, education, market development, etc.; and f) ecological benefits: reforestation, soil reclamation, etc. The working paper lists 340 separate data items for which quantitative estimates will be sought and specifies the sources of information, its representativeness (e.g., township-wide census or household sample) and the agencies responsible for providing the data. It is an ambitious exercise and reflects the EZO's desire that it should serve as a general model for improving China's rural statistical system as well as meet a particular M&E objective.

15. While many of these indicators refer to information which would normally be collected anyway through the routine statistical reporting channels, several of them represent new types of data which will be collected for the first time. For example, all the indicators in Tables II-2, II-4, II-5, and II-6 in Appendix 1 are new, as are many of those in Tables V-1 and V-2. The authorities recognize that it will not be easy to obtain reliable information on some of the indicators, for example those comparing land use fee payment with land area cultivated (Table II-2, data items 10 and 11), or revealing the extent of illegal land occupation (Table II-6, items 3 and 4) or land mis-use (Table II-6, items 7 and 8). Special efforts will be made to cross-check data from different sources for consistency.

16. Fen Gang County in Guizhou Province has been selected to provide reference data for the Meitan RRP. This information being used in a similar manner to the results of a "control experiment" in the physical sciences. The Provincial authorities do not intend to introduce any specific reform measures into Fen Gang for the time being, though if local initiatives are taken spontaneously they will not be impeded from above. It is not clear whether it is intended to replicate in Fen Gang the relatively elaborate arrangements being made for M&E in Meitan, including the recruitment and training of extra statistical staff, and monitor precisely the same indicators as in Meitan or whether data collection will be confined to what would have been undertaken anyway.

17. Training. The mission was advised that a training course in M&E would be held in November 1988 for district heads, township councillors, village leaders and party secretaries at district and township levels as well as for the professional statistical staff. The purpose, scope and methods of M&E will be outlined and basic instruction will be given in numerical calculation and the filling-in of questionnaires and data sheets. It is also considered essential to educate farmers in the importance of providing accurate information for M&E and cadres have already begun to take this message into the rural communities. Farmers are being told that the aim of

^{3/} Three income categories have been defined for these purposes: less than Y 200 per capita, Y 200 - Y 500, and more than Y 500.

the Meitan reforms is to help them to "get rich quick" and good M&E is necessary if the authorities are to be able to manage the reform process properly.

18. Reporting Procedures. Information obtained on a regular basis will be presented twice a year, in June and December. The Meitan County SSB will collate the data and pass it to the EZO M&E research group for computer-assisted analysis. This group will also incorporate findings, for ad hoc surveys and investigations in their reports to RCRD in Beijing.

Monitoring the Grain System Reforms in Xinxiang and Yulin

19. Overview. The Xinxiang and Yulin city governments have established grain system reform monitoring offices (RMOs) and initiated the work of data collection and analysis. Relying heavily on existing local data collection systems, these RMOs have set up effective monitoring programs in a short period of time and at little incremental cost. With the exception of the inadequate coverage of urban grain consumption, these monitoring programs will bring together detailed information on all other important aspects of the grain system reform programs. However, the timely assembly and presentation of monitoring data and regular analysis of these data is hampered by inadequate funding and the lack of even one computer within each Reform Office. Particularly in the case of Yulin, the timely assembly and careful analysis of these monitoring data would be significantly improved with RCRD technical support and a small amount of financial assistance earmarked for this purpose.

20. Organization and Staffing. The principal activities of the Xinxiang and Yulin RMOs is to consolidate data collected by the statistical and accounting units of a number of local governmental and quasi-governmental agencies and companies. These participating agencies and companies include the branch bureaux of several central government ministries and bureaux (e.g., the Ministries of Commerce, Finance and Agriculture, and the SSB), several municipal government commissions and offices (e.g., the Planning Commission and the Vegetable Office), a number of state-owned companies (e.g., the Fertilizer Company), and the Supply and Marketing Cooperative. Each of these agencies and companies has assigned one or two staff on a part time basis to assist with the monitoring program. In combination with several additional full time staff assigned by the municipal governments, each RMO has a total staff of about 30. None of the Xinxiang or Yulin RMO staff have received training under the monitoring program, but most or all of these staff are statisticians or accountants with substantial practical experience in data collection. The 15 agencies and companies participating in Xinxiang's monitoring program and the 15 participating in Yulin's program are listed in Appendix 2 to this report.

21. Funding and Technical Support. Although the incremental costs are not large, funding for the monitoring programs is quite limited; the Xinxiang and Yulin governments have only allocated 30,000 and about 10,000 yuan respectively for this purpose. Since the agencies and companies participating in the monitoring program routinely collect most of the data critical to monitoring the impact of the reforms, funding constraints will not significantly hamper data collection. However, inadequate funding for the monitoring programs is already retarding the consolidation and analysis of these routinely collected data. Technical support has also been uneven. RCRD assigned two operational-level staff (Messrs. Gao Xiaomong and Huang Yiping) to Xinxiang on a nearly full time basis during the design and initial implementation periods of that reform program. Yulin, on the other hand, has

received little or no technical support from RCRD despite repeated requests. The combination of inadequate funding and insufficient technical support has had a definite adverse affect on Yulin's monitoring program.

22. Monitoring Indicators. The RMOs have begun assembling data on: the production of agricultural inputs and outputs; production budgets and input use; the procurement and sales of agricultural inputs and outputs; planned, negotiated and free market prices for farm inputs and outputs; the fiscal costs of the reform: and urban and rural income and expenditure. Both RMOs have prepared detailed listings of the numerous monitoring indicators within each of these categories and the Xinxiang RMO has printed a monitoring program handbook with 65 tables detailing the content, frequency, geographic coverage, reporting deadlines and responsible units for each monitoring indicator. These monitoring indicators, which are summarized in Appendix 2 to this report, are in close conformance with those suggested by the RSAL appraisal team (see RSAL LIV Working Paper Number 3, pp. 46-49) and cover nearly all the data critical to monitoring the impact of the reforms. As noted above, most of these data are routinely collected by the statistical and accounting departments of the agencies and participating in the monitoring program. In addition, several special surveys have been undertaken in Xinxiang to secure data and information which are not routinely collected by participating agencies and companies. These include a pre-reform rural household survey focused on county and lower level agricultural taxes, fertilizer availability and prices, and income and expenditure, a post-reform opinion survey, and collection of free market price data for agricultural inputs and outputs in nearby counties. Yulin is planning two sample surveys similar to those undertaken in Xinxiang, but is currently lacking both the necessary funding and technical support.

23. The only serious gap in these monitoring indicators ^{4/} is the inadequate coverage of urban grain and vegetable oil consumption. The Xinxiang Municipal Statistical Bureau routinely surveys income and expenditure of 120 urban households. However, the routine survey does not adequately distinguish between ration and nonration purchases or differentiate grades and prices of grain and vegetable oil. More importantly, the Yulin Municipal Statistical Bureau does not undertake even the routine sample survey of urban households. This is particularly unfortunate since Yulin has undertaken the most radical reform of urban ration grain and vegetable oil prices in the nation (other than the complete decontrol reportedly undertaken in the Shenzhen SEZ). The Yulin RMO receives regular reports on total ration grain sales, but it is impossible to determine even average urban per capita grain consumption from these data. Thus, the Yulin RMO is at present unable to assess trends in actual grain consumption disaggregated by type of grain (i.e., ration and nonration, variety and grade) and income group. An accurate and detailed assessment of these trends would be an important contribution to predicting the impact of retail price reform on demand for grain and to future efforts to target urban consumer food subsidies.

^{4/} Agricultural taxes and local free market prices for farm outputs are given only limited coverage in Xinxiang. Since these data are routinely collected by the existing statistical and accounting system, these gaps in coverage should be easily filled.

24. Effectiveness. By relying on the local data collection system and a few special sample surveys, the Xinxiang and Yulin monitoring programs will bring together detailed information on almost all the important aspects of the grain system RRP's. However, an important shortcoming of these monitoring programs (other than the inadequate coverage of urban grain consumption discussed above) is that they are not geared to (a) synthesizing well organized summary information from the volumes of data routinely produced by the local data collection system or (b) regular analysis of these data and timely report writing. Inadequate funding for the monitoring program and lack of access to a computer certainly contribute to this problem. More importantly, technical support for RCRD has so far not been sufficient to overcome the usual Chinese practice of collecting excessive quantities of data and then failing to critically analyze these data. The failure to synthesize information and summarize findings in timely reports is particularly severe in Yulin where, as noted above, technical support has been minimal.

25. Recommendations. The two major problems with the monitoring programs set up in Xinxiang and Yulin are the inadequate coverage of urban grain consumption and the failure to produce quantitative summary reports on a timely basis. As a solution to the first of these problems, the supervision mission urged the Xinxiang RMO to substantially expand the grain and vegetable oil section of the standard SSB urban household sample survey and the Yulin RMO to initiate a similarly expanded SSB sample survey of its urban households. Mr. Wang Zhifeng of the Xinxiang RMO responded that he himself had previously noted the need for better coverage of urban grain consumption and felt confident that, with adequate support from RCRD, the appropriate section of the SSB survey would be expanded. Staff of the Yulin RMO also concurred with the supervision mission's suggestion, but noted that undertaking such a survey in Yulin would require some additional funding and strong technical support. The supervision mission also noted that a duplicate survey of a representative population in a nearby urban area would also need to be undertaken since it is no longer possible to accurately assess pre-reform patterns of urban grain consumption in Yulin.

26. As a solution to the second of these problems, the supervision mission recommends RCRD to provide additional financial and technical support to the monitoring programs. The timely assembly, careful analysis and summary presentation of available data would be greatly facilitated by providing each RMO with at least one computer. The Yulin RMO would greatly benefit from additional funding and, in particular, strong technical support for the urban household income and expenditure survey and overall monitoring report writing. Further, both RMOs will require assistance in the analysis and presentation of monitoring data. A moderate effort on-site by RCRD to assist in the initial phases of the monitoring program could represent an important contribution to Xinxiang and Yulin RMOs' work and substantially improve its effectiveness. An appropriate first step would be the preparation of summary table formats for each category of the monitoring indicators (i.e., production, procurement, sales and trade of principal farm products; production budgets and input use; planned, negotiated and free market prices for farm inputs and outputs; agricultural taxes; and urban and rural income and expenditure with an emphasis on grain consumption) and topic outlines for monitoring reports.

C. Issues Concerning M&E Arrangements

Separation of M&E Responsibilities from General Administrative Functions

27. It is premature to make any judgement at this stage as to how well the M&E arrangements being set up for the RRP's are likely to work in the case of Meitan, Xinxiang, Yulin, Guanghan and Shangzhi (Appendix 3). There is no doubt that considerable effort is being made to increase local monitoring capacity with the reallocation/recruitment of statistical staff to perform this function on a fulltime basis. What is less clear at the present time, however, is the extent to which M&E is going to be managed separately from the routine data gathering and reporting operations of local government offices. For example, it is not apparent from the arrangements being made for M&E in Meitan that there will be someone appointed at the provincial level whose sole responsibility will be to direct the M&E. Each EZO, however, will need to have attached to it a specialized "M&E unit", with its own head.

28. Good M&E requires that M&E staff report in the first instance to the next level up in their own organizational hierarchy via communication channels which are separate from those used for the day-to-day flow of information relating to program management. It is up to the head of the M&E unit to determine the best way of feeding across to program management--at various levels--M&E information which will enable program management to perform its task better. If the M&E staff cannot maintain some degree of functional independence in their operations, while at the same time working closely alongside program managers and local leaders, it will be difficult for M&E staff to sustain the objectivity needed for good monitoring and to avoid being distracted from their primary task of ensuring the timely collection of accurate information on the selected indicators.

Training in M&E

29. The M&E training efforts at both the national level and related to specific RRP's referred to above, represent a very good start. However, considerably more will be needed to bring M&E capabilities up to the level required. Some of the RRP's are extremely comprehensive in scope and complex in terms of the cause-and-effect processes linking action to outcome (e.g., Fuyang), requiring very careful design of surveys and investigations if these are to yield useful information cost-effectively. In other RRP's, investigators will face reluctant respondents on some issues which will call for sensitive interviewing techniques by skilled people.

30. M&E training may in future have to include a wider audience and have greater technical content than appears to be envisaged at present. Thus, emphasis will need to be given to two basic forms of training:

- (a) Training which "sensitizes" local government leaders to the need for M&E and makes clear the differences between M&E activities and the kind of information collecting and reporting they have been used to in the past. An understanding by local leaders of the philosophy behind M&E and some knowledge of its methods will be essential if they in turn are to persuade lower level cadres and the public in general to cooperate in special surveys and investigations. The

training workshops and courses already held in Meitan and Southern Jiangsu as part of the general process of educating community leaders in the reform experiments are a step in the right direction, but more discussion of the M&E function specifically may be necessary.

- (b) Training is the sociological aspects of survey design and execution. Sample surveying as a means of obtaining information, whether by mail or direct interview, has increased substantially in China in recent years. The work of the RESST has expanded and there are now more than 10 organizations (government and nongovernment) in Beijing alone, for example, undertaking "consumer research," attitude studies and even "opinion polls." However, the number of people involved in survey work in China who have had adequate technical training in social survey design and execution is relatively small. The training needs of the newly-recruited M & E staff in the RRP are going to stretch available personnel resources severely. The setting up of some kind of "training of trainers" program in social survey work to support the M & E efforts at the regional level deserves serious consideration.

Greater Emphasis on the Parallel Monitoring of 'Control' Experiments

31. While it is too early to reach any definite conclusions, some of the difficulties experienced with implementing M & E in the Fuyang RRP may be due to the sheer complexity of the experiment. With multiple reform initiatives covering a wide variety of activities occurring simultaneously, it may be extremely difficult to arrange and coordinate the systematic monitoring of every important event in the program whether it is an "input" to it or an "output" from it. In such circumstances, the detailed tracing through of chains of cause-and-effect linking specific reform actions to specific results, though theoretically desirable may be practically impossible. It may be sensible to fall back on a less rigorous but more manageable method of monitoring in which cause-and-effect is inferred by comparing what is happening in 'control' areas (where the reforms are not being officially implemented) with what is happening in the Experimental Area. This is really a "black box" approach which simply concentrates on observing how socio-economic behavior differs in the presence or absence of the reforms taken as a whole and does not seek to explain in any detail the processes at work.

32. Thus in the Fuyang RRP, adoption of this approach would mean concentrating M & E resources on surveys of the characteristics and performance of enterprises, markets, government agencies, etc. both within and outside the FA and comparing the results. Less effort would be devoted to the much more difficult task of tracking all the individual announcements made and actions taken in the name of reform and trying to establish how effective each one was. This would appear to be the more effective way of using limited M & E resources.

D. Follow-up Action by the Next Supervision Mission

33. The next supervision mission should give particular attention to four aspects of the M&E of the rural reform program: finalization of the choice of key monitoring indicators for the RRP; details of the M&E organizational and staffing situation in each RRP; actual data gathering capability in selected RRP and overall (national and regional levels) M&E training requirements.

Monitoring Indicators

34. Details will be needed of precisely what indicators of progress or change each EZO intends to monitor, on the lines of the working paper prepared for the Meitan RRP (Appendix 1). Without a definitive 'short list' of this sort, the M&E work will be difficult to organize as a distinct activity in its own right and the M&E reporting will lack focus and consistency. It is highly likely that, as experience with actual data gathering and analysis gets underway, it will be found necessary to change the list of monitoring indicators. Some will be found to be too difficult to measure or observe, others will be found to be too loosely defined or ambiguous. In some RRP's the whole scale of the data collection operation which was originally planned may have to be reduced to fit within time and budget constraints. This is to be expected and the first twelve months of M&E in each RRP can reasonably be regarded as a 'pilot project' to refine the scope and procedures of M&E. It is necessary, however, to begin with some clear ideas about what is to be monitored, even if they have to be revised later. Such provisional short lists of key indicators should be drawn up for all the RRP's by February.

Organization and Staffing

35. If the concept of an "M&E unit" within each EZO--as discussed in above--is accepted as a valid organizational model, then details of the existing or planned organization, staffing and reporting arrangements will be needed for each RRP. It would be very useful to have diagrams prepared showing the actual/intended relationships between the M&E staff, the EZO and the usual offices of rural administration, together with tabulated data on M&E staffing at each level and location.

Functional Efficiency of M&E

36. In one, possibly two RRP's, it is suggested that the next mission examines in some detail how well the monitoring process is working. It would be instructive to select a particular indicator or related group of indicators (for example, those dealing with land fragmentation or payments in arrears in Meitan--Appendix 1, Table II-6, data items 13 through 17) and follow the information flow from primary sources up through the reporting system to its use in various analyses and presentations. At each stage, an assessment would be made about how appropriately the information is being used in relation to what is known about its reliability, its consistency with data on similar subjects from other sources and its relevance to particular reform management issues. The purpose of this exercise would be to help the EZOs concerned refine their M&E systems.

Training in M&E

37. It would help the review of M&E training needs if details could be made available to the next supervision mission of all the M&E training which has taken place to date. This should include information on the occupational or professional background and--in the cases where trainees were M&E staff--qualifications of the participants, the curricula of the courses given and examples of class and field exercises undertaken. A review of this material would be followed up by interviews with some of the trainees to ascertain to what extent the training they received was sufficient (taking into account also their prior qualifications and experience) for the M&E job they have to do.

Monitoring the Meitan Land System RRP

Translation: "Program for the establishment of monitoring and evaluation system for the construction of land institution in Meitan Experimental Zone, Guizhou Province (Draft)"

I. Objectives. Significance and necessity of establishing such a system

1. Meitan is one of 16 experimental zones of rural reform approved by the State Council, the topic of experiment is construction of land institution. This is a fundamental topic, extensive, comprehensive, universal its implications. In order to examine the progress in achieving the goals of the experiment, rectify the deviations in the design of the experiment, observe the progress of the experiment and do all we can to base the experiment on the scientific and systematic data. We must establish the system of monitor and evaluation for the construction of land institution.

2. The establishment of this monitoring and evaluation system is not only an important link in the process of the land institutions reform experiment, but also an important element in deepening statistical reform in rural areas. Its establishment and improvement will provide reliable and conclusive evidence for the achievement of multi-dimensional, multi-level, superior-quality service and supervision, and of scientification and democratization of decision-making process.

II. Identify the indicators of monitoring and evaluation system

1. The orientation and objective of land institution reform experiment has been the adherence to collective ownership, the flexible exercise land use right, and gradual formation a regulatory land market. The qualitative and quantitative indicators centering around this objective can be broken down to 6 major categories and over 200 data. Six major categories are as follows (for details, see the attached tables):

2. Indicators to the general organizational set up: Including number of district township (market-town), village, team; number of household, population, strength of labor force in 12 sectors, and the distribution, composition and movement of labor force. Composition, decrease and increase of land (cultivation land, woodland, pastures, orchards, unvegetated hills, grassy slopes, water surface).

3. Dynamic indicators of the process of land exchange and of changing conditions for production. Including the mode of realizing land ownership, land use right, promotion of rational exchanges of land, land transfer with compensation, and adoption of tenancy system; exploitation of non-cultivable land resources (referring to the unexplored and unutilized land for instance, unvegetated hills and slopes, unproductive water-surface); reformation of land (including the rearrangement of fields and land, the reclamation of the water-washed of sand-stuffed land and so on), changes in grades and prices of land

(grades: high, medium, low); and consolidation (scale-farming), development of intensive farming; increase of farm-machinery and equipment, extension of acreage under effective (sufficient) irrigation and of drought-flooding of plots, the development of small and medium-scale hydraulic power-stations.

4. Indicator of feedback (responses) from cadres and farmers to the land institution reform. Mainly referring to the understanding and acceptance, on the part of cadres at local level and the farmers, of the government's intentions of reform, orientation and goals, new measures, new institutions; and the qualitative indicators about whether farmers' awareness of commercialization and value of land.

5. Indicators of economic benefits. Including indicators about output, mainly the changes in output and commodity volume of the major agricultural produces such as grains, oil, tobacco, tea, mulberry, fruits, medicinal herbs, and others, and of the major livestock and poultry products such as pigs, cattle, sheep, fowl, rabbit, eggs. Also including definitive indicators of values, such as total social output value in rural areas, total agricultural output value, Net agricultural output value, and growth rate of total income, net income of agro-economy; changes in internal structure and sectoral structure in rural areas; increase in the total output value, total income of TVEs, increase in TVEs submission of taxation to the state and in their net profit, improvement of the ratio between agricultural productivity and output of the land; changes in farmers' incomes and expenses, and the improvement of their living standard; changes in Engel coefficient; composition and changes in composition of "5-small-3-high" household, household with decent income, and poor households.

6. Indicators of social benefits. Increase in and changes in composition of revenues from the rural areas and output value of the light-industry products using agricultural produces as raw materials; increase in social welfare funds in rural areas, growth of social welfare, development of culture and education, improvement of quality and literacy of rural population and labor force, changes in the enrollment of school-age children, construction of township (market-town) and increase and enlargement of marketplaces for agricultural produces and other products, increase and changes in the volume and value of the traded agricultural produces and other products; movement of farmers to cities for running enterprises and second tertiary services, etc.

7. Indicators of ecological benefits. Including the increase in reforested area, preserved forest area and in forest coverage, turning steep slopes (over 30°) back into woodland, pastures, decrease in the acreage of land suffering soil-erosion; increase in afforested area, etc.

III. Means of monitoring and methodology

1. Since the experiment cover wide area, is complex and difficult, we intend to adopt the approach of combining comprehensive statistical work with non-comprehensive survey such as sample survey, focus survey, model survey, questionnaire survey, etc. We should make full use of the data of the

statistical departments and other competent departments, and enable the data to complement and check each other. Cross-reference and analysis, scientific computation should be conducted so that the data are sound, reliable, accurate and comprehensive.

2. It's necessary to be equipped with appropriate monitoring tools. The County Statistical Bureau's equipped with two microprocessors; the County Rural Survey Teams are equipped with surveying instrument, the County Agriculture Bureau's equipped with the apparatus for surveying land and testing physical and chemical property of the soil, etc.

IV. Organizing the implementation

1. Leadership. Under the leadership of Experimental Zone Office, the research groups of monitoring and evaluation will play a leading role in directing the County Statistics Bureau, the County Rural Survey Team, the County Land Regulation (management) Bureau to coordinate and do their share of job, shouldering joint responsibility for the implementation of the program.

2. Setting up a statistical network. To ensure the obtainment of accurate data, we should equip each district, township, village with a full-time, professional statistician (by the end of October this year) to set up a statistical network at grassroots level, so that we can secure a timely and accurate filling in of all kinds of regular formulas, annual formulas, and these people can also take up the responsibility for temporary surveying missions.

3. Do a conscientious and good job of training. A planned training course will be offered in November this year to district heads, township councilors, village leaders, to secretaries at district and township levels, and to full-time statisticians. The lectures will be concentrated on the scope of survey and statistical work for filling in the formulas and gathering data, the criteria for calculation and method of calculation. Through training, each trainee is required to have a command of the techniques and a good knowledge on how to fill in formulas and report.

4. Setting up perennial observing point. As an early-warning system, the observing-points sit on the representative (sample) points of the agro-economy network, the assistant surveyors at these points will serve as early-warning people. They will follow and carry-out dynamic frequent examinations of the land disputes, fragmentation of land, tendency toward decreased agriculture inputs, they, then will issue timely warnings after defecting symptoms of trouble, aberrations and possible abruption of (trouble) problems, typical problems, so that the troubles and problems would be studied and resolved as early as possible.

5. Selection of a reference county. In order to heighten the comparability of the land system reform equipment, we identified and chose an adjacent county (Feng Gang County) with the identical economic conditions as a reference to Meitan Experimental Zone.

6. Statisticians and surveyors at all levels and assistant surveyors at various points should strictly abide by "Statistical Law of People's Republic of China" "Details Rules for the Implementation of the Statistical Law of PRC" and "Provisional Regulations for the Statistical Management in Guizhou Provinces" completing the statistical and survey work in an accurate, comprehensive and timely way. No administrator should interfere with the work, and should wilfully alter the essential data. If the statistics are found to be incorrect, the responsible people can be ordered to check the statistics and report.

7. Sources of funds. Expenses for regular survey and statistical work will be covered by the operational fee of the County Statistics Bureau and by the operational fee allocated by the County to the Rural Survey Teams, the uncovered part will be shouldered by financial assistance from the county. Expenses for the training of the full-time professionals, for surveys, data processing and for purchasing and installing the equipment will be covered by the funds from the Experimental Zone.

V. Reporting Regime

1. Regular statistical formulas will be submitted twice a year, June 30 and December 31st; the date at which to submit irregular sample surveys and questionnaire survey formulas will be determined by the Experimental Zone Office.

2. After all kinds of statistic data are obtained, the County Statistics Bureau will categorize the data, and submit them to the Research Groups of Monitoring and Evaluation of the Provincial Statistics Bureau for microprocessing then the data will be handled over to the Experimental Zone

CHINA

RURAL SECTOR ADJUSTMENT LOAN (LOAN 2967-CHA/Cr. 1932-CHA)
SEPTEMBER 1988 SUPERVISION MISSION

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1.2	Movement of Labor Force in Agriculture		"	Appendix B of Table 1 of SoA	"	
2.1	Statistical Balance Sheet of Acreage of Cultivable Land		"	Survey at grass-roots level	"	
2.2	Acreage of Cultivable Land Owned by the Collectives		"	"	"	
2.3	Exploitation of the Non-Cultivable Land		"	"	"	
2.4	Rearrangement and Reformation of the Land of the Farm Households		"	"	"	
2.5	Development of Business Managed by the "5 Small-3 High" Households		"	"	"	
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3.2	Output of the Major Agricultural Produces and Quality Sold		Rural resident surveyed household	Table 2.3 of AR.F	Resident survey	
3.3	Production of Animal Husbandry and Sale of the Products		"	"	"	
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4.3	Inputs into Agricultural Production		"	Resident survey	"	
5.1	Borrowing Loans from the Land Finance Company		Township-wide with all its farm households	Provided by the LFC	Land Finance Co.	
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6.1	Farm Machinery, Electricity, Chemical Fertilizer and Water Conservancy		"	Table 4 of CAR.A	Township Council	
6.2	Procurement and Possession of the Major Categories, Essential Fixed Assets for Production		Rural resident surveyed household	Table 1 (cont'd) & Table 8 of AR.F	Resident survey	

Table I-1: GRASSROOTS UNITS IN THE RURAL AREAS

A	Unit B	Codename C	Number I
<u>Grassroots units in the rural areas</u>	-	-	
Number of township (market-town) council	(Ge)	01	
Including: the established township (market-town) council		02	
Village Committee		03	
Including: the established village committee		04	
<u>Number of resident household at village level, at township level</u>	Household	05	
<u>Population of the villages and townships</u>	Capita	06	
<u>Total of the Labor Force</u>	"	07	
Including: male labor force	"	08	
Labor force for agriculture, forestry, animal husbandry, fishery, sideline occupations	"	09	
Labor force for industry	"	10	
labor force in township enterprises	"	11	
labor force in village enterprises	"	12	
labor force in enterprises run by new economic combines	"	13	
labor force in household business endeavors	"	14	
Labor force in construction industry	"	15	
Labor force in transportation and postal service	"	16	
Labor force in commerce	"	17	
Labor force in bars and eateries	"	18	
Labor force in service trades	"	19	
Labor force in education, culture, art, broadcasting	"	20	
Labor force in health care, sports activity and social welfare	"	21	
Labor force in other non-agriculture units	"	22	
Average of the actual cultivable land	Mu	23	

Explanation: Data in this table are (is) obtained from Table 1 of the Comprehensive Annual Report of Agriculture.

Table I-2: MOVEMENT OF LABOR FORCE IN AGRICULTURE

A	Unit B	Codename C	Number I
Number of household paying back the loans on schedule	Household	01	
Value of the repayment of loans	Y	02	
Acragage of the mortgaged land to be returned by the Company	Mu	03	
<u>Labor force in agriculture at the beginning of the year</u>	Capita	01	
<u>Movement of labor force from agriculture to 2nd,3rd services during the year</u>	"	02	
To industry	"	03	
to township enterprises	"	04	
to village enterprises	"	05	
to economic combines	"	06	
to privately-run enterprises	"	07	
To construction industry	"	08	
To transportation and postal service	"	09	
To commerce	"	10	
To bars and eateries	"	11	
To service trades	"	12	
To education, culture and broadcasting	"	13	
To health care, sports activity and social welfare	"	14	
To other non-agriculture units	"	15	
<u>Movement of labor force from 2nd,3rd services back to agriculture</u>	"	16	
<u>Movement of labor force from agriculture to other sectors in national economy</u>	"	17	
<u>Labor force in agriculture at the end of the year</u>	"	18	

Explanation: Data in this table are obtained from Table I, Appendix b of the Survey of Agro-economy.

Table II-1: STATISTICAL BALANCE SHEET OF ACAGE OF CULTIVATABLE LAND

A	Codename B	Unit Mu Number I
<u>Acragage of cultivatable land at the beginning of the year</u>	01	
Irrigated land	02	
Dry land	03	
<u>Increase in acragage of cultivatable land during the year</u>	04	
Newly reclaimed lan	05	
Land for capital construction regained for cultivation	06	
Other causes	07	
<u>Decrease in acragage of cultivatable land during the year</u>	08	
Occupation of land by statefor capital construction	09	
Occupation of land by collectives at township and vllage levels for capital construction	10	
Occupation of land by farmers for building the houses	11	
Cultivatable land turned into woodland	12	
Cultivatable land turned into pastures	13	
Cultivatable land turned into fishponds	14	
Cultivatable land abandoned as a result of calamities	15	
Other causes	16	
<u>Acragage of cultivatable land at the end of the year</u>	17	
Irrigated land	18	
Dry land	19	

Table II-2: ACRAGE OF CULTIVATABLE LAND OWNED BY THE COLLECTIVES AND ITS USE

A	Unit B	Codename C	Number I
<u>Acragage of cultivatable land owned by the collectives</u>			
Number of household receiving the land certificate this year	House-	01	
	hold		
Acragage of cultivatable land the land certificates cover	Mu	02	
Number of household contracting the cultivatable land owned	House-	03	
by the collectives this year	hold		
(this year) Acragage of the contracted cultivatable land owned	Mu	04	
by the collectives			
Contracting price (fee) for the contracted cultivatable land	¥	05	
Including: number of household bidding-contracting	House-	06	
	hold		
acragage of bidder-contracted land	Mu	07	
revenue from bidding-contracting	¥	08	
Number of household surrendering land use this year	House-	09	
	hold		
Acragage of land the fees cover (this year)	Mu	10	
Value of the surrendered land use fees this year	¥	11	
<u>Use of the contracted cultivatable land</u>			
Number of household tilling the contracted cultivatable	House-	12	
land themselves this year	hold		
Acragage of this self-till contracted cultivatable land	Mu	13	
this year			
Number of household hiring workhand to till the contracted	House-	14	
cultivatable land this year	hold		
Acragage of this workhand-tilled contracted cultivatable land	Mu	15	
this year			
Number of household tenanting the contracted cultivatable	House-	16	
land this year	hold		
Acragage of this tenanted contracted cultivatable land	Mu	17	
this year			
Number of household whose contracted cultivatable land is	House-	18	
expropriated this year	hold		
Acragage of this expropriated cultivatable land this year	Mu	19	
Including: Number of household whose cultivatable land is	House-	20	
expropriated for the violation of the agreement			
Acragage of this expropriated cultivatable land	Mu	21	
Number of household whose cultivatable land is bidden-	House-	22	
contracted this year	hold		
Number of household whose cultivatable land stands idle	House-	24	
this year	hold		
Acragage of this idle cultivatable land this year	Mu	25	

Explanation:

1. Expropriation of the contracted cultivatable land: covering the land of the orphaned; the widow(er)ed; the dear departed; and of those households (person) moving from agriculture to non-agriculture business; of those households whose land stands idle for no reason; of those households which violated the agreement(s) or refused to pay the required taxes. [The number of household whose contracted land is expropriated and the acragage of this expropriated land.]
2. Subcontracting: referring to the transaction of the household (farmer) handing over the contracted cultivatable land to others for tilling, then the household (the farmer) get land rent either in the form of agreed amount or crops or in cash.

Table II-3: EXPLOITATION OF THE NON-CULTIVATABLE LAND

A	Codename B	Number of house- hold I	Acrage (mu) 2	Total of inputs			Revenue
				Loans from Land Finance Company 3	Loans from other financial institutions 4	Self-raised funds 5	Revenue of current team 6
Total of the exploited non-cultivable land	01						
Acrage of the exploited cultivatable land this year	02						
Acrage of the exploited woodland this year including:							
(wood) timber for commercial use	03						
timber for construction use	04						
the exploited tea groves this year	05						
the exploited mulberry fields this year	06						
the exploited orchards this year	07						
the exploited plots for (herbal medicine) medicinal herbs this year	08						
the exploited pastures this year	09						
the exploited fishponds this year	10						
the exploited plots for other uses	11						
	12						

Explanations:

1. Non-cultivable land: refers to this unvegetated hills (mountains); unvegetated slops; unused banks; non-productive water(s).
2. Self-raised funds: refers to the funds raised from the sources other than the Land Finance Company and other financial institutions.

Table II-4: REARRANGEMENT AND REFORMATION OF THE LAND OF THE FARM-HOUSEHOLDS

A	Unit B	Codename C	Number I
<u>Rearrangement of the land of the farm-households</u>			
Total of the households whose land is rearranged	Household		01
Total acreage of the rearranged land	Mu		02
Number of household whose cultivatable land area is extended	Household		03
Acreage of this extended land area	Mu		04
Number of household whose land is consolidated	Household		05
Acreage of the consolidated land	Mu		06
Number of household reclaiming the water-washed, sand-stuffed land for cultivation	Household		07
Acreage of the land reclaimed for cultivation	Mu		08
Number of household whose cultivatable land is levelled	Household		09
Acreage of the levelled land	Mu		10
<u>Reformation of land</u>			
Total of households whose cultivatable land is reformed	Household		11
Total acreage of the reformed cultivatable land	Mu		12
Number of household whose low-and-medium-yielding plots are reformed	Household		13
Acreage of the reformed plots	Mu		14
Number of household turning barren soil into fields	Household		15
Acreage of the claimed fields	Mu		16
Number of household turning slopes into terraced fields	Household		17
Acreage of these new terraced fields	Mu		18

Explanations:

1. Rearrangement of land refers to the quantitative modification, while reformation of land refers to the qualitative modification. They are different in meaning.
2. Acreage of the rearranged land refers to the acreage of the extended land area after the rearrangement, it excludes the original acreage.
3. Extension refers to the outside expansion on the basis of the original acreage.
4. Land consolidation refers to the elimination of the earth partitions, resulting in an increase in land area.
5. Levelled as opposed to unlevelled which means the land unable to be put into full use, the levelled cultivatable land refers to the land useful and usable after being levelled.
6. Acreage of the reformed land will be the total acreage of land reformed.

Table II-5: DEVELOPMENT OF BUSINESS MANAGED BY THE "5 SMALL-3 HIGH" HOUSEHOLDS

A	Unit B	Codename C	Number I
Total of households managing "5 small-3 high" businesses	Household	01	
Total of people of the households managing "5s-3h" businesses	Capita	02	
Total of income of these households managing the businesses	¥	03	
Number of household engaged in small-scale plantation	Household	04	
population engaged in small-scale plantation	Capita	05	
income from the management of small-scale plantation	¥	06	
acrage of land for small-scale plantation	Mu	07	
Number of household engaged in small-scale forestry	Household	08	
and fruit-growing			
population engaged in small-scale forestry and	Capita	09	
fruit-growing			
income from the management of small-scale forestry	¥	10	
and fruit-growing			
acrage of land for small-scale forestry and fruit growing	Mu	11	
Number of household engaged in small-scale animal husbandry	Household	12	
population engaged in small-scale animal husbandry	Capita	13	
income from the management of small-scale animal husbandry	¥	14	
acrage of land for small-scale animal husbandry	Mu	15	
Number of household engaged in small-scale processing	Household	16	
industry			
population engaged in small-scale processing industry	Capita	17	
income from the management of small-scale processing industry	¥	18	
Number of household engaged in small-scale transportation	Household	19	
and marketing			
population engaged in small-scale transportation and marketing	Capita	20	
income from the management of small-scale transportation	¥	21	
and marketing			

Explanations:

1. Number of household engaged in the "5s-3h" business refers to the number of household whose per capita net income is over ¥ 500, whose income from the enlarged business constitutes over 60% of the total income.
2. People (population) of the households engaged in "5s-3h" businesses refers to the permanent members of a household, excluding the hired workhands.
3. Income refers to net income.
4. Acrage of the land for "5s-3h" refers to the idle land about the dwellings and exploited non-cultivable land, excluding the contracted collectively-owned cultivatable land.

Table II-6: OCCURRENCES OF LAND-DISPUTES BETWEEN FARM HOUSEHOLDS

Unit	A	Codename		Number	
		B	C	Number of occurred disputes	Number of settled disputes
<u>Illegal occupation of land</u>					
		-	-		
	Number of household destroying forests forland	Household	01		
	Acreage of land reclaimed after forests are destroyed	Mu	02		
	Number of household illegally occupying other's contracted cultivatable land	Household	03		
	Acreage of the illegally occupied contracted cultivatable land	Mu	04		
	Number of household building houses in the contracted cultivatable land	Household	05		
	Acreage of the contracted cultivatable land used for building houses	Mu	06		
	Number of household using the clay in the contracted cultivatable land for bricks and tiles (or for kilns?)	Household	07		
	Acreage of this misused land	Mu	08		
<u>Occurrences of land-disputes</u>					
	Number of household having land-disputes with others over boundary of the contracted plots	Household	09		
	Occurrences of boundary disputes of the contracted plots	time	10		
	Number of household having disputes with others over water supply	Household	11		
	Occurrences of water supply disputes	time	12		
	Number of household fragmenting the land as a result of division of family property	Household	13		
	Acreage of the fragmented land	Mu	14		
	Number of household in arrears with taxes and state quota grain	Household	15		
	Amount of taxes and state quota grain in arrears	Kilograms	16		
	Value of taxes and state quota grain in arrears	¥	17		
	Number of household having disputes with others over land	Household	18		

Table III-1: ACRAGE UNDER CULTIVATION FOR AGRICULTURAL PRODUCES AND OUTPUT

Codename	A	Acragc under cultivation (Mu) B	1	Total output (kilogram) 2	Output per Mu (kilogram) 3
<u>Grain Category</u>		01			
Paddy rice		02			
Wheat		03			
Tubers		04			
Corn		05			
Sorghum		06			
Millet		07			
Other food grains		08			
Soybean		09			
<u>Cash Crops</u>		10			
Cotton		11			
Oil-bearing crops		12			
Including: rape seed		13			
peanut		14			
Hemp		15			
Sugar		16			
Including: sugarcane		17			
Tobacco		18			
Including: cured tobacco		19			
Medicinal herbs		20			
Others		21			
<u>Other Agricultural Produces</u>		22			
Including: vegetables		23			

Explanation: Data in this table (are) is obtained from Table 5 of the Comprehensive Annual Report of Agriculture.

Table III-2: OUTPUT OF THE MAJOR AGRICULTURAL PRODUCES AND QUANTITY SOLD

A	Codename B	Output (kilogram) 1	Quantity sold (kilogram) 2	Quantity sold constitute % of the output 3
Grain	01			
Oilbearing crops	02			
Including: rapeseed	03			
Hemp	04			
Sugar	05			
Tobacco	06			
Vegetables	07			
Tea	08			
Fruits	09			
Silkworm	10			
Medicinal herbs	11			
Others	12			

Table III-3: PRODUCTION OF ANIMAL HUSBANDRY AND SALE OF THE PRODUCTS

A	Unit B	Codename C	Number 1
Heads of pigs sold during the year	Head	01	
Heads of pigs slaughtered by farmers themselves during the year	Head	02	
Quantity of pork of farmer-slaughtered pigs sold during the year	Kilogram	03	
Quantity of pork sold during the year	Kilogram	04	
Heads of sheep sold during the year	Head	05	
Heads of sheep slaughtered by farmers themselves during the year	Head	06	
Quantity of farmer-slaughtered mutton sold during the year	Kilogram	07	
Including: Quantity of mutton sold	Kilogram	08	
Heads of farmer-slaughtered cattles whose beef is sold during the year	Head	09	
Quantity of beef sold during the year	Kilogram	10	Heads of farmer-raised poultry sold
during the year	Head	11	
Including: Quantity of poultry sold	Head	12	
Output of eggs of fowl during the year	Kilogram	13	
Including: Quantity of eggs sold	Kilogram	14	
Output of fish and shrimps during the year	Kilogram	15	
Including: Quantity of fish and shrimps sold	Kilogram	16	

Explanation:

Data in this table is (are) obtained from Table 2 of the Annual Report on farm-household.

Table IV-1: TOTAL INCOME AND NET INCOME OF FARM-HOUSEHOLDS

A	Unit B	Codename C	Number I
<u>Annual total income</u>			01
Income from collective management of businesses			02
Income from economic combines			03
Income of households			04
Income from agriculture			05
Including: Income from grains			06
Income from forestry			07
Income from animal husbandry			08
Income from fishery			09
Income from handicraft			10
Income from gathering, fishing and hunting			11
Income from industry (TVEs)			12
Including: Income from grain-processing			13
Income from construction industry			14
Income from transportation			15
Income from labor service			16
Income from commerce			17
Income from bars and eateries			18
Income from service trade			19
Income from other household-managed businesses			20
Income from other non-production-related sectors			21
<u>Net income of the year</u>			22
Average net income per capita			23

Explanation:

1. Data in this table is (are) obtained from Table 5 of the Annual Report on Farm-Households.

Table IV-2: TOTAL EXPENDITURE OF FARM HOUSEHOLDS

A	Unit B	Codename C	Number 1
<u>Annual total expenditure</u>			01
<u>Household's expenditure for businesses</u>			02
Expenditure for agricultural production			03
Expenditure for forestry production			04
Expenditure for animal husbandry production			05
Expenditure for fishery production			06
Expenditure for handicraft production			07
Expenditure for industrial production			08
Expenditure for construction industry			09
Expenditure for transportation			10
Expenditure for commerce			11
Expenditure for bars and eateries			12
Expenditure for service trade			13
Expenditure for other activities			14
<u>Expenditure for the procurement of fixed assets for production</u>			15
<u>Submission of taxation</u>			16
<u>Fulfillment of contractual commitments of the collectives</u>			17
<u>Expenditure for daily life</u>			18
Expenditure for consumer goods			19
Food			20
Clothing			21
Housing			22
Fuel			23
Needed items and others			24
Expenditure for other purposes			25
<u>Expenditure for other non-production purposes</u>			26

Table IV-3. INPUTS INTO AGRICULTURAL PRODUCTION

	Code name	Number 1
Total expenditure for agriculture production	01	Explanation:
Seeds	02	Data in this table are obtained (at resident) survey point
Fertilizers	03	from data provided by households keeping accounts.
Pesticides herbicide	04	
Purchase of simple farm tools and their repair	05	
Oils	06	
Feed for livestock	07	
Fees for ploughing	08	
Fees for drainage and irrigation	09	
Fees for electricity	10	
Other expenditures	11	

Table V-1: FARM MACHINERY ELECTRICITY CHEMICAL FERTILIZERS AND WATER CONSERVANCY

	Unit B	Code name C	Number I
Agricultural mechanization	-	-	
Actual acreage of machine-plowed cultivatable land this year	Mu	01	Explanation:
Actual acreage of machine-sowed land this year	Mu	02	Data in this table
Including: Acreage of rice paddies where seedling - transplanters are used	Mu	03	are obtained from
Acreage of machine-harvested fields this year	Mu	04	Table 4 of the Comprehensive Annual Report of Agriculture
Electrification of Agriculture	-	-	
Requirement for electricity in rural areas	Kilowatts/hr	05	
Hydraulic-power station run by township (market-town)	Ge	06	
Generating capacity	Kilowatts	07	
Hydraulic-power station run at village or sub-village levels	Ge	08	
Generating capacity	Kilowatts	09	
Application of chemical fertilizers (net amount)	Ton	10	
Nitrogenous fertilizer	Ton	11	
Including: Ammonia water	Ton	12	
Phosphate fertilizer	Ton	13	
Patash fertilizer	Ton	14	
Compound fertilizer	Ton	15	
Bio-gas pits (tanks)	-	-	
Water-conservancy	-	-	
Acreage of sufficiently-irrigated land-driven	Mu	16	
Including: Land irrigated by machine (engines) pumps	Mu	17	
Land irrigated by electricity-motored pumps	Mu	18	
Number of (engine, electrical) motor-pumped wells	Yan	19	

Table V-2: PROCUREMENT AND POSSESSION OF THE MAJOR CATEGORIES OF ESSENTIAL
FIXED ASSETS FOR PRODUCTION

	Unit B	Code name C 1	Number
Procurement of the essential fixed assets for production during the year	-	-	
Trucks and pick-ups	Liang	01	Explanation:
Large and medium-sized tractors	Tai	02	Data in this
Small and hand-tractors	Tai	03	table are obtained
Engine-driven (powered) threshers	Tai	04	from Table 1
Rubber-tyred carts	Liang	05	(continued) and
Rubber-tyred wheelbarrows	Liang	06	Table 8 of the
Water-drawing pumps	Tai	07	Annual Report on
Water paumps	Tai	08	Farm-households
Motor-vessels	Tiao	09	
Beasts of Labor	Head	10	
Livestock with reproductive value	Head	11	
Possession of the essential fixed assets for production at the end of the year	-	-	
Trucks and pick-ups	Liang	12	
Large and medium-sized tractors	Tai	13	
Small and hand-tractors	Tai	14	
Engine-powered threshers	Tai	15	
Rubber-tyred carts	Liang	16	
Rubber-tyred wheelbarrows	Liang	17	
Water-drawing pumps	Tai	18	
Water pumps	Tai	19	
Motor-vessels	Tiao	20	
Beasts of Labor	Head	21	
Livestock with reproductive value	Head	22	

Table V-2: REPAYMENT OF LOANS BY FARM TO THE LAND FINANCE COMPANY

	Unit B	Code name C	Number I
Number of household paying back the loans on Schedule	Household	01	
Value of the repayment of loans	Y	02	
Acrag of the mortgaged land to be returned by the Company	Mu	03	
Number of household falling to repay the loans to schedule	Household	04	
Value of the defaulted repayment	Y	05	
Acrag of the mortgaged land expropriated by the Company for the default	Mu	06	
Number of household repaying part of the loans	Household	07	
Value of the repayment to be completed	Y	08	
Acrag of the mortgaged land expropriated by the Company for the defaulted part	Mu	09	
Number of household failing to the repay the loans on schedule for non-human factors	Household	10	
Value of the defaulted loans due to non-human factors	Y	11	
Acrag of the mortgaged land in question	Mu	12	

Table V-1: BORROWING LOANS FROM THE LAND FINANCE COMPANY

	Unit B	Code name C	Number I
Number of household borrowing loans	Household		01
Total value of the loans	Y		02
Including: Number of household mortgaging cultivatable land to the Company for the loans	Household		03
Value of the loans mortgaged (b) on cultivatable land	Y		04
Acreage of the mortgaged cultivatable land	Mu		05
Projected uses of the loans			
Number of household borrowing loans for the exploitation of the non-cultivatable land	Household		06
Value of the loans	Y		07
Number of household borrowing for the reformation of cultivatable land	Household		08
Value of the loans	Y		09
Number of household borrowing for the land rearrangement	Household		10
Value of the loans	Y		11
Number of household borrowing loans for land transfer	Household		12
Value of the loans	Y		13
Number of household borrowing for the extension of Agro-technology	Household		14
Value of the loans	Y		15
Number of household borrowing for the construction of production base(s) of agricultural produces	Household		16
Value of the loans	Y		17
Number of household borrowing for the processing, transportation and marketing of agricultural produces	Household		18
Value of the loans	Y		19
Number of household borrowing for the construction of industrial and commercial areas of townships	Household		20
Value of the loans	Y		21

Monitoring the Grain System Reform Programs

Xinxiang

A. Design

1. Organization and Staffing. Mr. Liu Dongtao, of the Xinxiang Reform Leading Group (XRLG), has been appointed head of the reform monitoring program. Mr. Liu leads several staff in their principal activity of assembling monitoring data from the routine statistical and accounting work of 15 local governmental and quasi-nongovernmental agencies and companies. These participating agencies and companies, listed in full in the Tab to this Appendix, include the branch bureaux of several central government ministries and bureaux (e.g., MOF, MOA, and SSB), several municipal government commissions and offices (e.g., the Planning Commission and the Vegetable Office), a number of state owned enterprises (e.g., the Fertilizer Company), and the quasi-nongovernmental Supply and Marketing Cooperative. Consistent with its greater capabilities and experience, the Xinxiang Statistical Bureau (XSB) has taken a lead role in Xinxiang's monitoring program. Headed by Mr. Zhang Xishan, Chief of the Agriculture Division, the XSB has assigned six staff on a part time basis to participate in all aspects of the monitoring work. The other 14 participating agencies and companies have each assigned one or two staff to the RMO on a part time basis. In combination with the several staff working under Mr. Liu, a total of about 30 staff are involved in the monitoring program.

2. Monitoring Indicators. In close conformance with the suggestions of the RSAL appraisal team (see RSAL LIV Working Paper #3 pp. 46-49), Xinxiang's monitoring program focusses on assessing the impact of the reform program on the following six areas:

- production of agricultural inputs and outputs;
- production budgets and input use;
- wholesale procurement and retail sales of agricultural inputs and outputs;
- planned, negotiated and free market prices for farm inputs and outputs;
- urban and rural income and expenditure; and,
- agricultural taxes.

A large number of monitoring indicators are subsumed within these six categories. These indicators are briefly summarized in the Tab to this Appendix and listed in full in the monitoring program handbook prepared jointly by XRLG and XSB. The handbook comprises an index, which details the frequency of observation, geographic coverage, reporting deadlines and unit responsible for each monitoring indicator, and 65 tables which, when completed, will bring together most of the data and information necessary to monitor and evaluate the impact of the reform program.

B. Implementation

3. Funding and Technical Support. The Xinxiang government has appropriated only limited funding, Y30,000, to cover the operating costs of the monitoring program. However, since the agencies and companies participating in the monitoring program routinely collect most of the data critical to monitoring the impact of the reforms, this funding should be sufficient to cover the correspondingly moderate incremental data collection costs. RCRD has provided additional funding, about Y10,000, to cover the costs of two additional surveys have been undertaken to supplement information supplied through the regular data collection system. One survey, undertaken prior to the reform, assessed county and lower level agricultural taxes, fertilizer availability and prices, and rural household income and expenditure. The second survey, undertaken this summer, assessed farmers' and rural cadres' understanding and opinion of the reform.

4. The monitoring program has benefitted from technical support provided by RCRD. Mr. Gao Xiaomeng, of RCRD's Development Institute, was assigned to the Xinxiang reform on a nearly full time basis during the design and initial implementation phases of the reform. During this period he contributed to the design of the two surveys funded by RCRD and assisted with preparation of the monitoring program handbook. Technical support for the monitoring program has not, on the other hand, included training of the staff of the participating agencies and companies responsible for the majority of data collection. However, this should not adversely affect the monitoring program since most or all of these staff are practicing statisticians and accountants and the participating agencies and companies have a proven track record of data collection.

C. Issues

5. Relying on the local data collection system and two special surveys, the Xinxiang monitoring program can be expected to bring together detailed information on all important aspects of the reforms except urban grain and vegetable oil consumption. Although the XSB routinely surveys the income and expenditure of 120 urban households, the survey questionnaire does not adequately distinguish between ration and nonration purchases or sufficiently differentiate grades and prices of grain and vegetable oil. This is a serious gap in coverage, especially since urban consumer grain and vegetable oil prices would be radically altered under the planned second phase of the reform program. It should also be noted that the monitoring program handbook includes only limited coverage of post-reform state (not local) agricultural taxes and local free market prices for farm outputs. Since participating agencies routinely collect these data these gaps in coverage should be easily filled.

6. Another important issue is that the monitoring program is focussed too heavily on data collection and places insufficient emphasis on the evaluation of available information. The monitoring program is simply not geared to synthesizing well organized summary information from the large volume of data routinely produced by the local data collection system. As a practical matter, the lack of even

one desk computer for sole use by monitoring program staff make regular data analysis and timely report writing nearly impossible. Furthermore, even if greater emphasis was given to data evaluation, the objectivity of such analysis would be suspect since the higher level staff involved in the monitoring program are all members of the XRLG.

D. Recommendations

7. The supervision mission urged the XRLG to substantially expand the grain and vegetable oil consumption section of the XSB urban household survey. Mr. Wang Zhifeng, of the XRLG, responded that he himself had previously noted the need for better coverage of urban grain and vegetable consumption and felt confident that, with the backing of higher authorities, it would be possible to convince XSB of this need. The supervision mission also urged RCRD to provide additional financial and technical support to the monitoring program. At a minimum, additional funding for at least one desk computer should be provided. Technical support should be directed to the managers of the monitoring program and focus on improving data analysis and evaluation. Lastly, while it would be impossible and inadvisable to completely separate the monitoring program from the XRLG, there is a need to give staff involved in monitoring some degree of autonomy.

8. The XRLG invited the Bank to assist and participate in the analysis of the monitoring data. A moderate effort by RCRD to assist with data analysis and evaluation would contribute to the success of Xinxiang's monitoring work and could substantially improve the effectiveness of the May/June supervision. An appropriate first step would be the preparation of summary table formats for each category of the monitoring indicators and topic outlines for monitoring reports. The Bank could also make a critical contribution by working with XSB, SSB, and RCRD's Statistical Analysis Unit to develop an appropriate grain and vegetable oil consumption module to be included in the urban sample survey at the earliest possible opportunity.

Yulin

A. Design

9. Organization and Staffing. The Yulin Reform Leading Group (YRLG) has established a monitoring program which relies critically on the statistical and accounting units of 13 local governmental and quasi-nongovernmental agencies. These participating agencies are listed in full in the Tab to this Appendix and include the branch bureaux of several central government ministries and bureaux (e.g., MOC, MOA, and SSB), several municipal government commissions and offices (e.g., the Planning Commission and the Economic System Reform Office), and the quasi-nongovernmental Supply and Marketing Cooperative. The monitoring program is run directly by the YRLG; unlike the Xinxiang monitoring program, the YSB has not taken a lead role. About 30 full and mostly part time staff are involved in the monitoring program.

10. Monitoring Indicators. Yulin's monitoring program focusses on assessing the impact of the reform program on the following six areas:

- production of rice and principal cash crops;
- production budgets and input use for rice;
- wholesale procurement and retail sales of rice and the number of enterprises engaged in grain trade;
- free market retail prices for farm inputs and outputs;
- financial costs of the reform to the provincial and municipal governments and industrial, commercial, and private enterprises; and,
- urban and rural income and expenditure.

The large number of monitoring indicators subsumed within these six categories are listed in the draft system of monitoring indicators prepared by the YRLG. This long listing of indicators, which is summarized in the Tab to this Appendix, includes free market retail price for an excessive number (156) of agricultural inputs and outputs. Unfortunately, the listing does not indicate the frequency of observation, geographic coverage, reporting deadlines and unit responsible for these monitoring indicators -- suggesting that no specific plans have as yet been drawn up.

B. Implementation

11. Funding and Technical Support. Funding and technical support for Yulin's monitoring program are grossly inadequate. The Yulin government has appropriated only about Y10,000 to cover the operating costs of the monitoring program, an amount hardly sufficient to cover incremental data collection costs and certainly inadequate for the planned urban and rural household surveys. Of even greater concern, the monitoring program has received no technical support from RCRD. As a result, the Yulin RRP staff were reduced to requesting the supervision mission for a copy of the Xinxiang monitoring program handbook.

C. Issues

12. The Yulin monitoring program can not be expected to bring together adequately detailed information on all important aspects of the reforms and will almost certainly fail to undertake an objective and critical evaluation of the impact of the reforms on behavior of urban consumers. As in Xinxiang, the most serious gap in the monitoring indicators is the inadequate coverage of urban grain and vegetable oil consumption. Unfortunately, the YSB does not undertake even the routine survey of urban households. Total ration grain sales are known, but it is impossible to determine even average urban per capita consumption from such data. The Yulin RRP staff are completely unable to assess trends in actual grain consumption disaggregated by type of grain (i.e., by ration and nonration, variety and grade) and income group. This gap in coverage is particularly unfortunate since Yulin has undertaken the most radical reform of urban ration grain and vegetable oil prices in the nation (other than the reportedly complete decontrol in Shenzhen).

13. As is also true for Xinxiang, another important issue is that the monitoring program is focussed too heavily on data collection and places insufficient emphasis on the evaluation of available

information. The monitoring program is simply not geared to synthesizing well organized summary information from the large volume of data routinely produced by the local data collection system and lacks access to even one desk computer were staff inclined to undertake such analysis. Lastly, Yulin's monitoring program is even more closely intertwined with the YRLG than is the case in Xinxiang; independent monitoring and evaluation would not be possible in such a context.

D. Recommendations

14. The supervision mission urged the YRLG to undertake the standard SSB urban household survey with an appropriately expanded grain and vegetable oil consumption module. Staff of the YRLG were in agreement with this recommendation but noted that undertaking such a survey would require additional funding and strong technical support. The supervision mission also urged RCRD to provide additional financial and technical support to the monitoring program. The YRLG invited the Bank to assist and participate in the analysis of the monitoring data and, given the weakness of the monitoring program in Yulin, it is likely that a moderate effort would substantially improve the effectiveness of the grain system monitoring arrangements.

Monitoring the Grain System Reforms in Xinxiang and Yulin:
Responsible Agencies and Indicators

Xinxiang

Responsible Agencies

The Xinxiang City Grain System Monitoring Office consolidates data collected by the following 15 municipal agencies and companies: Statistical Bureau, Agricultural Bureau, Grain Bureau, Industry and Commerce Bureau, TVE Bureau, Foreign Economic Relations Commission, Economic Commission, Urban Survey Team, Vegetable Office, Supply and Marketing Cooperative, Production Inputs Company, Petroleum Company, Fertilizer Company, and the Meat Packing Company.

Monitoring Indicators

Production:

- area, yield and output of main crops
- output of animal products
- production capacity, planned production, and stocks of fertilizer

Production Budgets and Input Use:

- production budgets for wheat, corn, rice, soybeans, cotton, peanuts, and vegetables
- production budgets for pork and chicken
- use of fertilizer and diesel per mu of wheat, corn, rice, soybeans, cotton, and peanuts

Procurement, Sales and Prices:

- planned and actual contract procurement of grain and vegetable oil (by the Grain Bureau)
- urban sales and interregional trade of grain and vegetable oil
- rural sales of grain
- negotiated procurement and sales of grain and vegetable oil by the Grain Bureau, Trade Department, Supply and Marketing Cooperatives, TVEs, and SOEs
- free market procurement of grain and vegetable oil by the Grain Bureau
- free market trade volume and prices of pork and eggs
- sales and retail prices of vegetables
- free market prices of grain, vegetable oil, meat, eggs, and vegetables in other cities
- within and outside plan sales of urea
- free market price of fertilizer
- within and outside plan sales of diesel

Income:

- urban distribution of income

- average urban per capita income and expenditure
- budget shares by food category for average and poor urban households
- average rural per capita income by township
- average rural household income and expenditure by township
- rural income and expenditure by township for poor households

Yulin

Responsible Agencies

The Yulin City Grain System Monitoring Office consolidates data collected by the following 13 municipal agencies and companies: Statistical Bureau, Agricultural Bureau, Grain Bureau, Price Bureau, Industry and Commerce Bureau, Commerce Bureau, Planning Commission, Economic Commission, Agricultural Commission, Economic System Reform Office, Agricultural Production Office, Finance Office, and the Supply and Marketing Cooperative.

Monitoring Indicators

Production:

- area and output of rice (total and by season and type)
- area, yield and output of sugar cane, bananas, tobacco, and bast fibre

Production Budgets and Input Use:

- production budget and analysis for rice
- use of fertilizer, manure and labor in rice production

Procurement, Sales and Prices:

- contract procurement of rice (total and by type)
- monthly ration sales of rice (total and by type)
- negotiated sales of rice (total and by type)
- free market sales of rice
- number of enterprises engaged in grain trade
- retail prices of 16 farm tools, 15 fertilizers, pesticides, and diesel fuels, 9 other farm inputs, 7 staple foods, 60 nonstaple foods (mostly vegetables, meats and fish), 15 tobacco, tea and beverage products, 28 other foods (mostly fruits), and 6 heating fuels

Financial Analysis:

- absolute value and share of the fiscal costs of explicit grain subsidy (by prefectural and municipal governments and industrial, commercial and private enterprises)

Income and Welfare:

- planned sample survey of 100 urban households covering income distribution, monthly allotment of ration grain and actual grain consumption
- planned sample survey of 100 rural households covering area sown to grain, production expenses, contract and noncontract grain sales, grain purchase and consumption, and sources of income

Shangzhi County Rural Reform Pilot Area:
M&E Indicators Systems for Measuring Final Results 1/

0.1 Pilot project: Buildup of peasants' specialty cooperative organizations

0.2 Based on design requirements in the pilot project documents, final results should be manifested in three areas: A. Innovation in organizational forms: assisting the peasants to set up specialized cooperative organizations with a variety of formats and types, in order to form specialized cooperative systems consisting of many levels and functions. B. Institution building: formulating general principles and policies that would benefit the peasants' cooperative organizations, plus local laws, decrees, rules, and regulations. C. Economic development: promoting the development of specialized production and the level and speed of local economic development.

0.3 The establishment of M&E indicators systems to check the final

1/ Source: Pilot Area Newsletter No. 17, Issued by: Shangzhi County Rural Reform Pilot Area Office, May 26, 1988.

results of the pilot project means the quantification, by means of indicators, of the above-mentioned qualitative goals. This would facilitate efforts to measure the degree of success as exhibited in the final results and to strengthen control over the experiment processes.

I. M&E Targets

1.1 The Shanzhi Pilot Area covers 22 towns/townships, 346 administrative villages, and 698 natural tun (villages) in the county.

1.2 The M&E targets are the various types of peasant specialty cooperatives that have emerged within the confines of the pilot area. Because the emergence, growth, and development of such cooperative organizations are a dynamic process, with constant changes in terms of quantity, so it would be necessary to divide the M&E targets into two categories: those to be placed under direct M&E, and those under indirect M&E. The numbers in the first category are fixed, while the numbers in the second category are fluid. The sum of the two makes up the Comprehensive Whole under M&E. Evaluation of the final results is a comprehensive analysis of the Comprehensive Whole.

1.3 The Direct Target (475 in all) consist of various types of peasant specialty cooperative organizations, confirmed by a general survey, at the time the project proposal was being drawn up. The Indirect Targets are those peasant specialty cooperatives that have newly emerged since the pilot project began, due to the implementation of the new systems and an improvement

in the general climate. The M&E indicators that have been formulated are applicable to both. By the emphasis of M&E is on the Direct Targets.

1.4 The 475 direct targets can be divided into three types, according to the design laid out in the project proposal: A. Peasant Cooperative Funds: 330 in all. B. Peasant Specialized Production Associations: 38 in all. C. Combined Specialty Development Companies: 7 in all.

1.5 To facilitate tracking observation, the summarization of experiences and the promotion of role models, the direct targets are again divided into two tiers: A. Pilot Units: These are well-formed, representative specialty cooperative organizations, which again are divided into two sub-groups. One sub-group is placed under the direct monitoring of the County Pilot Area Office, totaling 14 organizations: including 4 cooperative funds; 7 specialty associations, and 3 development companies. The other sub-group is monitored by the Town/Township Office for Reform, totaling 88 organizations: 44 cooperative funds; 44 specialty associations. Pilot Units account for 21.5% of all direct M&E targets. B. Non-Pilot Units: 373 in all, account for 79.5%.

1.6 The above is an account of the M&E targets -- consisting of three types and three levels. In terms of levels, the first level comprises the 475 direct targets and 400 indirect targets (estimated), which together (875 in all) form the Comprehensive Whole. The second level comprises 102 Pilot Units. The third level has 373 Non-Pilot Units, as listed in Section 1.5.

1.7 The development and changes in the specialty cooperative organizations will necessarily be reflected in the rural economy and in the entire economy of the country. Therefore, the county's rural economy and the entire economy are also indirect targets of the Pilot Area's M&E system for an evaluation of the final results.

II. What Will Be Monitored and the Indicators Systems

2.1 Based on the requirements for final evaluation under the project, three sets of M&E indicators systems have been designed: A. The M&E indicators systems for direct targets. B. The M&E indicators systems for indirect targets. C. The M&E indicators systems for processes.

2.2 "A" above refers to the monitoring and evaluation of those direct objectives to be achieved by the pilot project with respect to the buildup of peasants' specialty cooperative organizations. Because such organizations in their aggregate and in their separate types have different goals to achieve, so the M&E priorities will be different. That is why different M&E indicators systems are developed.

2.2.1 The indicators system monitoring the peasants' specialty cooperative organizations as an aggregate includes:

17 aggregate indicators:

(1) Number of cooperatives

Of which: Cooperative funds

Specialty associations

Specialized development companies

(2) Distribution of trades/sectors

(3) Classification of organizational status

Of which: Entity type

Service type

Coordinating type

Single existence type

(4) Number of people who have joined

(5) Total output value (total revenue)

(6) Total assets

Of which: Fixed assets

Working fund

(7) Number of enterprises owned

Of which: Processing enterprises
Commercial enterprises
Service enterprises
Financial enterprises

(8) Number of staff and workers

Of which: Peasants

(9) Total enterprise assets

Of which: Fixed assets
Working fund

(10) Total enterprise output value (total revenue)

(11) Total volume of processing; output value

(12) Total sales; revenues

(13) Total volume of services rendered; value

(14) Taxes

(15) After-tax profits

(16) Per capita income

(17) Monetary amount of total cooperative shares

The above 17 indicators and their growth rate (rate of change) in a given period, plus the relative percentage as compared with the reference indicators, constitute the "aggregate M&E indicators system for measuring the results of the project."

2.2.2 M&E with regard to cooperative funds look into three areas: One, organizational buildup, including: internal setup, the function of each unit, and relationships with other cooperatives, the Party, and government agencies. Two, institution building, including: independent accounting system, democratic management, review and approval of loan applications, dividend-paying based on shares, and a post responsibility system. Three, role and functions, including: the funds' role in stimulating capital flow in the rural areas, and the distinctions between such cooperative funds and the Agricultural Bank, the credit co-ops and other state financial organizations. Also included is their role in promoting the development of a commodity economy in the rural areas. Major indicators include the following 15 items:

(1) Number of peasant cooperative funds

(2) Number of shareholders

(3) Number of persons in the leadership setup

Of which: Number of village cadres

Number of shareholders' representatives

(4) Shareholders' meetings or representatives' meetings called

(5) Total monetary amount of shares

(6) Total amount of working capital

(7) Amount committed to loans

(8) Capital turnover rate

(9) Amount of profits

Of which: Dividend paid

Enlarged of share fund base

Management cost

Wages and bonuses

(10) Amount of "three types of debts"

Of which: Owed by peasants
Owed by staff and workers
Owed by (work) units

- (11) Amount owed in on-lent funds
- (12) Amount in debt recovery
- (13) Monetary amount in added shares
- (14) Amount of deposits taken in
- (15) Average profit from per-¥100 loaned

In addition to these 15 indicators that involve the fund itself, there are yet 4 indicators that monitor the results that the loans bring in:

- (1) Total income for the village
 - Of which: Income from projects supported by loans
and the changes in growth
- (2) Peasants' per capita income
- (3) Output in various industries

Of which: Product output from projects supported by loans

- (4) Changes in income derived from production engaged in by typical households

Of which: How the poor households have broken free
How the specialty households have developed

The above system of indicators can not only be used to test the "pilot" cooperative funds, but can also be used for all cooperative funds under direct M&E.

2.2.3 The M&E as applied to the peasants' specialized production associations cover mainly the following areas:

Sorting out property relationships; setting up viable accounts; clarifying the relationships between responsibilities, rights and benefits for association members; formulating a principle for the distribution of benefits; working out viable rules and regulations; clearing up the external environment for the development of these associations; sorting out relations with the local Party and government organizations; raising the organizational level of peasant associations and their ability to conduct dialogues with society. This system of M&E indicators includes 20 aggregate indicators:

- (1) Number of associations

- (2) Total membership

- (3) Distribution of specializations

- (4) Classification of types
 - Of which: Entity type
 - Service type
 - Coordinating type
 - Single existence type

- (5) Classification of status
 - Of which: Mutual-aid associations
 - Cooperative associations

- (6) Geographic distribution
 - Of which: Within the community
 - Cross communities

- (7) Total amount of services; value

- (8) Trades and number of persons receiving the services

- (9) Total output value of specialized production (total revenue)

(10) Income from sales

(11) Net output value

(12) Number of enterprises set up

(13) Total wage bill

(14) Taxes

(15) After-tax profits

Of which: Dividends paid

Collective benefits

Management fee remitted

As additional investment

(16) Original value of fixed assets

(17) Net value of fixed assets

(18) Fixed assets added

(19) End-period amount of working capital tied up

- (20) End-period amount of financial loans (including all kinds of bank loans and short-term borrowings)

This M&E indicators system is fully applicable for all peasants' specialized production associations under direct monitoring and evaluation.

2.2.4 The M&E for specialized development companies covers mainly the following: organization, investment, operations, and distribution formats; and a "lead" processing function, a main-body investment function, a service-center function, a market-intermediary function, and a dialogue representative function. This system includes 18 aggregate indicators, 10 quality indicators, 16 indicators that reflect enterprise-building and sources of financing, 14 indicators that reflect distribution relationships in the enterprise, and finally 18 indicators that reflect the enterprise's balance sheet.

The 18 aggregate indicators are:

- (1) Number of development companies

Of which: HQ offices

Branch companies

- (2) Number of enterprises combined under the companies

Of which: State enterprises
Town/township enterprises
Village enterprises
Enterprises set up by cooperatives
Enterprises set up by individuals

(3) Forms of association between enterprise and company

Of which: Number of enterprises directly owned by company
Share participation by company
Supported by company's regulation fund
Receiving services from company

(4) Degree of peasant participation in company/enterprise

Of which: Amount of capital participation
Number of participating managers

(5) Number of staff and workers

Of which: Number of peasants

(6) Total output value (total revenue)

(7) Sales revenue

- (8) Net output value
- (9) Total wage bill (staff and worker average incomes)
- (10) Taxes
- (11) After-tax profits
 - Of which: Dividends paid
 - Return of profit
 - Collective benefits
 - Management fee remitted
 - Additional investments
- (12) Original value of fixed assets
- (13) Net value of fixed assets
- (14) Fixed assets added
- (15) End-period amount of working capital tied up
- (16) End-period amount of financial loans (including all kinds of bank loans and short-term borrowings)
- (17) Turnover rate of working capital

(18) Total monetary amount of shares

The 10 quality indicators are:

- (1) All-personnel productivity (rate)
- (2) Per capita net output value
- (3) Taxes per 100 yuan of output value
- (4) Profit rate per 100 yuan of output value
- (5) Fixed assets used per 100 yuan of output value
- (6) Working capital used per 100 yuan of output value
- (7) Loan fund used per 100 yuan of output value
- (8) Asset-liability rate (total loans + short-term borrowings/fixed assets + working capital ?)
- (9) Taxes and profit generated by per 10,000 yuan of loan
- (10) Staff-worker equipment co-efficient (per capita original value of fixed assets)

16 indicators for M&E that reflect the initial establishment of the company/enterprise and sources of funding:

(1) Initial investments during the period from initiation to formal operation (investment-in-kind should be converted to amounts of money); (2) in the initial investments, allocations from county government or above; (3) amount of working fund provided by county government and above; (4) bank loans (of which, loans from the Agricultural Bank). (5) loans from the Credit Co-ops; (6) amount of working fund provided by the department-in-charge or by other concerned departments; (7) accumulations by rural collectives; (8) civilian borrowings; (9) financing from staff in the enterprises; (10) funds raised from the public (11) investment by joint venture partner or partners; (12) processing of materials shipped from outside; (13) amounts of down payments received for future delivery of products; (14) donations from individuals and organizations; (15) amount of share capital; and (16) other sources of funding.

14 indicators that reflect distributional relationships in the enterprise:

(1) Staff and worker total income (of which: wages, bonuses, and dividends); (2) actual amounts of industrial and commercial taxes paid; (3) total profit; (4) actual amount of income tax paid; (5) profit remitted; (6) management fees remitted; (7) education funds remitted; (8) assessments and donations made; (9) repayment of loan principal; (10) other loan

repayments; (11) splitting profits with joint venture partner(s); (12) dividends paid to shareholders; (13) used for incentives for staff and workers; (14) set aside as enterprise accumulations (of which: as added fixed assets; as added working capital; used for collective benefits; as added reserve fund)

18 indicators the reflect the enterprise's status in respect of assets and liabilities:

(1) Original value of fixed assets; (2) net value of fixed assets; (3) total amount of working capital (of which: cash, bank deposits, receivables); (4) other funds being used; (5) total enterprise assets ($1 + 2 + 3 + 4 = 5$); (6) bank loans; (7) loans from department(s) concerned; (8) loans from outside units; (9) funds raised from the public (10) civilian borrowings; (11) funds raised from staff and workers in the enterprise; (12) wages payable; (13) taxes payable; (14) amount of profit to be remitted; (15) other payables; (16) total liabilities ($6 + 7 + 8 + 9 + 10 + 11 + 12 + 13 + 14 + 15 = 16$); (17) assets owned by the enterprise ($5 - 16$); (18) total assets sources ($16 + 17$)

Through the monitoring and evaluation by means of the above 78 variable indicators, the following may be basically found out about the company/enterprise: how it was first founded; its scale; sources of funding; internal property ownership relationships; its external assets and liability status; forms of income distribution; economic results, etc.

2.2.4 For the above aggregate M&E and three sub-projects, a total of 134 indicators have been designed, which can be used to evaluate the final results of the direct objectives set for the pilot area.

2.3 As for the M&E indicators systems for indirect objectives, they are used to monitor and evaluate the development and change that occur in the rural economy and in the general economic situation in the county.

2.3.1 8 "structural" indicators have been designed for the pilot area:

- (1) The makeup of GVIAO
- (2) The percentage of GVAO in Gross Social Output Value
- (3) The percentage of non-farm output value in total rural output value
- (4) Employment structure in the first, second and third industries
- (5) Percentage of farm labor moving over to non-farm industries
- (6) The income structure in the first, second and third industries

- (7) Total rural per-capita income

- (8) The percentage of non-farm income in rural per-capita income

The above 8 "structural" indicators can basically reflect the rural economy and the changes in its status in the national economy; it also reflects changes in the peasants' economic status.

2.4 The indicators systems for process M&E are used to monitor the phasic progress of the targets, with the aim to ensure that the pilot project could move ahead as scheduled and that timely corrections would be made for problems that may arise.

2.4.1 The overall process M&E indicators system for peasants' specialty cooperatives includes 3 "time" indicators for the evolving phases:

- (1) The design and justification phase for the pilot project (April 1987 to November 1987);

- (2) Operating and project-implementing phase (December 1987 to June 1989);

- (3) Summarization and evaluation phase (June 1989 to December 1989)

2.4.2 The process M&E indicators system for the peasants cooperative fund sub-project includes 7 "time" indicators for the various phases:

- (1) Sorting out debts and credits and converting them to shares for each household (6 months);
- (2) Establishing the organizational setup and formulating the charters (1 month);
- (3) Organizing the recovery of money owed and loans on-lent; initiating all sorts of activities (6 months);
- (4) Improving internal rules and regulations (2 months);
- (5) Expanding share capital base, initiating operations in deposit-taking and loan-making, and adding to the operations (6 months)
- (6) Developing higher-level credit cooperation (12 months);
- (7) Summarizing experiences, putting forth policies, and recommending laws and rules (4 months)

2.4.3 The process M&E indicators system for the peasants' specialized production association sub-project includes 8 "time" indicators for the various phases:

- (1) Selecting the pilot units (1 month)
- (2) Improvements to be made in the pilot units (2 months);
- (3) Selectively promoting the experiences in the pilot units and expanding the scope of the pilot project (3 months);
- (4) Organizing the training of cadres (3 months);
- (5) Sorting out the external environment (2 months);
- (6) Developing the processing industry (12 months);
- (7) Developing higher-level cooperation (12 months);
- (8) Summarizing experiences, putting forth policies, and recommending laws and rules (4 months)

2.4.4 The process M&E indicators system for the specialty development company sub-project includes 6 "time" indicators with respect to the phases:

- (1) Setting up the development companies (1 month);
- (2) Introducing rules and systems (1/2 month);

- (3) Setting up processing enterprises and building them into economic entities (12 months);
- (4) Sorting out property relationships, and improving the operating and managerial mechanisms (3 months);
- (5) Resolving the ways by which peasants can participate and the degree of government participation (4 months);
- (6) Summarizing experiences, putting forth policies, and recommending laws and rules (6 months)

Because the various types of specialty cooperative organizations have different circumstances and characteristics, so in the actual implementation of the pilot project the progress of the various evolving phases in bound to have different paces. In terms of the time schedule set, there will be a lot of overlapping and accommodations.

III. Means of Monitoring and Organizations

3.1. Different monitoring periods should be set for different targets, and different means shall be employed depending on the content of monitoring. For the 102 pilot M&E units, tracking surveys will be conducted for the compilation of monthly reports and a final year-end summarization report. Each quarter, a single-focus report will be prepared and by year-end

these will be consolidated into a comprehensive report. For the 373 non-pilot M&E units, a method will be used that comprises periodic summarization of a typical case or cases, timely feedback of information, quarterly reports, and year-end summarization. As to the indirect M&E targets, that is, for the estimated 400 or so peasant specialty cooperatives, a general survey will be used, which will be conducted on a semi-annual basis.

3.2 Monitoring on the indicators systems by the Pilot Area will be carried out in the following manner: The county will gather the data, mainly through regular reports and special-topic data submitted regularly by the grassroots units or uniformly required. Finally, statistical synthesis and analysis will be made by category and group. Simultaneously, survey forms and questionnaires will be distributed to facilitate summarization and analysis.

3.3 The monitoring organizations include the following: The M&E on 14 pilot units will be handled by the County Rural Reform Pilot Area Office itself. The 88 pilot units and non-pilot units throughout the Area will be handled by the Township/Town Reform Offices, which make regular reports to the County. The general survey on the indirect targets is to be organized by the County Office.

Asia files

THE WORLD BANK INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

Ln 2967/cr 1932-CHA

DATE: December 29, 1988

TO: Mr. Moeen A. Qureshi, Senior Vice President, OPN
Mr. Attila Karaosmanoglu, Regional Vice President, ASI

FROM: Joseph R. Goldberg, Division Chief, AS3AG JG

SUBJ: China-Rural Sector Adjustment Loan (RSAL)

As per Mr. Burki's request, attached please find the aide-memoire of the initial RSAL supervision mission which he would like to share with you. The loan and credit were declared effective on September 19, 1988.

Attachment

cc- Messrs. Yenai (ASIVP); Burki, Ahmad, Tidrick (AS3DR); Pearce (AS3CO)

RBurcroffII/ms

Executive Summary
(AIDE MEMOIRE)

EXECUTIVE SUMMARY

China RSAL: Findings of Post-Effectiveness Supervision

1. The Statement of Rural Reform Policies indicated that national reforms would be prepared during 1988, for implementation during 1989 and 1990. The regional reforms, in the form of "experimental" programs (RRPs), would either be initiated in 1988 or move into a second phase. It was agreed that monitoring systems would be developed along lines suggested by staff. The 1988 program was generally implemented on schedule. As a result of the stabilization policies, however, setbacks may occur during 1989. Main findings are summarized below.

2. Land Management System (LMS): The mission was invited to attend a high-level "rural work" conference, organized to establish a policy framework for LMS reform. The conference concluded that the difficult trade off between efficiency and employment objectives should be addressed through regionally tailored LMS policies that feature a much larger role for market forces. The mission endorsed this approach. Implementation of the LMS RRP was unbalanced during 1988. Progress with the leasehold market experiment (Meitan, Guizhou) has been noteworthy, including establishment of China's first land banking institution. In 1989, the Meitan design will be extended province-wide. However, the land consolidation experiments have either fallen behind schedule (Southern Jiangsu) or failed completely (Nanhai, Guangdong), a result of inappropriate design. The mission reiterated previous recommendations that agricultural marketing be freed-up completely in one of the three counties in Jiangsu and that grain imports be permitted. We also recommended that the Nanhai RRP be redesigned to test production and marketing arrangements for high valued crops.

3. Grain System. To help "counter inflation", a six part program is being adopted for 1989 to stimulate grain production through traditional administrative means. The mission advised that the program may destabilize the rural economy rather than achieve intended results and thus aggravate China's macroeconomic problems. The Bank offered to do a quick review of grain issues before China's guidelines for 1990 have been finalized. Implementation of the two grain system RRP (Xinxiang, Henan and Yulin, Guangxi) was very successful in 1988. Second stage plans are now being finalized. However, both RRP experienced budgetary shortfalls during 1988, a result of unanticipated inflation, and some erosion of staff morale. The mission recommended that adequate budget be assigned for 1989. To counter the morale problem, the State Council intends to reaffirm its commitment to the regional reforms in the near future.

4. Rural Enterprise System. TVE reform will likely become hostage to current restraints on off-Plan investment. Since the burden will be shouldered mainly by collectively- and privately-

owned enterprises, indiscriminate cutbacks could force stronger TVEs into liquidation alongside the less viable ones, thus imperilling China's off-farm employment objectives. National Private Enterprise Regulations were issued by the State Council in July, 1988. RCRD has drafted trial regulations for all non-State owned enterprises, which are broader and appear to be an improvement on the July 1988 proclamation. Together with trial insolvency regulations, these are scheduled for testing under the Fuyang, Anhui RRP once approval is received from provincial and local authorities. The mission believes that these trial regulations may demonstrate means for China to create a politically viable business environment, and therefore encouraged RCRD to initiate testing as soon as possible. Meanwhile, the Fuyang RRP's 20-odd components progressed at a rapid pace during 1988, supplemented by RCRD programs in four coastal regions to encourage TVE exports.

5. Rural Financial Markets. Though uncertainty is pervasive in China's rural financial markets, substantial progress was made during 1988 in the Guanghan, Sichuan RRP (for formal sector institutions) to increase unit autonomy, link staff remuneration with unit performance, establish interbank markets, and streamline settlement procedures. For the 1989 program, the mission recommended more autonomy in the setting of interest rates, and a review of unit performance in early 1989. Under the Fuyang RRP, however, worrying developments underscore the need for sound standards and broader financial policy guidelines for informal sector intermediaries. The mission offered Bank assistance for the preparation of trial rules and regulations. RCRD intends to respond shortly to this proposal.

6. Monitoring Systems. Good progress has been made to set up monitoring systems for the RRP's. Criteria have been determined, training initiated, and the requisite surveys have been designed. However, all M&E activities lack budget, while most have not been placed in functionally independent units. Within the Fuyang RRP, executive authority has been transferred from the prefectural office to the 8 participating counties. While these arrangements have eased implementation, effective M&E is nearly impossible. The mission urged RCRD to give the M&E units organizational autonomy, measurably augment their budgets, and--for Fuyang--to reassign responsibility for M&E to the prefectural level.

7. Withdrawals and Procurement. As of November 21, 1988, the equivalent of US\$ 243 million had been withdrawn from RSAL proceeds. The Credit has fully disbursed and was closed on December 19, 1988. The mission noted that this represents an extremely rapid draw down, though perhaps understandable given the financial stringency which China believes it faces. No ICB tendering has been utilized thus far. The MOF has confirmed via telex that at least US\$ 50 million of the remaining procurements would be carried out using serial ICB tendering procedures.

World Bank Mission to China
for 1st Supervision of the
Rural Sector Adjustment Loan

A. INTRODUCTION

1. A World Bank mission visited China from September 12-29 and October 16-November 16, 1988 to initiate supervision of the Rural Sector Adjustment Loan (RSAL). Our main tasks were to: (a) assist as necessary with arrangements for loan effectiveness, (b) review the status of the overall reforms, as detailed in Part III of the Statement of Rural Reform Policies, (c) update our understanding of developments in the regional reform programs (RRPs) being implemented under State Council guidance, and (d) advise on matters arising concerning the utilization of loan proceeds, procurement procedures and disbursements.

2. In Beijing, the mission was briefed on the pace of overall reform and progress in the experimental zones by senior officials of the Research Center for Rural Development (RCRD) and the China Agribusiness Trust & Investment Corporation (CATIC). Details of the nine new RRP's under the purview of the RCRD were also discussed. Subsequent meetings were held with the Ministries of Finance, Commerce, Agriculture and Water Resources to review the overall reforms; and with the State Planning Commission's Department of Rural Economy, the People's Bank and the Agricultural Bank of China to discuss reorganization of the State Investment Program and developments in China's rural financial markets.

3. After initial briefings, the mission travelled to various experimental zones to review progress with the grain system reform (Xinxiang Prefecture, Henan and Yulin City, Guangxi); land management reform (Meitan County, Guizhou and Shunyi County, Beijing); rural enterprise reform (Fuyang Prefecture, Anhui Province); and reform of rural financial markets (Guanghan, Sichuan, Fuyang Prefecture and Meitan). During these visits, our staff exchanged views with RCRD and local officials about design, implementation, initial impact, staffing, budgeting and plans. We also reviewed the monitoring systems and indicators being set-up to track progress. While in Guizhou, the mission was invited to attend the Conference on Land System Reform, held in Zunyi City between September 20-21, where we presented our views on the design and financing of the land-lease market and land consolidation programs. Also, two experts in the field of perishable products marketing, who joined the mission in response to a request from RCRD, reviewed product acquisition and distribution systems for fresh vegetables in Beijing and Guangzhou.

4. The mission was well received. We wish to express our appreciation for the warm hospitality, many courtesies extended, and arrangements made. In particular, we wish to thank Messrs. Wang Qishan and Wang Gang, President and Vice President of the CATIC; Lu Mai, Director of RCRD's Experimental Programs Office; Chen Xiwen, Acting Director of RCRD's Development Institute; Qian Fagen, Acting Director of the RSAL/World Bank Loan Implementation Office; and their staffs and colleagues at the provincial and local levels. The mission has agreed to provide RCRD with detailed summaries of our findings and recommendations by end-December, 1988.

B. GENERAL

5. This initial supervision took place during a period of reassessment in China. The need for China to address the difficult issues of inflation, monetary and credit expansion, and ultimately, the need to add substance to enterprise reform is appreciated. We realize (and agree) that the pace of rural policy reform must be articulated with, and will be somewhat contingent upon decisions made in regard to the non-rural reforms, especially Government's macroeconomic stabilization policies.

6. Having said this: there is a danger that the more fundamental of the rural reforms--*viz.* the land management and grain system reforms, and the restructuring of the TVEs' policy and business environment, if implemented too slowly, may increasingly become hostage to an overreaction to the current macroeconomic situation and the slow-moving reform of State-owned enterprises. There is an equally important concern that resources of both the informal financial service cooperatives in China and local branches of the specialized banks, as well as of China's ubiquitous Rural Credit Cooperatives are becoming tied-up in dubious loans to State-owned and collectively-owned entities. These loans generally are long term in nature, having--of late--somewhat doubtful profitability, and a risky expectation of timely repayment.

C. THE MISSION'S WORK PROGRAM

7. The mission's review of the overall program aimed mainly to (a) record recent developments in the realm of national policies, (b) understand Government's current thinking about the pace of rural reform in light of recent developments, and (c) assess the likelihood that Government would be able to implement the program of rural reforms referred to in the Statement of Rural Reform Policies (the "Policy Letter") within time frames indicated. Our

detailed review therefore emphasized the more immediate undertakings, i.e. "Price Reform" (paras. 14-18 of the Policy Letter), "Establishment of a Land Use System" (paras. 19-22), "Rationalization of the Rural Enterprise System" (paras. 26-29), and "Rural Investment System Reform" (paras. 30-33). The mission was also briefed on "Rural Marketing System Reform & Establishment of Rural Cooperative Organization" (paras. 23-25), but was not staffed to carry-out a detailed review of this topic. Our understandings are recorded below:

D. GRAIN SYSTEM & AGRICULTURAL PRICE REFORMS

-Program of General Reforms.

8. In the past few months, inflation has emerged as a major national issue and the Government has introduced steps to control it. We understand that the "counter-inflationary" program for agriculture in 1989 will entail new measures to stabilize markets by expanding supply and reducing demand for key commodities. In the grain sector, which is considered the key to regaining balance in the agricultural sector, the Government appears fully committed to accelerate grain production. A six-part program is being adopted, which--in broad outline--aims to (a) stimulate grain production, (b) constrain growth in urban food subsidies, (c) ration fertilizers and other modern inputs, (d) ration foreign exchange expenditures for agricultural operations, (e) establish new investment programs dedicated to grain production and (f) develop new, earmarked, taxation to finance these programs. If the Government is able to identify viable means for implementing these guidelines, the result would be a major step away from efficiency pricing and its institutional handmaiden: the liberalization of China's internal marketing and distribution systems. In addition, a tight national control of grain and agricultural input prices will inhibit the Grain System RRP from implementing planned further price reforms, thereby denying the possibility of learning appropriate lessons from these pilot reforms for wider application at the national level.

9. Clearly, the Government's ability to stabilize agricultural pricing will influence the transition towards macroeconomic balance and affect its pace, but the mission feels strongly that this must continue to be accompanied by strong incentives to encourage production, rationalize consumer subsidies, and render more transparent, buoyant and effective, the resource mobilization required to finance adjustments in the grain system. Indeed, the initial experience in the Xinxiang and Yulin experimental zones anticipates the kinds of gains which are possible and the rapidity by which these may be realized, even in the face of a worrisome inflation.

-Progress in the Experimental Zones.

10. The RRPs covenanted in the RSAL for grain system reform deal specifically with reform of the grain procurement and marketing system, and the financing of related subsidies. The mission focussed on decisions made and measures taken to implement the first phase of the Xinxiang, Henan and Yulin, Guangxi RRPs, and plans/preparations for the next phase. In this context, we reviewed (a) reforms to producer pricing policies in the experimental areas and the treatment of contract grain purchases; (b) the pricing and availability of production inputs--thus, also, inputs subsidies; (c) consumer pricing, ration sales and the monetization of ration coupons; (d) agricultural tax reform; and (e) monitoring systems for the RRPs. Our main findings are summarized here (though the discussion of monitoring arrangements is presented below in Section H), with details available in the mission reports that will be furnished presently.

11. Implementation of the Xinxiang RRP's first phase has been smooth and the initial impact was positive. Producer prices were increased, inputs subsidies reduced, and agricultural tax rates revised upwards. Grain production responded to increased producer incentives (in spite of the drought), the local grain stations were able to procure quota grains ahead of schedule and without problems, and the government was able to accelerate the collection of agricultural taxes. However, problems in three vital areas emerged during the second half of 1988 which--unless rectified soon--could seriously undermine the initial success at Xinxiang and make it difficult to introduce the crucial second phase. These problems include finance, availability of rationed inputs and a wavering of political will by local authorities.

12. Since the RRP was designed to be financially self-sustaining, the Xinxiang City and Henan Provincial governments did not budget additional financial resources to cover reform related expenditures. But now the RRP appears to be experiencing severe financial shortfalls due to the fact that about half of the 1988 fertilizer and diesel were sold before implementation began, at the old plan prices, whereas the bulk of the summer harvest was procured at the higher contract prices featured in Phase I of this RRP. Furthermore, Xinxiang did not receive its assigned allocation of urea and diesel due to various problems including transportation bottlenecks, which will likely constrain farmer response to Phase I incentives during Winter and Spring plantings. Further, since the gaps between market prices on the one hand, and contract grain and ration sales prices on the other, have widened far more than anticipated, the financial resource requirement for Phase II will likely be even higher than expected since this phase entails both a further increase of grain procurement prices and an increase in consumer prices.

13. The Xinxiang authorities are understandably nervous, fearing that the reform may be blamed for instabilities in production, consumption and finance that in fact derive from China's macroeconomic problems and rigidities in inputs supply. Morale is said to be a problem, and the mission was asked to convey a request for some kind of assurance from national-level authorities that the reform should progress as planned, and that necessary financial resources and production inputs will be made available to facilitate unhindered implementation. The mission strongly endorses these requests, and was advised that the State Council intends to confirm its endorsement of all of the experimental reforms being implemented under the purview of the RCRD in the not-too-distant future.

14. The pricing and marketing components of Yulin City's first phase RRP is more comprehensive than Xinxiang's and was not intended to be financially self-sustaining. The prices of contract grain (rice) procurement, of rationed sales to urban consumers and rural resales were raised to prevailing market levels; consumers were given fixed income supplements; prices of production inputs were substantially increased; and measures were introduced to make the remaining subsidies more transparent. Unlike Xinxiang, however, the Yulin City and Guangxi Zhuang Provincial governments agreed to share part of the remaining subsidies.

15. Implementation of the first phase was smooth and the initial impact has been quite positive. Rice production responded well to higher procurement prices, and perhaps most importantly, the plantings of input intensive hybrid rice increased dramatically. Indeed, Yulin now faces a shortage of hybrid rice seeds, much to the credit of the reform. Yulin's grain quota was fulfilled well ahead of schedule, accompanied by a rapid increase in the share of private operators in the local grain trade. As a result of these reforms, the market is reported to be very stable in spite of persistent inflationary pressure. The mission understands that Yulin plans to go ahead with the second phase, which will consist of further increase in grain purchase prices and increased reliance on the market, further reduction of quota sales, and the introduction of agricultural tax reform.

16. Similar to Xinxiang, the Yulin authorities face three problems that should be sorted out before the second phase begins. The first one concerns financing, the second relates to an overhang of unused ration coupons--which have become monetized and could place tremendous pressure on City finances were ever these "cashed-in", and the third (again) involves morale. The financial difficulties are known and will not be repeated here, except to underscore the mission's recommendations that

- (i) the Guangxi Zhuang Financial Bureau should be encouraged to release the central and provincial funds

already allocated to the Yulin RRP as soon as possible, and

- (ii) that earmarked exemptions to Yulin's credit ceilings should be granted to enable the City to finance the RRP's working capital requirements.

17. The overhang of ration coupons from previous years could present an equally serious problem. These coupons have been effectively monetized, and represent a store of unearned wealth beyond official control under present arrangements, and ready to be unleashed if consumer confidence erodes. Recognizing this problem, we understand that an expiry date is now assigned to newly issued ration coupons. Although the Yulin authorities have decided otherwise on "equity" grounds, the mission strongly recommends that those ration coupons being retained by consumers from before the reform was implemented also be given an expiry date, say on June 30, 1989, else simply be declared invalid. To protect low income consumers, a more dedicated targeting than that represented by the broadside distribution of ration coupons could be easily set-up within the framework of existing administration--and perhaps should be experimented with under Yulin's RRP.

18. The morale problem is similar to Xinxiang's: a result of uncertainties regarding State endorsement of the reforms being introduced. The State Council's intended reaffirmation (para. 13) should allay current concerns, though additional visits to Yulin by RCRD's officials would also help, since the absence of routine visits has made experimental zone authorities feel somewhat like orphans while trying to implement this far-reaching experiment without visible high-level support. Technical support, especially, will be required from RCRD when the Yulin authorities finalize designs and implementation details for the second phase reform, and is so recommended.

E. REFORM OF THE LAND MANAGEMENT SYSTEM

-Program of General Reforms

19. Amendments to Article 10 of China's Constitution by the National People's Congress on April 12, 1988 provided sanction for an expanded experimentation with the rural land management system (LMS). In addition to the RRPs reviewed while the RSAL was being formulated (at Meitan, Guizhou, in Southern Jiangsu and in Guangdong's Nanhai County), the State Council subsequently endorsed RRPs for Pingdu County, Shandong and Beijing Municipality's Shunyi County. The need for diversity, both regional and in recognition of agro-economic and off-farm opportunities, is implicit in the differing features of the land

system RRPs. The mission feels these have been selected wisely, and that an evaluation of program results will lend well to a formulation of national laws and regulations intended during 1990.

20. The mission was invited to attend (and make presentations at) a Conference on Land System Reform in Zhunyi, Guizhou, which was held to debate the shape and form that national policies might ultimately assume. This provided extremely valuable insights into the nature of the current debate in China, and the variety of approaches being considered. There is clearly widespread acceptance at all levels of the need to replace the present administrative procedures for allocating land use rights by a system which allows for a much greater role for market forces. The seminar also recognized that room for manoeuvre in LMS reform is presently constrained by agricultural pricing and marketing policies and by food security strategy and that, conversely, the range of options available for reforming these policies is itself partly determined by the potential impact which LMS reform will have on agricultural productivity.

-Progress in The Experimental Zones

21. The Meitan RRP is progressing steadily. The formal establishment in September 1988 of a land bank (The Meitan Land Finance Company) to finance land use transfers and agricultural development schemes was a major milestone in supportive institution building. The recently introduced land contracts (formalizing the leasing of land by households from the collective) will serve as collateral for the borrowings. We understand that a group from the Guizhou Provincial Land Management Bureau will visit Meitan shortly to supervise the issuing of land certificates to cover all land in the County. These will, in effect, serve the purpose of "title deeds" and facilitate the transfer of land between collectives and compensation for individual households concerned.

22. Revenue raising and financing of local level activities has been streamlined in the Meitan RRP by formally making villages administrative subunits of townships. Crop quotas and contract purchases have been reduced in amount, thus effectively raising farm prices in an effort to encourage greater use of agricultural inputs. Subsidized grain resales to rural consumers have also been reduced. The recently introduced land use fee appears to have been generally accepted by farmers.

23. The Meitan "model" has been endorsed by the Provincial Government, which is urging other counties in Guizhou to introduce similar reforms. Diffusion of this RRP within Guizhou will be closely monitored. The main question about the Meitan RRP concerns the rate at which land transfers will take place, with

the corresponding emergence of consolidated and/or specialized farms operating at high levels of efficiency. Much will depend on the schemes to bring into production the uncultivated uplands and the amount of surplus agricultural labor, made available through land consolidation in the lowlands, which can be productively employed on the uplands. This in turn will depend on the amount of good quality upland per capita, market opportunities and the type of upland production system (e.g. mini-estate, smallholding or a combination) which is instituted.

24. The Southern Jiangsu, Nanhai, Pingdu and Shunyi RRPs are all attempts to deal with problems caused by the high opportunity cost of land under grain crops and of labor needed to work the land, in an environment of rapidly growing demand for non-agricultural workers and for high value agricultural products. Production gains under the specialized household systems have been good this year in both Southern Jiangsu and Shunyi, but it is clear that these RRPs present expensive solutions to land fragmentation and the problem of low agricultural productivity, both in terms of the capital financing and the income support required from the non-agricultural sectors. Under present conditions, there is some question whether the Southern Jiangsu experiment can be sustained, since its diffusion to nearby towns and counties has fallen well behind schedule. With both of these experiments, replicability remains very much at issue--even in the labor deficit coastal zones and environs of major cities for which these RRPs are designed and where they are presently located.

25. In Guangzhou's Nanhai County, the RRP simply is not working. Only a tiny fraction of households have opted to become specialized producers of quota crops operating consolidated holdings. The lure of off-farm employment and the gains from producing vegetables and other high-valued crops (where gains from reduced fragmentation could be expected to be negligible) have eliminated any enthusiasm for the RRP that may originally have been present in Nanhai. There is a need for experimenting with land use rights transfers and/or other forms of land management within the context of a dynamic and highly commercialized agricultural environment, however, and the Nanhai RRP--if appropriately reformulated--presents an opportunity to begin this kind of reform. The mission so recommends, rather than pursue the current official thinking in Nanhai that stronger, even punitive measures, should be introduced to force farmers to participate in the RRP.

26. By way of contrast, the Pingdu RRP--in which all farmland is divided into food plots and responsibility plots--and use rights on the latter are auctioned off to competing bidders for a fixed term, appears to have been highly successful. It has fostered a reduction in fragmentation, and offers a semi-market based method for establishing land "rental" values. The biggest stage of

recruitment of villages has just been completed, bringing the proportion of villages in the county using the system to more than 90%. The features of this RRP may well provide a model for other labor deficit zones where reliance on quota grain production (rather than imports) will continue to prevail for the foreseeable future, and also--with local refinements--a general method for establishing the rental value of use rights (owed to the collective) and the value of compensation for improvements made by previous operators who have chosen to relinquish their responsibility lands.

F. REFORM OF THE RURAL ENTERPRISE SYSTEM

-Program of General Reforms

27. After China's Constitution was amended on April 12, 1988 to sanction private and other enterprise forms, a National Private Enterprise Law was promulgated in July 1988 which reconfirmed the legitimacy of enterprises operating outside of the state-owned sector and provided for their right to operate with a significant degree of freedom from local government control. This Law lays out the basic requirements for sole proprietorships and partnerships, as well as for private companies limited by shares. However, some provisions of the law are discriminatory, in that higher tax rates and stricter payment obligations apply to private enterprises than required of State- and collectively-owned firms.

28. Under the Fuyang, Anhui RRP (cf. below), a trial Non-governmental Enterprise Law has been drafted to apply both to private enterprises owned by individual citizens and to township or community-owned enterprises--the aim being to give all non-state enterprises equal status in law. This draft is expected to be implemented when approved by the provincial and local People's Congresses. The trial Insolvency ("Bankruptcy") Regulations for non-State enterprises also remains in draft form pending approval. Although both trial enactments will need to be tested in a controlled environment before national laws can be issued, the potential national significance is so great in terms of stabilizing the TVEs and establishing financial discipline in the non-State sector, that the mission strongly urges RCRD to bring as much pressure to bear as possible to have these enacted in Fuyang and to initiate testing.

-Progress in the Experimental Zones

29. The overall experimental frame appears to be spreading as RCRD now refers to four distinct models of TVE development: the Wushi (Jiangsu), Fuyang (Anhui), Wenzhou (Zhejiang) and Shishi

(Fujian) models respectively. The current concern with macroeconomic issues may not yet have had discernable impact on the growth of TVEs but the credit squeeze will undoubtedly do so. Some readjustment of policy priorities is under consideration, away from the less developed rural areas (such as Fuyang) where adjustments to the rural economic structure and the creation of off-farm jobs have been stressed, and towards the coastal regions which are better placed to develop exports and hard currency earnings. In this connection, the mission was advised that RCRD has been undertaking work with TVEs for the last two years to encourage the increased production of export commodities. This work has been concentrated in the coastal provinces of Fujian, Zhejiang, Jiangsu and Shandong. In some locales, TVEs have been given greater freedom to retain earnings and other receipts in foreign currency. The mission was gratified to learn that the formally endorsed RRP, which essentially focus on institutional issues, are being supplemented by assistance from the RCRD through less structured (but certainly no less important) means that focus more narrowly on TVE activities in promising economic subsectors. However, because of difficulties with arranging appointments with RCRD's "Rural Enterprise" staff in Beijing, the mission was unable to complete an in-depth review of these important developments, nor of the overall rural enterprise policy framework, and requests that during the next RSAL supervision appropriate arrangements be made.

30. Formal RRP for the development of TVEs and non-state enterprises have now been established in three areas: Fuyang Prefecture in Anhui Province, Wenzhou City in Zhejiang, and a new one in Zhebu City's Zhoucun County in Shandong Province. The emphasis in this newly introduced RRP will be on enterprise shareholding (joint stock) systems--systems designed in particular for enterprises currently owned or controlled by local governments.

31. During its visit to the Fuyang experimental zone, the mission noted that the majority of the 20 subprojects in this RRP are being implemented according to schedule. The industrial zones with their preferential policies to encourage new rural enterprises have undergone remarkable development in the last seven months. The subprojects to remove artificial restrictions in rural markets have been successful in the pilot counties and these reforms are now spreading rapidly within Anhui.

32. There are early indications that the number of enterprises, their output and profits have continued to increase at a significant rate in spite of the macroeconomic instability which also has affected Fuyang Prefecture. New enterprises are continuing to be set up to exploit new market opportunities, although there are signs that some of the markets into which TVEs first entered are reaching maturity. Fuyang's experimental zone office has introduced two new enterprise models--both for joint

ventures with foreign companies--but the enterprise structure subproject as a whole seems to be some way off from completion. Some of the RCRD staff involved in the enterprise reform subprojects have general reservations about the feasibility of a rapid introduction of "modern contractual" relationships into rural society, although China's reform growth targets would suggest that such relationships, embodied in enterprise charters and contracts, and protected by law and local courts, are both imperative and inevitable.

33. Two aspects of the Fuyang RRP give rise to concern. The first is the continued operation of the non-governmental financial service associations without a secure asset base and with potentially destabilizing lending policies. The danger of collapse and erosion of confidence is great. This is discussed in the next Section. The second is that the monitoring system is not being implemented as planned. This is discussed in Section H below.

G. INVESTMENT SYSTEM & RURAL FINANCIAL MARKETS

-Program of General Reforms

34. The mission exchanged views with RCRD staff and the State Planning Commission about the newly organized State Investment Corporations, and with RCRD on the current status and issues in China's financial system. The latter discussions focussed on rural financial markets and trial rules and regulations for the non-governmental financial service associations (NGFAs) that have proliferated of late. We also discussed concepts and issues in land banking with participants at the Zhunyi seminar on LMS reform.

35. China's rural investment system and financial markets are currently going through a difficult period in the wake of severe credit curbs imposed to constrain inflationary pressures, and recent changes in the interest rate structure which were initiated mainly to restrict the rapid draw down in deposits and to depress overall credit demand. These measures also are having an effect on the performance of the financial sector RRP's.

36. A key element of the general program for reform of the rural investment system is the formal review of rural financial market policies and preparation of trial rules and regulations for the NGFA indicated in paras. 32 and 33 of the Policy Letter. Since RCRD does not appear to have sufficient in-house resources, the mission indicated that it would recommend to Bank management that these tasks be carried out either through its economic and sector work program for China, or under future lending for agricultural credit such as the proposed Fourth Rural Credit Project. In

either event, the mission conveyed its views that involvement of the People's Bank and other major financial institutions would be required. RCRD agreed to inform the Bank of its proposals shortly.

-Progress in the Experimental Zones

37. As a result of economic uncertainty, the pace and impact of the Guanghan, Sichuan and Fuyang, Anhui RRPs in rural finance have noticeably slowed down. However, in Guanghan, much progress has been made towards introducing the contract responsibility system for management of local, governmental financial institutions. The result has been a genuinely increased autonomy in decision-making and business operations, and a linking of wages/remuneration with unit performance. There are, however, several areas in which the experimental design could be strengthened, including (a) methods for determining salary and wage incentives, (b) more flexibility in the interest rate structure, (c) interbank settlement procedures and (d) the internal organization of State-owned banks. To accommodate current uncertainties, the mission recommended that contractual targets for deposits, loans and profits for individual units within the Guanghan RRP should be subjected to frequent review and adjustment, since any rigidities in this regard could quickly prove counterproductive. This is an important consideration, since the Agricultural Bank of China has already adopted the contract responsibility system nationwide, and subsequent refinements will no doubt be influenced by staff performance within its Guanghan branches. The mission also recommended that a more detailed review be undertaken early in 1989, after operational performance data for financial institutions participating in this RRP become available for the three consecutive years (1986-1988) that elapsed since implementation began.

38. The Fuyang, Anhui experiment with NGFAs still represents the main experiment under State Council guidance for broadening rural financial markets and improving their dynamism and flexibility. However, the mission noted several worrying developments which underscores the urgent need to establish sound financial standards for these institutions and delineate the broader financial sector policy issues that will have to be addressed during future expansion of the NGFA system.

39. The management, technical and financial standards of the NGFAs in Fuyang require urgent attention. These entities appear to be operating more or less without informed advice from the experimental office, and limited regulation by provincial and central banking authorities. The latter, in any event, should be positioned to encourage NGFA development without imposing undue restrictions, while at the same time monitoring the NGFA's

decisions and performance to insure that these operate according to sound financial principles. The mission found that several of Fuyang's NGFAs have been concentrating their loan portfolios on politically-mandated investments having doubtful viability, and have a financial resource structure that is nearly risk free as far as the "shareholders" are concerned. If these fail (and some of the 7 NGFAs in Fuyang are approaching insolvency), the impact on investor confidence and the reaction from the already beleaguered State banks could sweep away this important institutional innovation. The result would be a loss of a benchmark experiment in the provision of informal financial services, which could lead to an untimely postponement of benefits from the inherent flexibility which the NGFAs--if managed intelligently--can provide.

40. The establishment of the Land Financing Company (MLFC) in Meitan, Guizhou is a remarkable development since contracts for land use rights will be used for the first time to secure loans for purchasing use-rights and to support agricultural development. This is the first institution of its kind in China of which we are aware, and its evolution and performance should be monitored with interest since it could serve as a model for the future development of land banking throughout China. The MLFC's conceptual framework is sound, though additional thought needs to be given to evolving financial instruments for raising longer term capital, reducing reliance on budgetary allocations for medium- and long-term loans, and to the MLFC's lending policies per se'. The mission offered to assist with this endeavor during future RSAL supervisions and other missions to review/prepare Bank operations in China's rural financial sector.

H. MONITORING ARRANGEMENTS

41. In this subject matter area, the mission concentrated on developments within the experimental reform programs. We were given an opportunity to discuss in detail the progress being made in establishing monitoring and evaluation (M&E) systems for the Xinxiang, Yulin, Meitan, Fuyang and Guanghan RRPs, and also received some information pertaining to the Southern Jiangsu RRP. It was decided to defer extensive discussion of M&E arrangements for tracking the diffusion of reforms at the national level and for reviewing other RRPs' M&E efforts until the next supervision mission. By that time, RCRD will have prepared the first semi-annual progress report based, in part, on the M&E reports from the various experimental reform offices.

General Issues

42. There are two general issues concerning M&E arrangements for the RRP's, which the mission recommends RCRD should address on fairly short order, since these arrangements are still being established and placed into effect.

- (i) It is not clear whether the need for clearly separating the M&E function from the general management function in the experimental reform offices is adequately appreciated. There is some danger that the RRP management and M&E roles of staff will become indistinguishable with a resulting lack of focus and objectivity, both needed for objective reporting and a continuity of performance on the M&E side. The issue (in all of the RRP's) is really one of recognizing the need for attaching a permanent M&E unit to each of the experimental offices, having the primary purpose of ensuring that the data-gathering agencies are reporting on time with the needed information, and each provided with desktop computers and necessary budget. The mission strongly urges RCRD to give these recommendations serious consideration.
- (ii) While it is perhaps too early for definitive judgement, there are grounds for believing that M&E training for the RRP's may need to include a wider audience and have greater technical content. Leaders below the county level may need to be better briefed in the objectives and methodological principles of M&E so that they in turn can ensure appropriate actions/responses by cadres and farmers. It is particularly important that the difference between M&E's information needs and the statistical agencies routine reporting formats be clearly understood and appropriate modifications be embedded in the M&E reporting formats. Greater technical ability among M&E staff to design and conduct surveys is also likely to be needed in order to cope with the (necessary) complexity of the RRP's' indicator systems.

The Grain System RRP's

42. In Xinxiang, good progress has been made to organize a system of monitoring indicators, but the organization for monitoring still lacks coherent organization, needed staff and financial resources, and data processing equipment to carry out M&E in a scientific and satisfactory way. Similarly, in Yulin City a monitoring system has been established, but it is not well organized and equipped. In particular, the system lacks the needed manpower and financial resources to monitor the impact of the reform, particularly on grain consumption patterns among

different income groups (there is no Urban Economic Sample Survey Team operating in Yulin City and its environs).

The Land Management RRPs

43. The effort which has gone into the design of M&E for the Meitan RRP is impressive. A land system "building, monitoring and population" research group has been set up under the auspices of Meitan's Leading Group for rural reform, and organized by Guizhou's Provincial Bureau of Statistics. This group has produced a document listing over 200 monitoring indicators in six main categories (general situation, changes in land use, attitudes/behavior/responses, economic benefits, social impacts and ecological effects). Many of these indicators require the collection of data which is not normally collected by the existing information channels. Staff recruitment is in hand to establish a network of statistical personnel at the grassroots level as well as an early warning system to detect LMS problems before they become too widespread. Some training of local leaders in M&E principles has already been undertaken and more has been programmed. Another county in Guizhou Province--Fenyang--has been selected as a control for the Meitan RRP and will provide comparative data. There is no doubt that M&E of the Meitan RRP is being taken very seriously by the authorities at both the provincial and county levels.

44. In the Southern Jiangsu RRP, leaders from 30 villages and five townships responsible for rural economic management have attended a training session on data collection, having particular reference to the monitoring of performance indicators during the 1988 Autumn harvest. It appears that a format for M&E reporting has been developed, but the mission was not able to review a copy at the time of the briefing.

The Rural Enterprise RRPs

45. The mission was only able to review M&E arrangements for the Fuyang RRP, which are much less satisfactory than those reported above. The decision to place responsibility for subproject coordination and monitoring with the various counties concerned, and staff shortages in the experimental office have led to the abandonment of plans to carry out some important enterprise surveys. There also appears to have been no systematic effort made (yet) to monitor the effectiveness of prefecture-wide changes in certain key policies or administrative actions taken as part of the reform program. For example, the impact of new regulations and procedures to reduce interference by local cadres in the operation of free markets has not been systematically checked, nor has anyone followed-up applications for model enterprise charters to see the extent to which the new charters

are actually being used. This failure/inability to monitor RRP "inputs" is potentially quite serious and should be urgently rectified.

The Financial Market Experiments

46. Monitoring systems for the two financial sector experiments (i.e. Guanghai, and Fuyang) are presently being set-up with RCRD's assistance. Detailed reporting formats are being finalized by the local experimental offices, which RCRD intends to append to the first semi-annual progress report to the Bank next January.

47. The mission was informed that M&E in the Guanghai RRP will focus both on quantitative and qualitative assessments of the financial performance of the involved intermediaries and staff productivity improvements. M&E will be based on semi-annual reports from the specialized banks and annual reports from nonbanking financial service companies. The socioeconomic impact of the RRP and exogenous macro-effects on the performance of participating institutions will be assessed annually based on statistical information compiled by the local statistical office, supplemented by special surveys. The M&E indicators will fall under three broad headings:

- (i) overall monetary indicators,
- (ii) financial performance indicators, and
- (iii) miscellaneous quantitative indicators.

The analytical (and reporting) frames would be by type of participating institution. In this connection, the mission recommended that the current four-category format be revised as follows to better reflect the nature of the participating institutions, viz. state-owned specialized banks, nonbanking state-owned financial institutions, collective institutions, and credit organizations which do not provide services to the general public (e.g. cooperative funds). The mission also urged that a systematic attempt be made to isolate the effects of inflation and macro-level policy directives from effects deriving from the design of the RRP, when monitoring unit performance and staff incentive systems.

48. Monitoring arrangements for Fuyang's NGFAs are still being devised. The mission was informed that the experimental office at Fuyang (which needs to be strengthened) plans to monitor the three initial NGFAs set up under the RRP, using financial indicators such as increases in deposits, loans and profits, and miscellaneous quantitative indicators. The experimental office also would review progress made in refining "stocks and

ownership" concepts, and the introduction of financial standards for the NGFAs banking operations.

I. DISBURSEMENTS

49. As of November 21, 1988, the equivalent of about US\$ 243.0 million have been disbursed from the loan and credit, leaving respective balances of about US\$ 57.0 million in the loan account and a zero balance in the credit account. This represents an extremely rapid draw down of loan and credit proceeds, which were expected to disburse over a 12 to 18 month period. On the other hand, the urgency for rapid draw down is appreciated in view of the pressures being placed on China's foreign accounts and domestic budgetary resources. (The possibility that part of the counterpart proceeds may be allocated to specific and scheduled budgetary expenditures for agriculture development is endorsed.)

50. Thus far, a total of ten withdrawal applications have been received, of which the first nine have been accepted and disbursed against, save for payments made before the loan was signed (cf. below), and a few items where inconsistencies showed in the withdrawal applications. The Ministry of Finance has been notified of details. Further, the proceeds of Category 3 in the loan and credit agreements have been reallocated to Category 1 as per MOF's telexed request of September 19, 1988. However, disbursements against Application No.10 are being withheld to retain undisbursed amounts sufficient to reimburse ICB procurement of an amount "at least not less than US\$ 50 million" as indicated in MOF's telex to the Bank's Director of China Operations dated October 7, 1988.

51. We regret that some confusion was caused by the Bank's disbursement letter for this operation, which stated that payments made after May 18, 1988 would be eligible for reimbursement. As with investment project agreements, however, the Bank's General Conditions are the legal referent--as indicated in Section 1.01 of the RSAL's Loan and Credit Agreements. (These stipulate that only payments after the date of Loan/Credit signing (July 15, 1988) are eligible for reimbursement unless retroactive financing has been authorized. Retroactive financing was neither applied for nor authorized for the China-RSAL.) The mistake occurred because of end-fiscal year pressures...we apologize for the inconvenience this may have caused.

J. PROCUREMENT

52. During appraisal and loan negotiations for the RSAL, it was generally understood that procurements in the amount of US\$ 125-150 million would be carried out under the loan/credit using serial international tendering ("serial ICB") procedures. It was further anticipated that these tendering procedures would be used mainly for fertilizer procurements by China's Chemical Industries Import-Export Corporation, known as SINOCHEM. This seemed an appropriate arrangement, given SINOCHEM's preeminent position in China's fertilizer imports vis-a-vis other importers such as the International Tendering Corporation.

53. Further, we appreciate that a genuine attempt was made by the RCRD and CATIC to implement these procedures: first, through advertisement in the Development Business section of "Development Forum", and second, through notifications to foreign embassies in Beijing. But we were advised that only 9 requests for registration applications were received, and only two had been returned by end-September. This is puzzling, since fully two and one-half months had elapsed since the advertisements and notifications were issued.

54. The mission was advised that SINOCHEM is reluctant to attempt serial ICB in the face of rising fertilizer prices. The mission emphasized that this argument is somewhat specious, and referred to the recent Indian fertilizer procurement experience under its Emergency Drought Relief Loan. (Like China, India is a major fertilizer importer-- capable of influencing prices if careless procurement is practiced.)

55. However, we were gratified to learn that Government intends to procure at least US\$ 50 million under the RSAL using serial ICB procedures, though it is unfortunate that more will not be attempted in view of the savings that normally are associated with ICB procurements. We also are concerned with SINOCHEM's ability to continue to operate as a trading company under the current stringent financial conditions, rather than behave more responsibly as one of the Government's most important procurement agencies.

K. SEMIANNUAL REPORTS

56. It was understood during loan negotiations that semiannual reports for the RSAL would be furnished commencing January 1989. A format was presented by RCRD during the mission's visit, which will be more than adequate. The mission suggested, however, that additional sections be added to encompass the monitoring arrangements being set up for the RRP's, including a summary of

procurement and disbursement activity under the loan and credit agreements.

L. NEXT SUPERVISION

57. The scope of the next supervision must necessarily be more comprehensive than the present one was. Originally scheduled to visit China in February 1989, we propose to postpone the next mission to May or June of 1989, to give sufficient time to RCRD and authorities in the experimental zones to implement changes and improvements currently being considered. Mandated by a need to review the impact of macroeconomic adjustment measures being adopted by the State Council, and with the benefit of more elapsed time for implementing the RRP's, the next mission would also carry out the formal program review scheduled during Loan Negotiations for May/June 1989. It thus will be expected to review progress with the overall reforms in greater detail, as well as visit RRP's not reviewed during this first supervision. A corollary responsibility would be to discuss a format and design for the proposed Second RSAL.

58. In spite of current setbacks, China's rural reform endeavors have global importance. We in the Bank are convinced that RCRD's programs will succeed, that the momentum for rural reform can not be reversed, and feel privileged to assist with this historically significant undertaking. We only hope that the current instability will be viewed in China as presenting an opportunity: one which can be used to set in place previously unpalatable reforms to enable China to move more squarely towards indirect macro-management and control of rural economic activities. The reverse, a wholesale retreat to traditional administrative measures, would merely destabilize the rural economy. It would impede the operation of forces already unleashed without being able to bring these under some form of indirect regulation, and thus would likely aggravate current macroeconomic problems. Worse, such measures would most definitely postpone progress towards meeting the needs of a Socialist Market Economy.

Richard Burcroff II
Richard Burcroff II
World Bank Mission Leader
December 16, 1988

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REF RURAL SECTOR ADJUSTMENT LOAN (LOAN 2967-CHA, CREDIT 1932-CHA): SEPTEMBER-NOVEMBER 1988 SUPERVISION.

AAA EYE AM SENDING THIS TELEX TO CONFIRM POINTS MADE BY THE SUPERVISION MISSION DURING WRAP-UP MEETINGS WITH SENIOR OFFICIALS FROM THE RCRD, CATIC AND REPRESENTATIVES OF THE MOF. OUR MAIN RECOMMENDATIONS HAVE BEEN CONVEYED IN GREATER DETAIL BY THE MISSION'S AIDE-MEMOIRE, AND IN A SEPARATE LETTER TO FOLLOW.

BBB THE MISSION WAS VERY WELL RECEIVED AND WISHES TO THANK RCRD AND CATIC FOR ARRANGEMENTS MADE AND FOR AN EXTREMELY VALUABLE EXCHANGE OF VIEWS. THE MISSION'S PRINCIPAL TASKS WERE TO

(1) REVIEW THE STATUS OF THE OVERALL PROGRAM OF RURAL REFORM, AS DETAILED IN PART III OF THE STATEMENT OF RURAL REFORM POLICIES,

(2) UPDATE THE BANK'S KNOWLEDGE OF DEVELOPMENTS IN THE EXPERIMENTAL REFORM AREAS, AND

(3) ADVISE ON MATTERS ARISING CONCERNING THE UTILIZATION OF LOAN AND CREDIT PROCEEDS, PROCUREMENT PROCEDURES AND DISBURSEMENTS.

CCC THE SUPERVISION TOOK PLACE DURING A PERIOD OF ECONOMIC REASSESSMENT IN CHINA, BUT THE MISSION WAS GRATIFIED TO LEARN THAT THE MOMENTUM FOR RURAL REFORM IS CONTINUING AND THAT NINE ADDITIONAL (AND TIMELY) EXPERIMENTAL PROJECTS HAVE BEEN ENDORSED FOR IMPLEMENTATION UNDER RCRD'S GUIDANCE.

DDD PERHAPS THE MOST IMPORTANT DEVELOPMENT HAS BEEN THE EXCELLENT PROGRESS MADE TO IMPLEMENT THE EXPERIMENTAL REFORMS REVIEWED WHILE THE RSAL WAS BEING PREPARED. THIS UNDERScores A POINT OF VIEW CONSISTENTLY MAINTAINED BY THE RCRD--THAT THE DESIRE FOR REFORM HAS BEEN FIRMLY IMPLANTED AT THE GRASSROOTS LEVEL AND CAN NO LONGER BE REVERSED. ON THE OTHER HAND, IMPLEMENTATION OF THE OVERALL PROGRAM HAS BEEN A BIT DISAPPOINTING, ESPECIALLY IN THE AREAS OF GRAIN PROCUREMENT AND MARKETING, AND OF INCENTIVES FOR RURAL INDUSTRIALIZATION. HOWEVER, WE APPRECIATE THAT THE SLOWDOWN STEMS DIRECTLY FROM A PERCEIVED CRISIS IN THE GRAIN SECTOR, AND FOR THE TVES, FROM A CONCERN THAT THE FREEZE ON OFF-PLAN INVESTMENTS MAY BE DIFFICULT TO ENFORCE. WE WOULD WELCOME AN OPPORTUNITY TO DISCUSS THESE SUBJECTS WITH YOU AT YOUR CONVENIENCE.

EEE WITH REFERENCE TO FIVE AREAS OF RURAL REFORM RECORDED IN PART III OF THE STATEMENT OF RURAL REFORM POLICIES, THE MISSION REVIEWED THE MORE IMMEDIATE GENERAL UNDERTAKINGS RECORDED THEREIN AND ON PROGRESS IN THE EXPERIMENTAL ZONES. ITS REVIEW ENCOMPASSED FOUR OF THE OF THE FIVE MAIN AREAS OF REFORM (PRICE REFORM, LAND MANAGEMENT SYSTEM, RURAL ENTERPRISE REFORM AND RURAL INVESTMENT SYSTEM), BUT THE MISSION WAS NOT STAFFED TO REVIEW RURAL MARKETING COOPERATIVES.

FFF PROGRAM OF OVERALL REFORMS:

(1) IN THE AREA OF PRICE REFORM, THE MISSION FOCUSED ON GRAIN PRICING AND MARKETING, AND IS CONCERNED THAT THE RECENT DECISION TO REIMPOSE ADMINISTRATIVE CONTROLS IN 1989 MAY REPRESENT A MAJOR STEP AWAY FROM THE DEVELOPMENT OF THE MARKET SYSTEM, WITHOUT REALLY ADDRESSING THE BINDING ISSUE OF THE REMAINING SUBSIDIES. CLEARLY THE GOVERNMENT'S ABILITY TO STABILIZE AGRICULTURAL PRICING WILL INFLUENCE THE TRANSITION TOWARDS MACROECONOMIC BALANCE AND AFFECT ITS PACE, BUT THE BANK FEELS STRONGLY THAT THIS SHOULD CONTINUE TO BE ACCOMPANIED BY STRONG INCENTIVES TO ENCOURAGE PRODUCTION (INCLUDING GRAIN), RATIONALIZE CONSUMER SUBSIDIES, AND RENDER MORE BUOYANT, TRANSPARENT AND EFFECTIVE THE RESOURCE MOBILIZATION REQUIRED TO FINANCE ADJUSTMENTS IN THE GRAIN SYSTEM. IN THIS REGARD, WE WOULD ONLY HOPE THAT THE CURRENT INSTABILITY IS VIEWED AS PRESENTING AN OPPORTUNITY: ONE WHICH CAN BE USED TO SET IN PLACE PREVIOUSLY UNPALATABLE REFORMS TO ENABLE CHINA TO MOVE MORE SQUARELY TOWARDS INDIRECT MACRO-MANAGEMENT AND THE INDIRECT REGULATION OF THE GRAIN SYSTEM AND RELATED RURAL ECONOMIC ACTIVITIES.

(2) THE MISSION WAS INVITED TO ATTEND A CONFERENCE ON REFORM OF THE LAND MANAGEMENT SYSTEM IN ZHUNYI CITY. THIS PROVIDED EXTREMELY VALUABLE INSIGHTS INTO THE NATURE OF THE CURRENT DEBATE IN CHINA, AND THE VARIETY OF APPROACHES BEING CONSIDERED. THE NEED TO REPLACE THE CURRENT SYSTEM WITH REGIONALLY TAILORED SYSTEMS FOR ALLOCATING LAND USE RIGHTS WAS CLEARLY APPRECIATED, EACH ADDRESSING THE DIFFICULT TRADE-OFF BETWEEN ALLOCATIVE EFFICIENCY AND EQUITY/EMPLOYMENT ON THE BASIS OF REGIONAL PARTICULARS, BUT ALL FEATURING A MUCH LARGER ROLE FOR MARKET FORCES. THE MISSION ENDORSES BOTH THE THRUST AND THE FLEXIBILITY OF THIS APPROACH. THE SEMINAR ALSO RECOGNIZED THAT ROOM FOR MANOEUVRE IN LAND SYSTEM REFORM IS PRESENTLY CONSTRAINED BY AGRICULTURAL PRICING AND MARKETING POLICIES, ESPECIALLY FOR GRAINS.

(3) REFORM OF THE RURAL ENTERPRISE SYSTEM, PARTICULARLY, COULD BECOME HOSTAGE TO CURRENT ATTEMPTS TO RESTRAIN OFF-PLAN INVESTMENTS.

WHILE SOME TVES HAVE BEEN TOO RESPONSIVE TO LOCAL INTERESTS IN THEIR USE OF CREDIT AND OTHER INVESTIBLE FUNDS, MANY THAT HAVE BEEN OBSERVED BY RSAL-RELATED MISSIONS (AND OTHER BANK MISSIONS) APPEAR TO BE FINANCIALLY SOUND AND RESPONSIBLE. AN INDISCRIMINATE CUTBACK IN OFF-PLAN INVESTMENTS, WHICH CHINA SEEMS TO BE IMPOSING AT THE MOMENT, COULD FORCE SOME OF THE POTENTIALLY (OR ACTUALLY) STRONGER ONES INTO LIQUIDATION ALONGSIDE THE LESS VIABLE TVES, THUS HAVE UNDESIRABLE LONGER TERM CONSEQUENCES ON THE FUTURE DEVELOPMENT ON THIS IMPORTANT ECONOMIC SECTOR. FURTHER, IF CONFIDENCE IS LOST IN THE TVE SECTOR, AND ONLY A SLUGGISH RECOVERY ENSUES, THE ACROSS THE BOARD CUT-BACK COULD HAVE VERY DAMAGING IMPACT ON THE ATTAINMENT OF CHINA'S RURAL OFF-FARM EMPLOYMENT OBJECTIVES. WE THEREFORE URGE GOVERNMENT TO ADOPT A MORE BALANCED APPROACH, ONE WHICH REMOVES THE DISCRIMINATION AGAINST COLLECTIVELY AND PRIVATELY OWNED BUSINESS ENTERPRISES, AND SETS IN PLACE RULES GOVERNING INVESTMENTS THAT APPLY EQUALLY TO TVES AND THE STATE-OWNED ENTERPRISE SECTOR.

THE MISSION WAS ADVISED THAT RCRD HAS EXPRESSED RESERVATIONS

CONCERNING THE NATIONAL PRIVATE ENTERPRISE REGULATION PROMULGATED IN JULY 1988, AND HAS DRAFTED TRIAL NON-GOVERNMENTAL ENTERPRISE REGULATIONS WHICH, TOGETHER WITH THE TRIAL INSOLVENCY REGULATIONS, WILL BE TESTED IN ANHUI PROVINCE ONCE APPROVAL BY THE PROVINCIAL AND LOCAL PEOPLE'S CONGRESSES HAS BEEN GIVEN. WE BELIEVE THAT THE POTENTIAL NATIONAL SIGNIFICANCE OF THESE TRIAL REGULATIONS IS QUITE FAR-REACHING. IF TESTED SUCCESSFULLY, THESE MAY DEMONSTRATE WAYS BY WHICH CHINA CAN CREATE A POLITICALLY VIABLE BUSINESS ENVIRONMENT, CONDUCIVE TO STABILIZING THE TVES AND ESTABLISHING (THROUGH INDIRECT MEANS) FINANCIAL DISCIPLINE IN THE NON-STATE OWNED SECTOR. TO ENABLE TESTING TO BEGIN, WE THEREFORE URGE RCRD TO SEEK AN EARLY APPROVAL OF THESE REGULATIONS IN ANHUI.

(4) IN CONNECTION WITH REFORM OF THE RURAL INVESTMENT SYSTEM, THE MISSION EXCHANGED VIEWS WITH (A) RCRD AND THE STATE PLANNING COMMISSION ABOUT THE NEWLY ORGANIZED STATE INVESTMENT CORPORATIONS, (B) WITH CATIC ABOUT ITS BUSINESS PLAN (WHICH THE BANK ENDORSES-- AND INDEED IS GRATIFIED THAT CATIC HAS MADE A STRONG START), AND (C) WITH RCRD AND SEVERAL STATE-OWNED BANKS: THE CURRENT STATUS OF CHINA'S RURAL FINANCIAL MARKETS AND ISSUES CONCERNING THE NON-GOVERNMENTAL FINANCIAL SERVICE ASSOCIATIONS (NGFA'S) THAT HAVE PROLIFERATED OF LATE. THE MISSION ALSO DISCUSSED CONCEPTS AND ISSUES IN LAND BANKING.

-A KEY ELEMENT OF THE GENERAL REFORM OF THE RURAL INVESTMENT SYSTEM IS THE FORMAL REVIEW OF RURAL FINANCIAL MARKET POLICIES AND PREPARATION OF TRIAL RULES AND REGULATIONS FOR THE NGFA'S INDICATED IN PARAS. 32 AND 33 OF THE POLICY STATEMENT. SINCE THE MISSION WAS ADVISED THAT RCRD DOES NOT APPEAR TO HAVE SUFFICIENT IN-HOUSE RESOURCES, THE BANK WOULD BE PLEASED TO SUPPORT THESE ACTIVITIES AS A COMPONENT IN THE PROPOSED FOURTH RURAL CREDIT PROJECT OR THROUGH OTHER MEANS. THE MISSION ALSO CONVEYED ITS VIEWS THAT INVOLVEMENT OF THE PEOPLE'S BANK OF CHINA AND OTHER MAJOR FINANCIAL INSTITUTIONS WOULD LIKELY BE REQUIRED. RCRD'S OFFICIALS AGREED TO INFORM THE BANK SHORTLY OF ITS PROPOSALS.

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G G G P R O G R E S S I N T H E E X P E R I M E N T A L Z O N E S :

WITH THE EXCEPTION OF THE LAND SYSTEM EXPERIMENT IN NANHAI, GUANGDONG AND THE NGFA PART OF THE FUYANG EXPERIMENT, PROGRESS WITH IMPLEMENTING THE PROGRAM OF EXPERIMENTAL REFORMS HAS BEEN QUITE GOOD. TWO GENERAL PROBLEMS, HOWEVER, ARE MORALE AND INADEQUATE FINANCING. OUR MAIN RECOMMENDATIONS ARE THE FOLLOWING:

(1) MORALE HAS EMERGED AS A PROBLEM, PARTICULARLY IN THE XINXIANG, HENAN AND YULIN, GUANGXI GRAIN SYSTEM REFORMS, RESULTING FROM UNCERTAINTIES ASSOCIATED WITH THE CURRENT ECONOMIC CLIMATE AND THE GOVERNMENT'S APPARENT STEP BACKWARDS IN NATIONAL GRAIN SYSTEM POLICIES. WE STRONGLY URGE THAT THE STATE COUNCIL REAFFIRM ITS INTENTION TO SEE THESE EXPERIMENTAL PROGRAMS THROUGH, WHICH WOULD

PROVIDE NEEDED REASSURANCE TO LOCAL PROGRAM OFFICIALS. WE FURTHER RECOMMEND THAT THE FREQUENCY OF VISITS BY RCRD'S STAFF TO THE YULIN AREA BE INCREASED, SINCE THEY ARE ABOUT TO PREPARE PHASE II OF THE REFORM AND REQUIRE TECHNICAL ADVICE AND SUPPORT.

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(3) THE EXPERIMENTAL REFORM IN GUANGZHOU'S NANHAI COUNTY SIMPLY IS NOT WORKING. THE LURE OF OFF-FARM EMPLOYMENT AND RETURN TO THE PRODUCTION OF VEGETABLES AND OTHER HIGH-VALUED CROPS (WHERE GAINS FROM LAND CONSOLIDATION WOULD IN ANY EVENT BE MARGINAL) SUGGEST THAT THE LOCAL AUTHORITIES ARE TRYING TO IMPLEMENT AN INAPPROPRIATE EXPERIMENTAL DESIGN. THERE DOES APPEAR TO BE A NEED, HOWEVER, TO EXPERIMENT WITH LAND USE RIGHT TRANSFERS AND/OR OTHER FORMS OF LAND MANAGEMENT IN THE CONTEXT OF A DYNAMIC AND HIGHLY COMMERCIALIZED AGRICULTURAL ENVIRONMENT, SUCH AS NANHAI'S. THE NANHAI EXPERIMENTAL PROGRAM, IF APPROPRIATELY REFORMULATED, PRESENTS AN OPPORTUNITY TO BEGIN THIS KIND OF REFORM. THE MISSION SO RECOMMENDS, RATHER THAN IMPOSE STRONGER, EVEN PUNITIVE, MEASURES TO COERCE PARTICIPATION BY FARMERS IN THE "SCALE OPERATION" REFORM AT NANHAI.

(4) WITHIN THE FUYANG EXPERIMENTAL PROGRAM, THE MANAGEMENT, TECHNICAL AND FINANCIAL STANDARDS OF THE NGFAS REQUIRE URGENT ATTENTION. THESE ENTITIES APPEAR TO OPERATING WITHOUT INFORMED ADVICE FROM THE EXPERIMENTAL OFFICE, AND LIMITED REGULATION BY PROVINCIAL AND CENTRAL BANKING AUTHORITIES. THE MISSION FOUND THAT SEVERAL OF FUYANG'S NGFAS HAVE CONCENTRATED THEIR LOAN PORTFOLIOS ON POLITICALLY-MANDATED INVESTMENT HAVING DOUBTFUL VIABILITY, AND HAVE A FINANCIAL RESOURCE STRUCTURE WHICH COULD QUICKLY EVAPORATE SHOULD "SHAREHOLDER" CONFIDENCE TURN SOUR. IF THESE ENTITIES FAIL (AND SOME OF THE NGFAS IN FUYANG ARE APPROACHING INSOLVENCY), THE IMPACT ON INVESTOR AND DEPOSITOR CONFIDENCE, AND REACTION FROM THE ALREADY BELEAGUERED STATE BANKS COULD SWEEP AWAY THIS IMPORTANT INSTITUTIONAL INNOVATION (WHICH IS ANOTHER REASON FOR DEVELOPING TRIAL RULES AND REGULATIONS FOR NGFAS AS SUGGESTED IN PARA. FFF (4) ABOVE).

HHH DISBURSEMENT OF LOAN/CREDIT PROCEEDS: AS OF NOVEMBER 22, 1988, THE EQUIVALENT OF ABOUT USDOLLAR 236 MILLION HAVE BEEN DISBURSED FROM THE RSAL, LEAVING RESPECTIVE BALANCES OF ABOUT USDOLLAR 57 MILLION IN THE LOAN ACCOUNT, AND A ZERO BALANCE IN THE CREDIT ACCOUNT. THE LATTER WAS OFFICIALLY CLOSED ON OCTOBER 17, 1988 BY RECENT LETTER FROM MR. BURKI TO THE MINISTER OF FINANCE. THIS REPRESENTS AN EXTREMELY RAPID DRAW DOWN OF LOAN AND CREDIT

PROCEEDS, WHICH WERE EXPECTED TO DISBURSE OVER A 12-18 MONTH PERIOD. ON THE OTHER HAND, THE URGENCY FOR RAPID DRAW DOWN IS APPRECIATED IN VIEW OF PRESSURES BEING PLACED ON CHINA'S FOREIGN ACCOUNTS AND DOMESTIC BUDGETARY RESOURCES.

III PROCUREMENT PROCEDURES: DURING LOAN NEGOTIATIONS, IT WAS GENERALLY UNDERSTOOD THAT PROCUREMENTS IN THE NEIGHBORHOOD OF US\$125 MILLION WOULD BE CARRIED OUT USING SERIAL INTERNATIONAL COMPETITIVE BIDDING PROCEDURES. IT WAS FURTHER ANTICIPATED THAT THESE PROCEDURES WOULD BE USED MAINLY FOR FERTILIZER PROCUREMENTS BY THE SINOCHEM. ALTHOUGH RCRD AND CATIC MADE A CONSIDERED EFFORT TO IMPLEMENT THESE PROCEDURES, THE MISSION WAS ADVISED THAT SINOCHEM REMAINS LESS THAN ENTHUSIASTIC ABOUT USING SERIAL ICB. HOWEVER, WE WERE GRATIFIED TO LEARN THAT GOVERNMENT INTENDS TO PROCURE AT LEAST US\$50 MILLION UNDER THE RSAL USING SERIAL TENDERING PROCEDURES, THOUGH IT IS UNFORTUNATE THAT MORE WILL NOT BE ATTEMPTED IN VIEW OF THE SAVINGS NORMALLY ASSOCIATED WITH INTERNATIONAL COMPETITIVE BIDDING.

JJJ IT WAS UNDERSTOOD DURING LOAN NEGOTIATIONS THAT SEMIANNUAL REPORTS FOR THE RSAL WOULD BE FURNISHED COMMENCING JANUARY 1989. A FORMAT WAS PRESENTED BY RCRD DURING THE MISSION'S VISIT, WHICH WILL BE ACCEPTABLE SUBJECT TO A FEW SUGGESTIONS MADE BY THE MISSION DURING ITS REVIEW.

KKK ORIGINALLY SCHEDULED TO VISIT CHINA IN FEBRUARY, 1989, WE PROPOSE TO POSTPONE THE NEXT FORMAL SUPERVISION UNTIL MAY/JUNE 1989 TO PROVIDE RCRD AND EXPERIMENTAL ZONE AUTHORITIES WITH SUFFICIENT TIME TO IMPLEMENT CHANGES IN PROGRAM DESIGN CURRENTLY BEING CONSIDERED. IF THIS PROPOSAL IS ACCEPTABLE, THE NEXT MISSION ALSO WOULD CARRY OUT THE PROGRAM REVIEW SCHEDULED FOR MAY/JUNE, AND INITIATE FORMAL IDENTIFICATION OF THE PROPOSED SECOND RSAL.

LLL IN SPITE OF CURRENT SETBACKS, WE IN THE BANK ARE CONVINCED THAT THE RURAL REFORM ENDEAVORS SUPPORTED BY THE RURAL SECTOR ADJUSTMENT LOAN WILL SUCCEED, AND FEEL PRIVILEGED TO ASSIST WITH THIS HISTORICALLY SIGNIFICANT UNDERTAKING. BUT SHOULD THE APPARENT RETREAT TO TRADITIONAL ADMINISTRATIVE MEASURES MEASURABLY CURTAIL THE MOMENTUM FOR REFORM, WE ARE FEARFUL SUCH WILL MERELY AGGRAVATE THE OPERATION OF ECONOMIC FORCES ALREADY UNLEASHED IN RURAL AREAS WITHOUT BEING ABLE TO SECURE AN EFFECTIVE COORDINATION OF THESE FORCES. THE POSSIBLE CONSEQUENCES FOR REGAINING MACROECONOMIC STABILITY AND FOR DEVELOPING THE SOCIALIST MARKET ECONOMY ARE RATHER WORRISOME.

WITH WARM PERSONAL REGARDS. JOSEPH R. GOLDBERG, DIVISION CHIEF, CHINA AGRICULTURAL OPERATIONS, ASIA REGIONAL OFFICE, WORLD BANK.

ZCZC ASIF1160 S3AS0030

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***** LN 2967/CR 1932

WDIAL
REF : AS3AG
OINFO

-SUBJECT: RURAL SECTOR ADJUSTMENT LOAN (LOAN 2967-CHA,
-CREDIT-1932-CHA): SEPTEMBER-NOVEMBER 1988 SUPERVISION.
-DRAFTED BY: R. BURCROFFII/EL EXT. 72443
-FILENAME: TELEXDU
-AUTHORIZED BY: J. GOLDBERG, CHIEF, AS3AG
-CW AND CC: BURKI (AS3DR), TANAKA (LEGAS), HWANG (LOAAS)
-CC: YENAL, GOUVEIA (ASIVP) AHMAD, TIDRICK (AS3DR),
- PEARCE, CADARIO, ODY, YUSUF (AS3CO), STERN,
- SINGH (AS3IF), PIAZZA, BI, DESHPANDE (O/R) (AS3AG),
- AS3AG STAFF, ASIA FILES

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-STATE COUNCIL
-BEIJING, CHINA
-ATTN: MR. DU RUNSHENG, DIRECTOR
-INFO: MR. LU MAI, DIRECTOR, EXPERIMENTAL PROGRAMS OFFICE
-MESSRS. CHEN XIWEN, ACTING DIRECTOR, AND LIN YIFU, DEPUTY -
-DIRECTOR, RURAL DEVELOPMENT INSTITUTE
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-INFO: MR. CHEN FENG, DIRECTOR
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-INTBAFRAD
-BEIJING, CHINA
-INFO: MESSRS. LIM, GOERING, AND ZHOU WEIGOU, RMC

BT

WASHINGTON D.C. - 28-DEC-88

TEXT: FOR MR. DU RUNSHENG, DIRECTOR, RESEARCH CENTER FOR RURAL
DEVELOPMENT. COPIED TO FOR INFORMATION MR. LU MAI, DIRECTOR,
EXPERIMENTAL PROGRAMS OFFICE SEMICOLON CHEN XIWEN, ACTING DIRECTOR
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PRESIDENT, RESPECTIVELY, CHINA AGRIBUSINESS TRUST & INVESTMENT CORPORATION (CATIC) SEMICOLON MR. WANG LIANSHENG, DIRECTOR AND ZHU XIAN, DEPUTY DIVISION CHIEF, MINISTRY OF FINANCE, WORLD BANK DEPARTMENT SEMICOLON MR. CHEN FENG, DIRECTOR, WORLD BANK/RSAL LOAN ADMINISTRATION OFFICE SEMICOLON AND MESSRS. LIM, GOERING, ZHOU WEIGOU, RESIDENT MISSION CHINA.

REF RURAL SECTOR ADJUSTMENT LOAN (LOAN 2967-CHA, CREDIT 1932-CHA): SEPTEMBER-NOVEMBER 1988 SUPERVISION.

AAA EYE AM SENDING THIS TELEX TO CONFIRM POINTS MADE BY THE SUPERVISION MISSION DURING WRAP-UP MEETINGS WITH SENIOR OFFICIALS FROM THE RCRD, CATIC AND REPRESENTATIVES OF THE MOF. OUR MAIN RECOMMENDATIONS HAVE BEEN CONVEYED IN GREATER DETAIL BY THE MISSION'S AIDE-MEMOIRE, AND IN A SEPARATE LETTER TO FOLLOW.

BBB THE MISSION WAS VERY WELL RECEIVED AND WISHES TO THANK RCRD AND CATIC FOR ARRANGEMENTS MADE AND FOR AN EXTREMELY VALUABLE EXCHANGE OF VIEWS. THE MISSION'S PRINCIPAL TASKS WERE TO

(1) REVIEW THE STATUS OF THE OVERALL PROGRAM OF RURAL REFORM, AS DETAILED IN PART III OF THE STATEMENT OF RURAL REFORM POLICIES,

(2) UPDATE THE BANK'S KNOWLEDGE OF DEVELOPMENTS IN THE EXPERIMENTAL REFORM AREAS, AND

(3) ADVISE ON MATTERS ARISING CONCERNING THE UTILIZATION OF LOAN AND CREDIT PROCEEDS, PROCUREMENT PROCEDURES AND DISBURSEMENTS.

CCC THE SUPERVISION TOOK PLACE DURING A PERIOD OF ECONOMIC REASSESSMENT IN CHINA, BUT THE MISSION WAS GRATIFIED TO LEARN THAT THE MOMENTUM FOR RURAL REFORM IS CONTINUING AND THAT NINE ADDITIONAL (AND TIMELY) EXPERIMENTAL PROJECTS HAVE BEEN ENDORSED FOR IMPLEMENTATION UNDER RCRD'S GUIDANCE.

DDD PERHAPS THE MOST IMPORTANT DEVELOPMENT HAS BEEN THE EXCELLENT PROGRESS MADE TO IMPLEMENT THE EXPERIMENTAL REFORMS REVIEWED WHILE THE RSAL WAS BEING PREPARED. THIS UNDERSCORES A POINT OF VIEW CONSISTENTLY MAINTAINED BY THE RCRD--THAT THE DESIRE FOR REFORM HAS BEEN FIRMLY IMPLANTED AT THE GRASSROOTS LEVEL AND CAN NO LONGER BE REVERSED. ON THE OTHER HAND, IMPLEMENTATION OF THE OVERALL PROGRAM HAS BEEN A BIT DISAPPOINTING, ESPECIALLY IN THE AREAS OF GRAIN PROCUREMENT AND MARKETING, AND OF INCENTIVES FOR RURAL INDUSTRIALIZATION. HOWEVER, WE APPRECIATE THAT THE SLOWDOWN STEMS DIRECTLY FROM A PERCEIVED CRISIS IN THE GRAIN SECTOR, AND FOR THE TVES, FROM A CONCERN THAT THE FREEZE ON OFF-PLAN INVESTMENTS MAY BE DIFFICULT TO ENFORCE. WE WOULD WELCOME AN OPPORTUNITY TO DISCUSS THESE SUBJECTS WITH YOU AT YOUR CONVENIENCE.

EEE WITH REFERENCE TO FIVE AREAS OF RURAL REFORM RECORDED IN PART III OF THE STATEMENT OF RURAL REFORM POLICIES, THE MISSION REVIEWED THE MORE IMMEDIATE GENERAL UNDERTAKINGS RECORDED THEREIN AND ON PROGRESS IN THE EXPERIMENTAL ZONES. ITS REVIEW ENCOMPASSED FOUR OF THE OF THE FIVE MAIN AREAS OF REFORM (PRICE REFORM, LAND MANAGEMENT SYSTEM, RURAL ENTERPRISE REFORM AND RURAL INVESTMENT SYSTEM), BUT THE MISSION WAS NOT STAFFED TO REVIEW RURAL MARKETING COOPERATIVES.

FFF PROGRAM OF OVERALL REFORMS:

(1) IN THE AREA OF PRICE REFORM, THE MISSION FOCUSED ON GRAIN

PRICING AND MARKETING, AND IS CONCERNED THAT THE RECENT DECISION TO REIMPOSE ADMINISTRATIVE CONTROLS IN 1989 MAY REPRESENT A MAJOR STEP AWAY FROM THE DEVELOPMENT OF THE MARKET SYSTEM, WITHOUT REALLY ADDRESSING THE BINDING ISSUE OF THE REMAINING SUBSIDIES. CLEARLY THE GOVERNMENT'S ABILITY TO STABILIZE AGRICULTURAL PRICING WILL INFLUENCE THE TRANSITION TOWARDS MACROECONOMIC BALANCE AND AFFECT ITS PACE, BUT THE BANK FEELS STRONGLY THAT THIS SHOULD CONTINUE TO BE ACCOMPANIED BY STRONG INCENTIVES TO ENCOURAGE PRODUCTION (INCLUDING GRAIN), RATIONALIZE CONSUMER SUBSIDIES, AND RENDER MORE BUOYANT, TRANSPARENT AND EFFECTIVE THE RESOURCE MOBILIZATION REQUIRED TO FINANCE ADJUSTMENTS IN THE GRAIN SYSTEM. IN THIS REGARD, WE WOULD ONLY HOPE THAT THE CURRENT INSTABILITY IS VIEWED AS PRESENTING AN OPPORTUNITY: ONE WHICH CAN BE USED TO SET IN PLACE PREVIOUSLY UNPALATABLE REFORMS TO ENABLE CHINA TO MOVE MORE SQUARELY TOWARDS INDIRECT MACRO-MANAGEMENT AND THE INDIRECT REGULATION OF THE GRAIN SYSTEM AND RELATED RURAL ECONOMIC ACTIVITIES.

(2) THE MISSION WAS INVITED TO ATTEND A CONFERENCE ON REFORM OF THE LAND MANAGEMENT SYSTEM IN ZHUNYI CITY. THIS PROVIDED EXTREMELY VALUABLE INSIGHTS INTO THE NATURE OF THE CURRENT DEBATE IN CHINA, AND THE VARIETY OF APPROACHES BEING CONSIDERED. THE NEED TO REPLACE THE CURRENT SYSTEM WITH REGIONALLY TAILORED SYSTEMS FOR ALLOCATING LAND USE RIGHTS WAS CLEARLY APPRECIATED, EACH ADDRESSING THE DIFFICULT TRADE-OFF BETWEEN ALLOCATIVE EFFICIENCY AND EQUITY/EMPLOYMENT ON THE BASIS OF REGIONAL PARTICULARS, BUT ALL FEATURING A MUCH LARGER ROLE FOR MARKET FORCES. THE MISSION ENDORSES BOTH THE THRUST AND THE FLEXIBILITY OF THIS APPROACH. THE SEMINAR ALSO RECOGNIZED THAT ROOM FOR MANOEUVRE IN LAND SYSTEM REFORM IS PRESENTLY CONSTRAINED BY AGRICULTURAL PRICING AND MARKETING POLICIES, ESPECIALLY FOR GRAINS.

(3) REFORM OF THE RURAL ENTERPRISE SYSTEM, PARTICULARLY, COULD BECOME HOSTAGE TO CURRENT ATTEMPTS TO RESTRAIN OFF-PLAN INVESTMENTS.

WHILE SOME TVES HAVE BEEN TOO RESPONSIVE TO LOCAL INTERESTS IN THEIR USE OF CREDIT AND OTHER INVESTIBLE FUNDS, MANY THAT HAVE BEEN OBSERVED BY RSAL-RELATED MISSIONS (AND OTHER BANK MISSIONS) APPEAR TO BE FINANCIALLY SOUND AND RESPONSIBLE. AN INDISCRIMINATE CUTBACK IN OFF-PLAN INVESTMENTS, WHICH CHINA SEEMS TO BE IMPOSING AT THE MOMENT, COULD FORCE SOME OF THE POTENTIALLY (OR ACTUALLY) STRONGER ONES INTO LIQUIDATION ALONGSIDE THE LESS VIABLE TVES, THUS HAVE UNDESIRABLE LONGER TERM CONSEQUENCES ON THE FUTURE DEVELOPMENT ON THIS IMPORTANT ECONOMIC SECTOR. FURTHER, IF CONFIDENCE IS LOST IN THE TVE SECTOR, AND ONLY A SLUGGISH RECOVERY ENSUES, THE ACROSS THE BOARD CUT-BACK COULD HAVE VERY DAMAGING IMPACT ON THE ATTAINMENT OF CHINA'S RURAL OFF-FARM EMPLOYMENT OBJECTIVES. WE THEREFORE URGE GOVERNMENT TO ADOPT A MORE BALANCED APPROACH, ONE WHICH REMOVES THE DISCRIMINATION AGAINST COLLECTIVELY AND PRIVATELY OWNED BUSINESS ENTERPRISES, AND SETS IN PLACE RULES GOVERNING INVESTMENTS THAT APPLY EQUALLY TO TVES AND THE STATE-OWNED ENTERPRISE SECTOR.

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NONOPERABLE UNDER ARRANGEMENTS MADE FOR THE FUYANG EXPERIMENT), ALTHOUGH GOOD PROGRESS IS BEING MADE WITH INITIAL STAFF TRAINING AND THE IDENTIFICATION OF MONITORING INDICATORS, AND (B) THE BASIC SUSTAINABILITY OF THE XINXIANG AND YULIN EXPERIMENTAL PROGRAMS. WE RECOMMEND THAT THE BUDGETARY RESOURCES FOR M & E IN ALL OF THE PROGRAMS, AND THE GENERAL BUDGET AND PRODUCTION INPUT ALLOCATIONS FOR THE GRAIN SYSTEM EXPERIMENTS BE SUBSTANTIALLY AUGMENTED AS SOON AS POSSIBLE.

(3) THE EXPERIMENTAL REFORM IN GUANGZHOU'S NANHAI COUNTY SIMPLY IS NOT WORKING. THE LURE OF OFF-FARM EMPLOYMENT AND RETURN TO THE PRODUCTION OF VEGETABLES AND OTHER HIGH-VALUED CROPS (WHERE GAINS FROM LAND CONSOLIDATION WOULD IN ANY EVENT BE MARGINAL) SUGGEST THAT THE LOCAL AUTHORITIES ARE TRYING TO IMPLEMENT AN INAPPROPRIATE EXPERIMENTAL DESIGN. THERE DOES APPEAR TO BE A NEED, HOWEVER, TO EXPERIMENT WITH LAND USE RIGHT TRANSFERS AND/OR OTHER FORMS OF LAND MANAGEMENT IN THE CONTEXT OF A DYNAMIC AND HIGHLY COMMERCIALIZED AGRICULTURAL ENVIRONMENT, SUCH AS NANHAI'S. THE NANHAI EXPERIMENTAL PROGRAM, IF APPROPRIATELY REFORMULATED, PRESENTS AN OPPORTUNITY TO BEGIN THIS KIND OF REFORM. THE MISSION SO RECOMMENDS, RATHER THAN IMPOSE STRONGER, EVEN PUNITIVE, MEASURES TO COERCE PARTICIPATION BY FARMERS IN THE "SCALE OPERATION" REFORM AT NANHAI.

(4) WITHIN THE FUYANG EXPERIMENTAL PROGRAM, THE MANAGEMENT, TECHNICAL AND FINANCIAL STANDARDS OF THE NGFAS REQUIRE URGENT ATTENTION. THESE ENTITIES APPEAR TO OPERATING WITHOUT INFORMED ADVICE FROM THE EXPERIMENTAL OFFICE, AND LIMITED REGULATION BY PROVINCIAL AND CENTRAL BANKING AUTHORITIES. THE MISSION FOUND THAT SEVERAL OF FUYANG'S NGFAS HAVE CONCENTRATED THEIR LOAN PORTFOLIOS ON POLITICALLY-MANDATED INVESTMENT HAVING DOUBTFUL VIABILITY, AND HAVE A FINANCIAL RESOURCE STRUCTURE WHICH COULD QUICKLY EVAPORATE SHOULD "SHAREHOLDER" CONFIDENCE TURN SOUR. IF THESE ENTITIES FAIL (AND SOME OF THE NGFAS IN FUYANG ARE APPROACHING INSOLVENCY), THE IMPACT ON INVESTOR AND DEPOSITOR CONFIDENCE, AND REACTION FROM THE ALREADY BELEAGUERED STATE BANKS COULD SWEEP AWAY THIS IMPORTANT INSTITUTIONAL INNOVATION (WHICH IS ANOTHER REASON FOR DEVELOPING TRIAL RULES AND REGULATIONS FOR NGFAS AS SUGGESTED IN PARA. FFF (4) ABOVE).

HHH DISBURSEMENT OF LOAN/CREDIT PROCEEDS: AS OF NOVEMBER 22, 1988, THE EQUIVALENT OF ABOUT USDOLLAR 236 MILLION HAVE BEEN DISBURSED FROM THE RSAL, LEAVING RESPECTIVE BALANCES OF ABOUT USDOLLAR 57 MILLION IN THE LOAN ACCOUNT, AND A ZERO BALANCE IN THE CREDIT ACCOUNT. THE LATTER WAS OFFICIALLY CLOSED ON OCTOBER 17, 1988 BY RECENT LETTER FROM MR. BURKI TO THE MINISTER OF FINANCE. THIS REPRESENTS AN EXTREMELY RAPID DRAW DOWN OF LOAN AND CREDIT PROCEEDS, WHICH WERE EXPECTED TO DISBURSE OVER A 12-18 MONTH PERIOD. ON THE OTHER HAND, THE URGENCY FOR RAPID DRAW DOWN IS APPRECIATED IN VIEW OF PRESSURES BEING PLACED ON CHINA'S FOREIGN ACCOUNTS AND DOMESTIC BUDGETARY RESOURCES.

III PROCUREMENT PROCEDURES: DURING LOAN NEGOTIATIONS, IT WAS GENERALLY UNDERSTOOD THAT PROCUREMENTS IN THE NEIGHBORHOOD OF US\$125 MILLION WOULD BE CARRIED OUT USING SERIAL INTERNATIONAL COMPETITIVE BIDDING PROCEDURES. IT WAS FURTHER ANTICIPATED THAT THESE PROCEDURES WOULD BE USED MAINLY FOR FERTILIZER PROCUREMENTS BY THE SINOCEM. ALTHOUGH RCRD AND CATIC MADE A CONSIDERED EFFORT TO IMPLEMENT THESE PROCEDURES, THE MISSION WAS ADVISED THAT SINOCEM REMAINS LESS THAN ENTHUSIASTIC ABOUT USING SERIAL ICB.

HOWEVER, WE WERE GRATIFIED TO LEARN THAT GOVERNMENT INTENDS TO PROCURE AT LEAST US\$50 MILLION UNDER THE RSAL USING SERIAL TENDERING PROCEDURES, THOUGH IT IS UNFORTUNATE THAT MORE WILL NOT BE ATTEMPTED IN VIEW OF THE SAVINGS NORMALLY ASSOCIATED WITH INTERNATIONAL COMPETITIVE BIDDING.

JJJ IT WAS UNDERSTOOD DURING LOAN NEGOTIATIONS THAT SEMIANNUAL REPORTS FOR THE RSAL WOULD BE FURNISHED COMMENCING JANUARY 1989. A FORMAT WAS PRESENTED BY RCRD DURING THE MISSION'S VISIT, WHICH WILL BE ACCEPTABLE SUBJECT TO A FEW SUGGESTIONS MADE BY THE MISSION DURING ITS REVIEW.

KKK ORIGINALLY SCHEDULED TO VISIT CHINA IN FEBRUARY, 1989, WE PROPOSE TO POSTPONE THE NEXT FORMAL SUPERVISION UNTIL MAY/JUNE 1989 TO PROVIDE RCRD AND EXPERIMENTAL ZONE AUTHORITIES WITH SUFFICIENT TIME TO IMPLEMENT CHANGES IN PROGRAM DESIGN CURRENTLY BEING CONSIDERED. IF THIS PROPOSAL IS ACCEPTABLE, THE NEXT MISSION ALSO WOULD CARRY OUT THE PROGRAM REVIEW SCHEDULED FOR MAY/JUNE, AND INITIATE FORMAL IDENTIFICATION OF THE PROPOSED SECOND RSAL.

LLL IN SPITE OF CURRENT SETBACKS, WE IN THE BANK ARE CONVINCED THAT THE RURAL REFORM ENDEAVORS SUPPORTED BY THE RURAL SECTOR ADJUSTMENT LOAN WILL SUCCEED, AND FEEL PRIVILEGED TO ASSIST WITH THIS HISTORICALLY SIGNIFICANT UNDERTAKING. BUT SHOULD THE APPARENT RETREAT TO TRADITIONAL ADMINISTRATIVE MEASURES MEASURABLY CURTAIL THE MOMENTUM FOR REFORM, WE ARE FEARFUL SUCH WILL MERELY AGGRAVATE THE OPERATION OF ECONOMIC FORCES ALREADY UNLEASHED IN RURAL AREAS WITHOUT BEING ABLE TO SECURE AN EFFECTIVE COORDINATION OF THESE FORCES. THE POSSIBLE CONSEQUENCES FOR REGAINING MACROECONOMIC STABILITY AND FOR DEVELOPING THE SOCIALIST MARKET ECONOMY ARE RATHER WORRISOME.

WITH WARM PERSONAL REGARDS. JOSEPH R. GOLDBERG, DIVISION CHIEF, CHINA AGRICULTURAL OPERATIONS, ASIA REGIONAL OFFICE, WORLD BANK.

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Washington, D.C. 20433

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CITY AND COUNTRY: INTBAFRAD
FOR ATTENTION OF: BEIJING, CHINA

Ln 2967 / or 1932-ETHA

FACSIMILE/ TELEFAX NO.: (Group 2/3) 8315902

SUBJECT: RSAL SUPERVISION MISSION: AIDE-MEMOIRE

✓
Aide Memoire for the RSAL mission.

cc:

Transmission authorized by: J. Goldberg, Chief, AS3AG *J. Goldberg*

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OFFICE MEMORANDUM

DATE: December 16, 1988

TO: Mr. T. James Goering, RMC (by fax)

FROM: *R. Burcroff II*
R. Burcroff II, AS3AG

SUBJ: RSAL Supervision Mission(s): Aide-Memoire

Attached please find the Aide-Memoire of the September-October and into-November supervision of the RSAL. Grateful if copies could be furnished to the World Bank/RSAL Loan Administration Office for distribution to the following Chinese officials:

RCRD: Messrs. Du Runsheng, Lu Mai, Chen Xiwen and Justin Lin
CATIC: Messrs. Wang Qishan and Wang Gang
MOF: Messrs. Wang Liansheng, Luo Qing and Zhu Xian

Please note that we intend to postpone the February 1989 supervision until May/June 1989 unless RCRD absolutely insists on one (unlikely). However, we still expect to receive the first semiannual progress report by end-January 1989, and will provide comments from here.

Attachment

cc: Messrs. Burki, Ahmad, Tidrick (AS3DR); Pearce, Cadario, Ody, Yusuf (AS3CO); Goldberg, Bi, Deshpande, Piazza (AS3AG); Lim, Zhou (RMC); Tanaka (LEGAS); Ms. Hwang (LOAAS); AS3AG Staff

RBurcroffII/ms

World Bank Mission to China
for 1st Supervision of the
Rural Sector Adjustment Loan

A. INTRODUCTION

1. A World Bank mission visited China from September 12-29 and October 16-November 16, 1988 to initiate supervision of the Rural Sector Adjustment Loan (RSAL). Our main tasks were to (a) assist as necessary with arrangements for loan effectiveness, (b) review the status of the overall reforms, as detailed in Part III of the Statement of Rural Reform Policies, (c) update our understanding of developments in the regional reform programs (RRPs) being implemented under State Council guidance, and (d) advise on matters arising concerning the utilization of loan proceeds, procurement procedures and disbursements.

2. In Beijing, the mission was briefed on the pace of overall reform and progress in the experimental zones by senior officials of the Research Center for Rural Development (RCRD) and the China Agribusiness Trust & Investment Corporation (CATIC). Details of the nine new RRP's under the purview of the RCRD were also discussed. Subsequent meetings were held with the Ministries of Finance, Commerce, Agriculture and Water Resources to review the overall reforms; and with the State Planning Commission's Department of Rural Economy, the People's Bank and the Agricultural Bank of China to discuss reorganization of the State Investment Program and developments in China's rural financial markets.

3. After initial briefings, the mission travelled to various experimental zones to review progress with the grain system reform (Xinxiang Prefecture, Henan and Yulin City, Guangxi); land management reform (Meitan County, Guizhou and Shunyi County, Beijing); rural enterprise reform (Fuyang Prefecture, Anhui Province); and reform of rural financial markets (Guanghan, Sichuan, Fuyang Prefecture and Meitan). During these visits, our staff exchanged views with RCRD and local officials about design, implementation, initial impact, staffing, budgeting and plans. We also reviewed the monitoring systems and indicators being set-up to track progress. While in Guizhou, the mission was invited to attend the Conference on Land System Reform, held in Zunyi City between September 20-21, where we presented our views on the design and financing of the land-lease market and land consolidation programs. Also, two experts in the field of perishable products marketing, who joined the mission in response to a request from RCRD, reviewed product acquisition and distribution systems for fresh vegetables in Beijing and Guangzhou.

4. The mission was well received. We wish to express our appreciation for the warm hospitality, many courtesies extended, and arrangements made. In particular, we wish to thank Messrs. Wang Qishan and Wang Gang, President and Vice President of the CATIC; Lu Mai, Director of RCRD's Experimental Programs Office; Chen Xiwen, Acting Director of RCRD's Development Institute; Qian Fagen, Acting Director of the RSAL/World Bank Loan Implementation Office; and their staffs and colleagues at the provincial and local levels. The mission has agreed to provide RCRD with detailed summaries of our findings and recommendations by end-December, 1988.

B. GENERAL

5. This initial supervision took place during a period of reassessment in China. The need for China to address the difficult issues of inflation, monetary and credit expansion, and ultimately, the need to add substance to enterprise reform is appreciated. We realize (and agree) that the pace of rural policy reform must be articulated with, and will be somewhat contingent upon decisions made in regard to the non-rural reforms, especially Government's macroeconomic stabilization policies.

6. Having said this: there is a danger that the more fundamental of the rural reforms--viz. the land management and grain system reforms, and the restructuring of the TVEs' policy and business environment, if implemented too slowly, may increasingly become hostage to an overreaction to the current macroeconomic situation and the slow-moving reform of State-owned enterprises. There is an equally important concern that resources of both the informal financial service cooperatives in China and local branches of the specialized banks, as well as of China's ubiquitous Rural Credit Cooperatives are becoming tied-up in dubious loans to State-owned and collectively-owned entities. These loans generally are long term in nature, having--of late--somewhat doubtful profitability, and a risky expectation of timely repayment.

C. THE MISSION'S WORK PROGRAM

7. The mission's review of the overall program aimed mainly to (a) record recent developments in the realm of national policies, (b) understand Government's current thinking about the pace of rural reform in light of recent developments, and (c) assess the likelihood that Government would be able to implement the program of rural reforms referred to in the Statement of Rural Reform Policies (the "Policy Letter") within time frames indicated. Our

detailed review therefore emphasized the more immediate undertakings, i.e. "Price Reform" (paras. 14-18 of the Policy Letter), "Establishment of a Land Use System" (paras. 19-22), "Rationalization of the Rural Enterprise System" (paras. 26-29), and "Rural Investment System Reform" (paras. 30-33). The mission was also briefed on "Rural Marketing System Reform & Establishment of Rural Cooperative Organization" (paras. 23-25), but was not staffed to carry-out a detailed review of this topic. Our understandings are recorded below:

D. GRAIN SYSTEM & AGRICULTURAL PRICE REFORMS

-Program of General Reforms.

8. In the past few months, inflation has emerged as a major national issue and the Government has introduced steps to control it. We understand that the "counter-inflationary" program for agriculture in 1989 will entail new measures to stabilize markets by expanding supply and reducing demand for key commodities. In the grain sector, which is considered the key to regaining balance in the agricultural sector, the Government appears fully committed to accelerate grain production. A six-part program is being adopted, which--in broad outline--aims to (a) stimulate grain production, (b) constrain growth in urban food subsidies, (c) ration fertilizers and other modern inputs, (d) ration foreign exchange expenditures for agricultural operations, (e) establish new investment programs dedicated to grain production and (f) develop new, earmarked, taxation to finance these programs. If the Government is able to identify viable means for implementing these guidelines, the result would be a major step away from efficiency pricing and its institutional handmaiden: the liberalization of China's internal marketing and distribution systems. In addition, a tight national control of grain and agricultural input prices will inhibit the Grain System RRP from implementing planned further price reforms, thereby denying the possibility of learning appropriate lessons from these pilot reforms for wider application at the national level.

9. Clearly, the Government's ability to stabilize agricultural pricing will influence the transition towards macroeconomic balance and affect its pace, but the mission feels strongly that this must continue to be accompanied by strong incentives to encourage production, rationalize consumer subsidies, and render more transparent, buoyant and effective, the resource mobilization required to finance adjustments in the grain system. Indeed, the initial experience in the Xinxiang and Yulin experimental zones anticipates the kinds of gains which are possible and the rapidity by which these may be realized, even in the face of a worrisome inflation.

-Progress in the Experimental Zones.

10. The RRP's covenanted in the RSAL for grain system reform deal specifically with reform of the grain procurement and marketing system, and the financing of related subsidies. The mission focussed on decisions made and measures taken to implement the first phase of the Xinxiang, Henan and Yulin, Guangxi RRP's, and plans/preparations for the next phase. In this context, we reviewed (a) reforms to producer pricing policies in the experimental areas and the treatment of contract grain purchases; (b) the pricing and availability of production inputs--thus, also, inputs subsidies; (c) consumer pricing, ration sales and the monetization of ration coupons; (d) agricultural tax reform; and (e) monitoring systems for the RRP's. Our main findings are summarized here (though the discussion of monitoring arrangements is presented below in Section H), with details available in the mission reports that will be furnished presently.

11. Implementation of the Xinxiang RRP's first phase has been smooth and the initial impact was positive. Producer prices were increased, inputs subsidies reduced, and agricultural tax rates revised upwards. Grain production responded to increased producer incentives (in spite of the drought), the local grain stations were able to procure quota grains ahead of schedule and without problems, and the government was able to accelerate the collection of agricultural taxes. However, problems in three vital areas emerged during the second half of 1988 which--unless rectified soon--could seriously undermine the initial success at Xinxiang and make it difficult to introduce the crucial second phase. These problems include finance, availability of rationed inputs and a wavering of political will by local authorities.

12. Since the RRP was designed to be financially self-sustaining, the Xinxiang City and Henan Provincial governments did not budget additional financial resources to cover reform related expenditures. But now the RRP appears to be experiencing severe financial shortfalls due to the fact that about half of the 1988 fertilizer and diesel were sold before implementation began, at the old plan prices, whereas the bulk of the summer harvest was procured at the higher contract prices featured in Phase I of this RRP. Furthermore, Xinxiang did not receive its assigned allocation of urea and diesel due to various problems including transportation bottlenecks, which will likely constrain farmer response to Phase I incentives during Winter and Spring plantings. Further, since the gaps between market prices on the one hand, and contract grain and ration sales prices on the other, have widened far more than anticipated, the financial resource requirement for Phase II will likely be even higher than expected since this phase entails both a further increase of grain procurement prices and an increase in consumer prices.

13. The Xinxiang authorities are understandably nervous, fearing that the reform may be blamed for instabilities in production, consumption and finance that in fact derive from China's macroeconomic problems and rigidities in inputs supply. Morale is said to be a problem, and the mission was asked to convey a request for some kind of assurance from national-level authorities that the reform should progress as planned, and that necessary financial resources and production inputs will be made available to facilitate unhindered implementation. The mission strongly endorses these requests, and was advised that the State Council intends to confirm its endorsement of all of the experimental reforms being implemented under the purview of the RCRD in the not-too-distant future.

14. The pricing and marketing components of Yulin City's first phase RRP is more comprehensive than Xinxiang's and was not intended to be financially self-sustaining. The prices of contract grain (rice) procurement, of rationed sales to urban consumers and rural resales were raised to prevailing market levels; consumers were given fixed income supplements; prices of production inputs were substantially increased; and measures were introduced to make the remaining subsidies more transparent. Unlike Xinxiang, however, the Yulin City and Guangxi Zhuang Provincial governments agreed to share part of the remaining subsidies.

15. Implementation of the first phase was smooth and the initial impact has been quite positive. Rice production responded well to higher procurement prices, and perhaps most importantly, the plantings of input intensive hybrid rice increased dramatically. Indeed, Yulin now faces a shortage of hybrid rice seeds, much to the credit of the reform. Yulin's grain quota was fulfilled well ahead of schedule, accompanied by a rapid increase in the share of private operators in the local grain trade. As a result of these reforms, the market is reported to be very stable in spite of persistent inflationary pressure. The mission understands that Yulin plans to go ahead with the second phase, which will consist of further increase in grain purchase prices and increased reliance on the market, further reduction of quota sales, and the introduction of agricultural tax reform.

16. Similar to Xinxiang, the Yulin authorities face three problems that should be sorted out before the second phase begins. The first one concerns financing, the second relates to an overhang of unused ration coupons--which have become monetized and could place tremendous pressure on City finances were ever these "cashed-in", and the third (again) involves morale. The financial difficulties are known and will not be repeated here, except to underscore the mission's recommendations that

- (i) the Guangxi Zhuang Financial Bureau should be encouraged to release the central and provincial funds

already allocated to the Yulin RRP as soon as possible, and

- (ii) that earmarked exemptions to Yulin's credit ceilings should be granted to enable the City to finance the RRP's working capital requirements.

17. The overhang of ration coupons from previous years could present an equally serious problem. These coupons have been effectively monetized, and represent a store of unearned wealth beyond official control under present arrangements, and ready to be unleashed if consumer confidence erodes. Recognizing this problem, we understand that an expiry date is now assigned to newly issued ration coupons. Although the Yulin authorities have decided otherwise on "equity" grounds, the mission strongly recommends that those ration coupons being retained by consumers from before the reform was implemented also be given an expiry date, say on June 30, 1989, else simply be declared invalid. To protect low income consumers, a more dedicated targeting than that represented by the broadside distribution of ration coupons could be easily set-up within the framework of existing administration--and perhaps should be experimented with under Yulin's RRP.

18. The morale problem is similar to Xinxiang's: a result of uncertainties regarding State endorsement of the reforms being introduced. The State Council's intended reaffirmation (para. 13) should allay current concerns, though additional visits to Yulin by RCRD's officials would also help, since the absence of routine visits has made experimental zone authorities feel somewhat like orphans while trying to implement this far-reaching experiment without visible high-level support. Technical support, especially, will be required from RCRD when the Yulin authorities finalize designs and implementation details for the second phase reform, and is so recommended.

E. REFORM OF THE LAND MANAGEMENT SYSTEM

-Program of General Reforms

19. Amendments to Article 10 of China's Constitution by the National People's Congress on April 12, 1988 provided sanction for an expanded experimentation with the rural land management system (LMS). In addition to the RRP's reviewed while the RSAL was being formulated (at Meitan, Guizhou, in Southern Jiangsu and in Guangdong's Nanhai County), the State Council subsequently endorsed RRP's for Pingdu County, Shandong and Beijing Municipality's Shunyi County. The need for diversity, both regional and in recognition of agroeconomic and off-farm opportunities, is implicit in the differing features of the land

system RRP. The mission feels these have been selected wisely, and that an evaluation of program results will lend well to a formulation of national laws and regulations intended during 1990.

20. The mission was invited to attend (and make presentations at) a Conference on Land System Reform in Zhunyi, Guizhou, which was held to debate the shape and form that national policies might ultimately assume. This provided extremely valuable insights into the nature of the current debate in China, and the variety of approaches being considered. There is clearly widespread acceptance at all levels of the need to replace the present administrative procedures for allocating land use rights by a system which allows for a much greater role for market forces. The seminar also recognized that room for manoeuvre in LMS reform is presently constrained by agricultural pricing and marketing policies and by food security strategy and that, conversely, the range of options available for reforming these policies is itself partly determined by the potential impact which LMS reform will have on agricultural productivity.

-Progress in The Experimental Zones

21. The Meitan RRP is progressing steadily. The formal establishment in September 1988 of a land bank (The Meitan Land Finance Company) to finance land use transfers and agricultural development schemes was a major milestone in supportive institution building. The recently introduced land contracts (formalizing the leasing of land by households from the collective) will serve as collateral for the borrowings. We understand that a group from the Guizhou Provincial Land Management Bureau will visit Meitan shortly to supervise the issuing of land certificates to cover all land in the County. These will, in effect, serve the purpose of "title deeds" and facilitate the transfer of land between collectives and compensation for individual households concerned.

22. Revenue raising and financing of local level activities has been streamlined in the Meitan RRP by formally making villages administrative subunits of townships. Crop quotas and contract purchases have been reduced in amount, thus effectively raising farm prices in an effort to encourage greater use of agricultural inputs. Subsidized grain resales to rural consumers have also been reduced. The recently introduced land use fee appears to have been generally accepted by farmers.

23. The Meitan "model" has been endorsed by the Provincial Government, which is urging other counties in Guizhou to introduce similar reforms. Diffusion of this RRP within Guizhou will be closely monitored. The main question about the Meitan RRP concerns the rate at which land transfers will take place, with

the corresponding emergence of consolidated and/or specialized farms operating at high levels of efficiency. Much will depend on the schemes to bring into production the uncultivated uplands and the amount of surplus agricultural labor, made available through land consolidation in the lowlands, which can be productively employed on the uplands. This in turn will depend on the amount of good quality upland per capita, market opportunities and the type of upland production system (e.g. mini-estate, smallholding or a combination) which is instituted.

24. The Southern Jiangsu, Nanhai, Pingdu and Shunyi RRPs are all attempts to deal with problems caused by the high opportunity cost of land under grain crops and of labor needed to work the land, in an environment of rapidly growing demand for non-agricultural workers and for high value agricultural products. Production gains under the specialized household systems have been good this year in both Southern Jiangsu and Shunyi, but it is clear that these RRPs present expensive solutions to land fragmentation and the problem of low agricultural productivity, both in terms of the capital financing and the income support required from the non-agricultural sectors. Under present conditions, there is some question whether the Southern Jiangsu experiment can be sustained, since its diffusion to nearby towns and counties has fallen well behind schedule. With both of these experiments, replicability remains very much at issue--even in the labor deficit coastal zones and environs of major cities for which these RRPs are designed and where they are presently located.

25. In Guangzhou's Nanhai County, the RRP simply is not working. Only a tiny fraction of households have opted to become specialized producers of quota crops operating consolidated holdings. The lure of off-farm employment and the gains from producing vegetables and other high-valued crops (where gains from reduced fragmentation could be expected to be negligible) have eliminated any enthusiasm for the RRP that may originally have been present in Nanhai. There is a need for experimenting with land use rights transfers and/or other forms of land management within the context of a dynamic and highly commercialized agricultural environment, however, and the Nanhai RRP--if appropriately reformulated--presents an opportunity to begin this kind of reform. The mission so recommends, rather than pursue the current official thinking in Nanhai that stronger, even punitive measures, should be introduced to force farmers to participate in the RRP.

26. By way of contrast, the Pingdu RRP--in which all farmland is divided into food plots and responsibility plots--and use rights on the latter are auctioned off to competing bidders for a fixed term, appears to have been highly successful. It has fostered a reduction in fragmentation, and offers a semi-market based method for establishing land "rental" values. The biggest stage of

recruitment of villages has just been completed, bringing the proportion of villages in the county using the system to more than 90%. The features of this RRP may well provide a model for other labor deficit zones where reliance on quota grain production (rather than imports) will continue to prevail for the foreseeable future, and also--with local refinements--a general method for establishing the rental value of use rights (owed to the collective) and the value of compensation for improvements made by previous operators who have chosen to relinquish their responsibility lands.

F. REFORM OF THE RURAL ENTERPRISE SYSTEM

-Program of General Reforms

27. After China's Constitution was amended on April 12, 1988 to sanction private and other enterprise forms, a National Private Enterprise Law was promulgated in July 1988 which reconfirmed the legitimacy of enterprises operating outside of the state-owned sector and provided for their right to operate with a significant degree of freedom from local government control. This Law lays out the basic requirements for sole proprietorships and partnerships, as well as for private companies limited by shares. However, some provisions of the law are discriminatory, in that higher tax rates and stricter payment obligations apply to private enterprises than required of State- and collectively-owned firms.

28. Under the Fuyang, Anhui RRP (cf. below), a trial Non-governmental Enterprise Law has been drafted to apply both to private enterprises owned by individual citizens and to township or community-owned enterprises--the aim being to give all non-state enterprises equal status in law. This draft is expected to be implemented when approved by the provincial and local People's Congresses. The trial Insolvency ("Bankruptcy") Regulations for non-State enterprises also remains in draft form pending approval. Although both trial enactments will need to be tested in a controlled environment before national laws can be issued, the potential national significance is so great in terms of stabilizing the TVEs and establishing financial discipline in the non-State sector, that the mission strongly urges RCRD to bring as much pressure to bear as possible to have these enacted in Fuyang and to initiate testing.

-Progress in the Experimental Zones

29. The overall experimental frame appears to be spreading as RCRD now refers to four distinct models of TVE development: the Wushi (Jiangsu), Fuyang (Anhui), Wenzhou (Zhejiang) and Shishi

(Fujian) models respectively. The current concern with macroeconomic issues may not yet have had discernable impact on the growth of TVEs but the credit squeeze will undoubtedly do so. Some readjustment of policy priorities is under consideration, away from the less developed rural areas (such as Fuyang) where adjustments to the rural economic structure and the creation of off-farm jobs have been stressed, and towards the coastal regions which are better placed to develop exports and hard currency earnings. In this connection, the mission was advised that RCRD has been undertaking work with TVEs for the last two years to encourage the increased production of export commodities. This work has been concentrated in the coastal provinces of Fujian, Zhejiang, Jiangsu and Shandong. In some locales, TVEs have been given greater freedom to retain earnings and other receipts in foreign currency. The mission was gratified to learn that the formally endorsed RRP's, which essentially focus on institutional issues, are being supplemented by assistance from the RCRD through less structured (but certainly no less important) means that focus more narrowly on TVE activities in promising economic subsectors. However, because of difficulties with arranging appointments with RCRD's "Rural Enterprise" staff in Beijing, the mission was unable to complete an in-depth review of these important developments, nor of the overall rural enterprise policy framework, and requests that during the next RSAL supervision appropriate arrangements be made.

30. Formal RRP's for the development of TVEs and non-state enterprises have now been established in three areas: Fuyang Prefecture in Anhui Province, Wenzhou City in Zhejiang, and a new one in Zhebu City's Zhoucun County in Shandong Province. The emphasis in this newly introduced RRP will be on enterprise shareholding (joint stock) systems--systems designed in particular for enterprises currently owned or controlled by local governments.

31. During its visit to the Fuyang experimental zone, the mission noted that the majority of the 20 subprojects in this RRP are being implemented according to schedule. The industrial zones with their preferential policies to encourage new rural enterprises have undergone remarkable development in the last seven months. The subprojects to remove artificial restrictions in rural markets have been successful in the pilot counties and these reforms are now spreading rapidly within Anhui.

32. There are early indications that the number of enterprises, their output and profits have continued to increase at a significant rate in spite of the macroeconomic instability which also has affected Fuyang Prefecture. New enterprises are continuing to be set up to exploit new market opportunities, although there are signs that some of the markets into which TVEs first entered are reaching maturity. Fuyang's experimental zone office has introduced two new enterprise models--both for joint

ventures with foreign companies--but the enterprise structure subproject as a whole seems to be some way off from completion. Some of the RCRD staff involved in the enterprise reform subprojects have general reservations about the feasibility of a rapid introduction of "modern contractual" relationships into rural society, although China's reform growth targets would suggest that such relationships, embodied in enterprise charters and contracts, and protected by law and local courts, are both imperative and inevitable.

33. Two aspects of the Fuyang RRP give rise to concern. The first is the continued operation of the non-governmental financial service associations without a secure asset base and with potentially destabilizing lending policies. The danger of collapse and erosion of confidence is great. This is discussed in the next Section. The second is that the monitoring system is not being implemented as planned. This is discussed in Section H below.

G. INVESTMENT SYSTEM & RURAL FINANCIAL MARKETS

-Program of General Reforms

34. The mission exchanged views with RCRD staff and the State Planning Commission about the newly organized State Investment Corporations, and with RCRD on the current status and issues in China's financial system. The latter discussions focussed on rural financial markets and trial rules and regulations for the non-governmental financial service associations (NGFAs) that have proliferated of late. We also discussed concepts and issues in land banking with participants at the Zhunyi seminar on LMS reform.

35. China's rural investment system and financial markets are currently going through a difficult period in the wake of severe credit curbs imposed to constrain inflationary pressures, and recent changes in the interest rate structure which were initiated mainly to restrict the rapid draw down in deposits and to depress overall credit demand. These measures also are having an effect on the performance of the financial sector RRP's.

36. A key element of the general program for reform of the rural investment system is the formal review of rural financial market policies and preparation of trial rules and regulations for the indicated in paras. 32 and 33 of the Policy Letter. Since RCRD does not appear to have sufficient in-house resources, the mission indicated that it would recommend to Bank management that these tasks be carried out either through its economic and sector work program for China, or under future lending for agricultural credit such as the proposed Fourth Rural Credit Project. In

either event, the mission conveyed its views that involvement of the People's Bank and other major financial institutions would be required. RCRD agreed to inform the Bank of its proposals shortly.

-Progress in the Experimental Zones

37. As a result of economic uncertainty, the pace and impact of the Guanghan, Sichuan and Fuyang, Anhui RRPs in rural finance have noticeably slowed down. However, in Guanghan, much progress has been made towards introducing the contract responsibility system for management of local, governmental financial institutions. The result has been a genuinely increased autonomy in decision-making and business operations, and a linking of wages/remuneration with unit performance. There are, however, several areas in which the experimental design could be strengthened, including (a) methods for determining salary and wage incentives, (b) more flexibility in the interest rate structure, (c) interbank settlement procedures and (d) the internal organization of State-owned banks. To accommodate current uncertainties, the mission recommended that contractual targets for deposits, loans and profits for individual units within the Guanghan RRP should be subjected to frequent review and adjustment, since any rigidities in this regard could quickly prove counterproductive. This is an important consideration, since the Agricultural Bank of China has already adopted the contract responsibility system nationwide, and subsequent refinements will no doubt be influenced by staff performance within its Guanghan branches. The mission also recommended that a more detailed review be undertaken early in 1989, after operational performance data for financial institutions participating in this RRP become available for the three consecutive years (1986-1988) that elapsed since implementation began.

38. The Fuyang, Anhui experiment with NGFAs still represents the main experiment under State Council guidance for broadening rural financial markets and improving their dynamism and flexibility. However, the mission noted several worrying developments which underscores the urgent need to establish sound financial standards for these institutions and delineate the broader financial sector policy issues that will have to be addressed during future expansion of the NGFA system.

39. The management, technical and financial standards of the NGFAs in Fuyang require urgent attention. These entities appear to be operating more or less without informed advice from the experimental office, and limited regulation by provincial and central banking authorities. The latter, in any event, should be positioned to encourage NGFA development without imposing undue restrictions, while at the same time monitoring the NGFA's

decisions and performance to insure that these operate according to sound financial principles. The mission found that several of Fuyang's NGFAs have been concentrating their loan portfolios on politically-mandated investments having doubtful viability, and have a financial resource structure that is nearly risk free as far as the "shareholders" are concerned. If these fail (and some of the 7 NGFAs in Fuyang are approaching insolvency), the impact on investor confidence and the reaction from the already beleaguered State banks could sweep away this important institutional innovation. The result would be a loss of a benchmark experiment in the provision of informal financial services, which could lead to an untimely postponement of benefits from the inherent flexibility which the NGFAs--if managed intelligently--can provide.

40. The establishment of the Land Financing Company (MLFC) in Meitan, Guizhou is a remarkable development since contracts for land use rights will be used for the first time to secure loans for purchasing use-rights and to support agricultural development. This is the first institution of its kind in China of which we are aware, and its evolution and performance should be monitored with interest since it could serve as a model for the future development of land banking throughout China. The MLFC's conceptual framework is sound, though additional thought needs to be given to evolving financial instruments for raising longer term capital, reducing reliance on budgetary allocations for medium- and long-term loans, and to the MLFC's lending policies per se'. The mission offered to assist with this endeavor during future RSAL supervisions and other missions to review/prepare Bank operations in China's rural financial sector.

H. MONITORING ARRANGEMENTS

41. In this subject matter area, the mission concentrated on developments within the experimental reform programs. We were given an opportunity to discuss in detail the progress being made in establishing monitoring and evaluation (M&E) systems for the Xixiang, Yulin, Meitan, Fuyang and Guanghan RRPs, and also received some information pertaining to the Southern Jiangsu RRP. It was decided to defer extensive discussion of M&E arrangements for tracking the diffusion of reforms at the national level and for reviewing other RRPs' M&E efforts until the next supervision mission. By that time, RCRD will have prepared the first semi-annual progress report based, in part, on the M&E reports from the various experimental reform offices.

General Issues

42. There are two general issues concerning M&E arrangements for the RRP, which the mission recommends RCRD should address on fairly short order, since these arrangements are still being established and placed into effect.

(i) It is not clear whether the need for clearly separating the M&E function from the general management function in the experimental reform offices is adequately appreciated. There is some danger that the RRP management and M&E roles of staff will become indistinguishable with a resulting lack of focus and objectivity, both needed for objective reporting and a continuity of performance on the M&E side. The issue (in all of the RRP) is really one of recognizing the need for attaching a permanent M&E unit to each of the experimental offices, having the primary purpose of ensuring that the data-gathering agencies are reporting on time with the needed information, and each provided with desktop computers and necessary budget. The mission strongly urges RCRD to give these recommendations serious consideration.

(ii) While it is perhaps too early for definitive judgement, there are grounds for believing that M&E training for the RRP may need to include a wider audience and have greater technical content. Leaders below the county level may need to be better briefed in the objectives and methodological principles of M&E so that they in turn can ensure appropriate actions/responses by cadres and farmers. It is particularly important that the difference between M&E's information needs and the statistical agencies routine reporting formats be clearly understood and appropriate modifications be embedded in the M&E reporting formats. Greater technical ability among M&E staff to design and conduct surveys is also likely to be needed in order to cope with the (necessary) complexity of the RRP's indicator systems.

The Grain System RRP

42. In Xinxiang, good progress has been made to organize a system of monitoring indicators, but the organization for monitoring still lacks coherent organization, needed staff and financial resources, and data processing equipment to carry out M&E in a scientific and satisfactory way. Similarly, in Yulin City a monitoring system has been established, but it is not well organized and equipped. In particular, the system lacks the needed manpower and financial resources to monitor the impact of the reform, particularly on grain consumption patterns among

different income groups (there is no Urban Economic Sample Survey Team operating in Yulin City and its environs).

The Land Management RRPs

43. The effort which has gone into the design of M&E for the Meitan RRP is impressive. A land system "building, monitoring and population" research group has been set up under the auspices of Meitan's Leading Group for rural reform, and organized by Guizhou's Provincial Bureau of Statistics. This group has produced a document listing over 200 monitoring indicators in six main categories (general situation, changes in land use, attitudes/behavior/responses, economic benefits, social impacts and ecological effects). Many of these indicators require the collection of data which is not normally collected by the existing information channels. Staff recruitment is in hand to establish a network of statistical personnel at the grassroots level as well as an early warning system to detect LMS problems before they become too widespread. Some training of local leaders in M&E principles has already been undertaken and more has been programmed. Another county in Guizhou Province--Fenyang--has been selected as a control for the Meitan RRP and will provide comparative data. There is no doubt that M&E of the Meitan RRP is being taken very seriously by the authorities at both the provincial and county levels.

44. In the Southern Jiangsu RRP, leaders from 30 villages and five townships responsible for rural economic management have attended a training session on data collection, having particular reference to the monitoring of performance indicators during the 1988 Autumn harvest. It appears that a format for M&E reporting has been developed, but the mission was not able to review a copy at the time of the briefing.

The Rural Enterprise RRPs

45. The mission was only able to review M&E arrangements for the Fuyang RRP, which are much less satisfactory than those reported above. The decision to place responsibility for subproject coordination and monitoring with the various counties concerned, and staff shortages in the experimental office have led to the abandonment of plans to carry out some important enterprise surveys. There also appears to have been no systematic effort made (yet) to monitor the effectiveness of prefecture-wide changes in certain key policies or administrative actions taken as part of the reform program. For example, the impact of new regulations and procedures to reduce interference by local cadres in the operation of free markets has not been systematically checked, nor has anyone followed-up applications for model enterprise charters to see the extent to which the new charters

are actually being used. This failure/inability to monitor RRP "inputs" is potentially quite serious and should be urgently rectified.

The Financial Market Experiments

46. Monitoring systems for the two financial sector experiments (i.e. Guanghan, and Fuyang) are presently being set-up with RCRD's assistance. Detailed reporting formats are being finalized by the local experimental offices, which RCRD intends to append to the first semi-annual progress report to the Bank next January.

47. The mission was informed that M&E in the Guanghan RRP will focus both on quantitative and qualitative assessments of the financial performance of the involved intermediaries and staff productivity improvements. M&E will be based on semi-annual reports from the specialized banks and annual reports from nonbanking financial service companies. The socioeconomic impact of the RRP and exogenous macro-effects on the performance of participating institutions will be assessed annually based on statistical information compiled by the local statistical office, supplemented by special surveys. The M&E indicators will fall under three broad headings:

- (i) overall monetary indicators,
- (ii) financial performance indicators, and
- (iii) miscellaneous quantitative indicators.

The analytical (and reporting) frames would be by type of participating institution. In this connection, the mission recommended that the current four-category format be revised as follows to better reflect the nature of the participating institutions, viz. state-owned specialized banks, nonbanking state-owned financial institutions, collective institutions, and credit organizations which do not provide services to the general public (e.g. cooperative funds). The mission also urged that a systematic attempt be made to isolate the effects of inflation and macro-level policy directives from effects deriving from the design of the RRP, when monitoring unit performance and staff incentive systems.

48. Monitoring arrangements for Fuyang's NGFAs are still being devised. The mission was informed that the experimental office at Fuyang (which needs to be strengthened) plans to monitor the three initial NGFAs set up under the RRP, using financial indicators such as increases in deposits, loans and profits, and miscellaneous quantitative indicators. The experimental office also would review progress made in refining "stocks and

ownership" concepts, and the introduction of financial standards for the NGFAS banking operations.

I. DISBURSEMENTS

49. As of November 21, 1988, the equivalent of about US\$ 243.0 million have been disbursed from the loan and credit, leaving respective balances of about US\$ 57.0 million in the loan account and a zero balance in the credit account. This represents an extremely rapid draw down of loan and credit proceeds, which were expected to disburse over a 12 to 18 month period. On the other hand, the urgency for rapid draw down is appreciated in view of the pressures being placed on China's foreign accounts and domestic budgetary resources. (The possibility that part of the counterpart proceeds may be allocated to specific and scheduled budgetary expenditures for agriculture development is endorsed.)

50. Thus far, a total of ten withdrawal applications have been received, of which the first nine have been accepted and disbursed against, save for payments made before the loan was signed (cf. below), and a few items where inconsistencies showed in the withdrawal applications. The Ministry of Finance has been notified of details. Further, the proceeds of Category 3 in the loan and credit agreements have been reallocated to Category 1 as per MOF's telexed request of September 19, 1988. However, disbursements against Application No.10 are being withheld to retain undisbursed amounts sufficient to reimburse ICB procurement of an amount "at least not less than US\$ 50 million" as indicated in MOF's telex to the Bank's Director of China Operations dated October 7, 1988.

51. We regret that some confusion was caused by the Bank's disbursement letter for this operation, which stated that payments made after May 18, 1988 would be eligible for reimbursement. As with investment project agreements, however, the Bank's General Conditions are the legal referent--as indicated in Section 1.01 of the RSAL's Loan and Credit Agreements. (These stipulate that only payments after the date of Loan/Credit signing (July 15, 1988) are eligible for reimbursement unless retroactive financing has been authorized. Retroactive financing was neither applied for nor authorized for the China-RSAL.) The mistake occurred because of end-fiscal year pressures...we apologize for the inconvenience this may have caused.

J. PROCUREMENT

52. During appraisal and loan negotiations for the RSAL, it was generally understood that procurements in the amount of US\$ 125-150 million would be carried out under the loan/credit using serial international tendering ("serial ICB") procedures. It was further anticipated that these tendering procedures would be used mainly for fertilizer procurements by China's Chemical Industries Import-Export Corporation, known as SINOCHEM. This seemed an appropriate arrangement, given SINOCHEM's preeminent position in China's fertilizer imports vis-a-vis other importers such as the International Tendering Corporation.

53. Further, we appreciate that a genuine attempt was made by the RCRD and CATIC to implement these procedures: first, through advertisement in the Development Business section of "Development Forum", and second, through notifications to foreign embassies in Beijing. But we were advised that only 9 requests for registration applications were received, and only two had been returned by end-September. This is puzzling, since fully two and one-half months had elapsed since the advertisements and notifications were issued.

54. The mission was advised that SINOCHEM is reluctant to attempt serial ICB in the face of rising fertilizer prices. The mission emphasized that this argument is somewhat specious, and referred to the recent Indian fertilizer procurement experience under its Emergency Drought Relief Loan. (Like China, India is a major fertilizer importer--capable of influencing prices if careless procurement is practiced.)

55. However, we were gratified to learn that Government intends to procure at least US\$ 50 million under the RSAL using serial ICB procedures, though it is unfortunate that more will not be attempted in view of the savings that normally are associated with ICB procurements. We also are concerned with SINOCHEM's ability to continue to operate as a trading company under the current stringent financial conditions, rather than behave more responsibly as one of the Government's most important procurement agencies.

K. SEMIANNUAL REPORTS

56. It was understood during loan negotiations that semiannual reports for the RSAL would be furnished commencing January 1989. A format was presented by RCRD during the mission's visit, which will be more than adequate. The mission suggested, however, that additional sections be added to encompass the monitoring arrangements being set up for the RRP's, including a summary of

procurement and disbursement activity under the loan and credit agreements.

L. NEXT SUPERVISION

57. The scope of the next supervision must necessarily be more comprehensive than the present one was. Originally scheduled to visit China in February 1989, we propose to postpone the next mission to May or June of 1989, to give sufficient time to RCRD and authorities in the experimental zones to implement changes and improvements currently being considered. Mandated by a need to review the impact of macroeconomic adjustment measures being adopted by the State Council, and with the benefit of more elapsed time for implementing the RRP's, the next mission would also carry out the formal program review scheduled during Loan Negotiations for May/June 1989. It thus will be expected to review progress with the overall reforms in greater detail, as well as visit RRP's not reviewed during this first supervision. A corollary responsibility would be to discuss a format and design for the proposed Second RSAL.

58. In spite of current setbacks, China's rural reform endeavors have global importance. We in the Bank are convinced that RCRD's programs will succeed, that the momentum for rural reform can not be reversed, and feel privileged to assist with this historically significant undertaking. We only hope that the current instability will be viewed in China as presenting an opportunity: one which can be used to set in place previously unpalatable reforms to enable China to move more squarely towards indirect macro-management and control of rural economic activities. The reverse, a wholesale retreat to traditional administrative measures, would merely destabilize the rural economy. It would impede the operation of forces already unleashed without being able to bring these under some form of indirect regulation, and thus would likely aggravate current macroeconomic problems. Worse, such measures would most definitely postpone progress towards meeting the needs of a Socialist Market Economy.

Richard Burcroff II
Richard Burcroff II
World Bank Mission Leader
December 16, 1988

Files

December 19, 1988

The Honorable Wang Bingqian
Minister of Finance
Ministry of Finance
Beijing
People's Republic of China

Dear Mr. Minister:

Re: Credit 1932-CHA
(Rural Sector Adjustment Loan)
Closing of Credit Account

I refer to the Development Credit Agreement dated July 15, 1988 between the People's Republic of China and the International Development Association for the above-mentioned project and wish to advise you that with the partial payment made on October 17, 1988 against application No. 9, of US\$ 174,100.71 (equivalent to SDR 131,284.80), the above Credit has been fully disbursed. The final disbursement position by category under the said Credit is as follows:

<u>Category</u>	<u>Disbursements (SDR)</u>
1. Commodities and Raw Materials for the Rural Sector	16,494,286.19
2. Agricultural Inputs	55,745,713.81
3. Machinery, Equipment and Spare Parts for the Rural Sector	0.00
Credit Amount	72,240,000.00

With the final payment of October 17, 1988, the Credit is closed of that day.

Sincerely yours,

Shahid Javed Burki
Shahid Javed Burki
Director
Country Department 3
Asia Regional Office

cc: Messrs. Tanaka, Pearce, Lim (RMC)
Ms. Nancy Hwang
✓ Asia Files
Black Book

CHA. W 2967/CR 1932

12/16/88

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

Asia Files

DATE: December 16, 1988
TO: Mr. T. James Goering, RMC (by fax)
FROM: *R. Burcroff II*
R. Burcroff II, AS3AG
SUBJ: RSAL Supervision Mission(s): Aide-Memoire

Attached please find the Aide-Memoire of the September-October and into-November supervision of the RSAL. Grateful if copies could be furnished to the World Bank/RSAL Loan Administration Office for distribution to the following Chinese officials:

RCRD: Messrs. Du Runsheng, Lu Mai, Chen Xiwen and Justin Lin
CATIC: Messrs. Wang Qishan and Wang Gang
MOF: Messrs. Wang Liansheng, Luo Qing and Zhu Xian

Please note that we intend to postpone the February 1989 supervision until May/June 1989 unless RCRD absolutely insists on one (unlikely). However, we still expect to receive the first semiannual progress report by end-January 1989, and will provide comments from here.

Attachment

cc: Messrs. Burki, Ahmad, Tidrick (AS3DR); Pearce, **Cadario**, Ody, Yusuf (AS3CO); Goldberg, Bi, Deshpande, Piazza (AS3AG); Lim, Zhou (RMC); Tanaka (LEGAS); Ms. Hwang (LOAAS); AS3AG Staff

RBurcroffII/ms

World Bank Mission to China
for 1st Supervision of the
Rural Sector Adjustment Loan

A. INTRODUCTION

1. A World Bank mission visited China from September 12-29 and October 16-November 16, 1988 to initiate supervision of the Rural Sector Adjustment Loan (RSAL). Our main tasks were to (a) assist as necessary with arrangements for loan effectiveness, (b) review the status of the overall reforms, as detailed in Part III of the Statement of Rural Reform Policies, (c) update our understanding of developments in the regional reform programs (RRPs) being implemented under State Council guidance, and (d) advise on matters arising concerning the utilization of loan proceeds, procurement procedures and disbursements.

2. In Beijing, the mission was briefed on the pace of overall reform and progress in the experimental zones by senior officials of the Research Center for Rural Development (RCRD) and the China Agribusiness Trust & Investment Corporation (CATIC). Details of the nine new RRP's under the purview of the RCRD were also discussed. Subsequent meetings were held with the Ministries of Finance, Commerce, Agriculture and Water Resources to review the overall reforms; and with the State Planning Commission's Department of Rural Economy, the People's Bank and the Agricultural Bank of China to discuss reorganization of the State Investment Program and developments in China's rural financial markets.

3. After initial briefings, the mission travelled to various experimental zones to review progress with the grain system reform (Xinxiang Prefecture, Henan and Yulin City, Guangxi); land management reform (Meitan County, Guizhou and Shunyi County, Beijing); rural enterprise reform (Fuyang Prefecture, Anhui Province); and reform of rural financial markets (Guanghan, Sichuan, Fuyang Prefecture and Meitan). During these visits, our staff exchanged views with RCRD and local officials about design, implementation, initial impact, staffing, budgeting and plans. We also reviewed the monitoring systems and indicators being set-up to track progress. While in Guizhou, the mission was invited to attend the Conference on Land System Reform, held in Zunyi City between September 20-21, where we presented our views on the design and financing of the land-lease market and land consolidation programs. Also, two experts in the field of perishable products marketing, who joined the mission in response to a request from RCRD, reviewed product acquisition and distribution systems for fresh vegetables in Beijing and Guangzhou.

4. The mission was well received. We wish to express our appreciation for the warm hospitality, many courtesies extended, and arrangements made. In particular, we wish to thank Messrs. Wang Qishan and Wang Gang, President and Vice President of the CATIC; Lu Mai, Director of RCRD's Experimental Programs Office; Chen Xiwen, Acting Director of RCRD's Development Institute; Qian Fagen, Acting Director of the RSAL/World Bank Loan Implementation Office; and their staffs and colleagues at the provincial and local levels. The mission has agreed to provide RCRD with detailed summaries of our findings and recommendations by end-December, 1988.

B. GENERAL

5. This initial supervision took place during a period of reassessment in China. The need for China to address the difficult issues of inflation, monetary and credit expansion, and ultimately, the need to add substance to enterprise reform is appreciated. We realize (and agree) that the pace of rural policy reform must be articulated with, and will be somewhat contingent upon decisions made in regard to the non-rural reforms, especially Government's macroeconomic stabilization policies.

6. Having said this: there is a danger that the more fundamental of the rural reforms--viz. the land management and grain system reforms, and the restructuring of the TVEs' policy and business environment, if implemented too slowly, may increasingly become hostage to an overreaction to the current macroeconomic situation and the slow-moving reform of State-owned enterprises. There is an equally important concern that resources of both the informal financial service cooperatives in China and local branches of the specialized banks, as well as of China's ubiquitous Rural Credit Cooperatives are becoming tied-up in dubious loans to State-owned and collectively-owned entities. These loans generally are long term in nature, having--of late--somewhat doubtful profitability, and a risky expectation of timely repayment.

C. THE MISSION'S WORK PROGRAM

7. The mission's review of the overall program aimed mainly to (a) record recent developments in the realm of national policies, (b) understand Government's current thinking about the pace of rural reform in light of recent developments, and (c) assess the likelihood that Government would be able to implement the program of rural reforms referred to in the Statement of Rural Reform Policies (the "Policy Letter") within time frames indicated. Our

detailed review therefore emphasized the more immediate undertakings, i.e. "Price Reform" (paras. 14-18 of the Policy Letter), "Establishment of a Land Use System" (paras. 19-22), "Rationalization of the Rural Enterprise System" (paras. 26-29), and "Rural Investment System Reform" (paras. 30-33). The mission was also briefed on "Rural Marketing System Reform & Establishment of Rural Cooperative Organization" (paras. 23-25), but was not staffed to carry-out a detailed review of this topic. Our understandings are recorded below:

D. GRAIN SYSTEM & AGRICULTURAL PRICE REFORMS

-Program of General Reforms.

8. In the past few months, inflation has emerged as a major national issue and the Government has introduced steps to control it. We understand that the "counter-inflationary" program for agriculture in 1989 will entail new measures to stabilize markets by expanding supply and reducing demand for key commodities. In the grain sector, which is considered the key to regaining balance in the agricultural sector, the Government appears fully committed to accelerate grain production. A six-part program is being adopted, which--in broad outline--aims to (a) stimulate grain production, (b) constrain growth in urban food subsidies, (c) ration fertilizers and other modern inputs, (d) ration foreign exchange expenditures for agricultural operations, (e) establish new investment programs dedicated to grain production and (f) develop new, earmarked, taxation to finance these programs. If the Government is able to identify viable means for implementing these guidelines, the result would be a major step away from efficiency pricing and its institutional handmaiden: the liberalization of China's internal marketing and distribution systems. In addition, a tight national control of grain and agricultural input prices will inhibit the Grain System RRs from implementing planned further price reforms, thereby denying the possibility of learning appropriate lessons from these pilot reforms for wider application at the national level.

9. Clearly, the Government's ability to stabilize agricultural pricing will influence the transition towards macroeconomic balance and affect its pace, but the mission feels strongly that this must continue to be accompanied by strong incentives to encourage production, rationalize consumer subsidies, and render more transparent, buoyant and effective, the resource mobilization required to finance adjustments in the grain system. Indeed, the initial experience in the Xinxiang and Yulin experimental zones anticipates the kinds of gains which are possible and the rapidity by which these may be realized, even in the face of a worrisome inflation.

-Progress in the Experimental Zones.

10. The RRPs covenanted in the RSAL for grain system reform deal specifically with reform of the grain procurement and marketing system, and the financing of related subsidies. The mission focussed on decisions made and measures taken to implement the first phase of the Xinxiang, Henan and Yulin, Guangxi RRPs, and plans/preparations for the next phase. In this context, we reviewed (a) reforms to producer pricing policies in the experimental areas and the treatment of contract grain purchases; (b) the pricing and availability of production inputs--thus, also, inputs subsidies; (c) consumer pricing, ration sales and the monetization of ration coupons; (d) agricultural tax reform; and (e) monitoring systems for the RRPs. Our main findings are summarized here (though the discussion of monitoring arrangements is presented below in Section H), with details available in the mission reports that will be furnished presently.

11. Implementation of the Xinxiang RRP's first phase has been smooth and the initial impact was positive. Producer prices were increased, inputs subsidies reduced, and agricultural tax rates revised upwards. Grain production responded to increased producer incentives (in spite of the drought), the local grain stations were able to procure quota grains ahead of schedule and without problems, and the government was able to accelerate the collection of agricultural taxes. However, problems in three vital areas emerged during the second half of 1988 which--unless rectified soon--could seriously undermine the initial success at Xinxiang and make it difficult to introduce the crucial second phase. These problems include finance, availability of rationed inputs and a wavering of political will by local authorities.

12. Since the RRP was designed to be financially self-sustaining, the Xinxiang City and Henan Provincial governments did not budget additional financial resources to cover reform related expenditures. But now the RRP appears to be experiencing severe financial shortfalls due to the fact that about half of the 1988 fertilizer and diesel were sold before implementation began, at the old plan prices, whereas the bulk of the summer harvest was procured at the higher contract prices featured in Phase I of this RRP. Furthermore, Xinxiang did not receive its assigned allocation of urea and diesel due to various problems including transportation bottlenecks, which will likely constrain farmer response to Phase I incentives during Winter and Spring plantings. Further, since the gaps between market prices on the one hand, and contract grain and ration sales prices on the other, have widened far more than anticipated, the financial resource requirement for Phase II will likely be even higher than expected since this phase entails both a further increase of grain procurement prices and an increase in consumer prices.

13. The Xinxiang authorities are understandably nervous, fearing that the reform may be blamed for instabilities in production, consumption and finance that in fact derive from China's macroeconomic problems and rigidities in inputs supply. Morale is said to be a problem, and the mission was asked to convey a request for some kind of assurance from national-level authorities that the reform should progress as planned, and that necessary financial resources and production inputs will be made available to facilitate unhindered implementation. The mission strongly endorses these requests, and was advised that the State Council intends to confirm its endorsement of all of the experimental reforms being implemented under the purview of the RCRD in the not-too-distant future.

14. The pricing and marketing components of Yulin City's first phase RRP is more comprehensive than Xinxiang's and was not intended to be financially self-sustaining. The prices of contract grain (rice) procurement, of rationed sales to urban consumers and rural resales were raised to prevailing market levels; consumers were given fixed income supplements; prices of production inputs were substantially increased; and measures were introduced to make the remaining subsidies more transparent. Unlike Xinxiang, however, the Yulin City and Guangxi Zhuang Provincial governments agreed to share part of the remaining subsidies.

15. Implementation of the first phase was smooth and the initial impact has been quite positive. Rice production responded well to higher procurement prices, and perhaps most importantly, the plantings of input intensive hybrid rice increased dramatically. Indeed, Yulin now faces a shortage of hybrid rice seeds, much to the credit of the reform. Yulin's grain quota was fulfilled well ahead of schedule, accompanied by a rapid increase in the share of private operators in the local grain trade. As a result of these reforms, the market is reported to be very stable in spite of persistent inflationary pressure. The mission understands that Yulin plans to go ahead with the second phase, which will consist of further increase in grain purchase prices and increased reliance on the market, further reduction of quota sales, and the introduction of agricultural tax reform.

16. Similar to Xinxiang, the Yulin authorities face three problems that should be sorted out before the second phase begins. The first one concerns financing, the second relates to an overhang of unused ration coupons--which have become monetized and could place tremendous pressure on City finances were ever these "cashed-in", and the third (again) involves morale. The financial difficulties are known and will not be repeated here, except to underscore the mission's recommendations that

- (i) the Guangxi Zhuang Financial Bureau should be encouraged to release the central and provincial funds

already allocated to the Yulin RRP as soon as possible, and

- (ii) that earmarked exemptions to Yulin's credit ceilings should be granted to enable the City to finance the RRP's working capital requirements.

17. The overhang of ration coupons from previous years could present an equally serious problem. These coupons have been effectively monetized, and represent a store of unearned wealth beyond official control under present arrangements, and ready to be unleashed if consumer confidence erodes. Recognizing this problem, we understand that an expiry date is now assigned to newly issued ration coupons. Although the Yulin authorities have decided otherwise on "equity" grounds, the mission strongly recommends that those ration coupons being retained by consumers from before the reform was implemented also be given an expiry date, say on June 30, 1989, else simply be declared invalid. To protect low income consumers, a more dedicated targeting than that represented by the broadside distribution of ration coupons could be easily set-up within the framework of existing administration--and perhaps should be experimented with under Yulin's RRP.

18. The morale problem is similar to Xinxiang's: a result of uncertainties regarding State endorsement of the reforms being introduced. The State Council's intended reaffirmation (para. 13) should allay current concerns, though additional visits to Yulin by RCRD's officials would also help, since the absence of routine visits has made experimental zone authorities feel somewhat like orphans while trying to implement this far-reaching experiment without visible high-level support. Technical support, especially, will be required from RCRD when the Yulin authorities finalize designs and implementation details for the second phase reform, and is so recommended.

E. REFORM OF THE LAND MANAGEMENT SYSTEM

-Program of General Reforms

19. Amendments to Article 10 of China's Constitution by the National People's Congress on April 12, 1988 provided sanction for an expanded experimentation with the rural land management system (LMS). In addition to the RRPs reviewed while the RSAL was being formulated (at Meitan, Guizhou, in Southern Jiangsu and in Guangdong's Nanhai County), the State Council subsequently endorsed RRPs for Pingdu County, Shandong and Beijing Municipality's Shunyi County. The need for diversity, both regional and in recognition of agroeconomic and off-farm opportunities, is implicit in the differing features of the land

system RRPs. The mission feels these have been selected wisely, and that an evaluation of program results will lend well to a formulation of national laws and regulations intended during 1990.

20. The mission was invited to attend (and make presentations at) a Conference on Land System Reform in Zhunyi, Guizhou, which was held to debate the shape and form that national policies might ultimately assume. This provided extremely valuable insights into the nature of the current debate in China, and the variety of approaches being considered. There is clearly widespread acceptance at all levels of the need to replace the present administrative procedures for allocating land use rights by a system which allows for a much greater role for market forces. The seminar also recognized that room for manoeuvre in LMS reform is presently constrained by agricultural pricing and marketing policies and by food security strategy and that, conversely, the range of options available for reforming these policies is itself partly determined by the potential impact which LMS reform will have on agricultural productivity.

-Progress in The Experimental Zones

21. The Meitan RRP is progressing steadily. The formal establishment in September 1988 of a land bank (The Meitan Land Finance Company) to finance land use transfers and agricultural development schemes was a major milestone in supportive institution building. The recently introduced land contracts (formalizing the leasing of land by households from the collective) will serve as collateral for the borrowings. We understand that a group from the Guizhou Provincial Land Management Bureau will visit Meitan shortly to supervise the issuing of land certificates to cover all land in the County. These will, in effect, serve the purpose of "title deeds" and facilitate the transfer of land between collectives and compensation for individual households concerned.

22. Revenue raising and financing of local level activities has been streamlined in the Meitan RRP by formally making villages administrative subunits of townships. Crop quotas and contract purchases have been reduced in amount, thus effectively raising farm prices in an effort to encourage greater use of agricultural inputs. Subsidized grain resales to rural consumers have also been reduced. The recently introduced land use fee appears to have been generally accepted by farmers.

23. The Meitan "model" has been endorsed by the Provincial Government, which is urging other counties in Guizhou to introduce similar reforms. Diffusion of this RRP within Guizhou will be closely monitored. The main question about the Meitan RRP concerns the rate at which land transfers will take place, with

the corresponding emergence of consolidated and/or specialized farms operating at high levels of efficiency. Much will depend on the schemes to bring into production the uncultivated uplands and the amount of surplus agricultural labor, made available through land consolidation in the lowlands, which can be productively employed on the uplands. This in turn will depend on the amount of good quality upland per capita, market opportunities and the type of upland production system (e.g. mini-estate, smallholding or a combination) which is instituted.

24. The Southern Jiangsu, Nanhai, Pingdu and Shunyi RRPs are all attempts to deal with problems caused by the high opportunity cost of land under grain crops and of labor needed to work the land, in an environment of rapidly growing demand for non-agricultural workers and for high value agricultural products. Production gains under the specialized household systems have been good this year in both Southern Jiangsu and Shunyi, but it is clear that these RRPs present expensive solutions to land fragmentation and the problem of low agricultural productivity, both in terms of the capital financing and the income support required from the non-agricultural sectors. Under present conditions, there is some question whether the Southern Jiangsu experiment can be sustained, since its diffusion to nearby towns and counties has fallen well behind schedule. With both of these experiments, replicability remains very much at issue--even in the labor deficit coastal zones and environs of major cities for which these RRPs are designed and where they are presently located.

25. In Guangzhou's Nanhai County, the RRP simply is not working. Only a tiny fraction of households have opted to become specialized producers of quota crops operating consolidated holdings. The lure of off-farm employment and the gains from producing vegetables and other high-valued crops (where gains from reduced fragmentation could be expected to be negligible) have eliminated any enthusiasm for the RRP that may originally have been present in Nanhai. There is a need for experimenting with land use rights transfers and/or other forms of land management within the context of a dynamic and highly commercialized agricultural environment, however, and the Nanhai RRP--if appropriately reformulated--presents an opportunity to begin this kind of reform. The mission so recommends, rather than pursue the current official thinking in Nanhai that stronger, even punitive measures, should be introduced to force farmers to participate in the RRP.

26. By way of contrast, the Pingdu RRP--in which all farmland is divided into food plots and responsibility plots--and use rights on the latter are auctioned off to competing bidders for a fixed term, appears to have been highly successful. It has fostered a reduction in fragmentation, and offers a semi-market based method for establishing land "rental" values. The biggest stage of

recruitment of villages has just been completed, bringing the proportion of villages in the county using the system to more than 90%. The features of this RRP may well provide a model for other labor deficit zones where reliance on quota grain production (rather than imports) will continue to prevail for the foreseeable future, and also--with local refinements--a general method for establishing the rental value of use rights (owed to the collective) and the value of compensation for improvements made by previous operators who have chosen to relinquish their responsibility lands.

F. REFORM OF THE RURAL ENTERPRISE SYSTEM

-Program of General Reforms

27. After China's Constitution was amended on April 12, 1988 to sanction private and other enterprise forms, a National Private Enterprise Law was promulgated in July 1988 which reconfirmed the legitimacy of enterprises operating outside of the state-owned sector and provided for their right to operate with a significant degree of freedom from local government control. This Law lays out the basic requirements for sole proprietorships and partnerships, as well as for private companies limited by shares. However, some provisions of the law are discriminatory, in that higher tax rates and stricter payment obligations apply to private enterprises than required of State- and collectively-owned firms.

28. Under the Fuyang, Anhui RRP (cf. below), a trial Non-governmental Enterprise Law has been drafted to apply both to private enterprises owned by individual citizens and to township or community-owned enterprises--the aim being to give all non-state enterprises equal status in law. This draft is expected to be implemented when approved by the provincial and local People's Congresses. The trial Insolvency ("Bankruptcy") Regulations for non-State enterprises also remains in draft form pending approval. Although both trial enactments will need to be tested in a controlled environment before national laws can be issued, the potential national significance is so great in terms of stabilizing the TVEs and establishing financial discipline in the non-State sector, that the mission strongly urges RCRD to bring as much pressure to bear as possible to have these enacted in Fuyang and to initiate testing.

-Progress in the Experimental Zones

29. The overall experimental frame appears to be spreading as RCRD now refers to four distinct models of TVE development: the Wushi (Jiangsu), Fuyang (Anhui), Wenzhou (Zhejiang) and Shishi

(Fujian) models respectively. The current concern with macroeconomic issues may not yet have had discernable impact on the growth of TVEs but the credit squeeze will undoubtedly do so. Some readjustment of policy priorities is under consideration, away from the less developed rural areas (such as Fuyang) where adjustments to the rural economic structure and the creation of off-farm jobs have been stressed, and towards the coastal regions which are better placed to develop exports and hard currency earnings. In this connection, the mission was advised that RCRD has been undertaking work with TVEs for the last two years to encourage the increased production of export commodities. This work has been concentrated in the coastal provinces of Fujian, Zhejiang, Jiangsu and Shandong. In some locales, TVEs have been given greater freedom to retain earnings and other receipts in foreign currency. The mission was gratified to learn that the formally endorsed RRP, which essentially focus on institutional issues, are being supplemented by assistance from the RCRD through less structured (but certainly no less important) means that focus more narrowly on TVE activities in promising economic subsectors. However, because of difficulties with arranging appointments with RCRD's "Rural Enterprise" staff in Beijing, the mission was unable to complete an in-depth review of these important developments, nor of the overall rural enterprise policy framework, and requests that during the next RSAL supervision appropriate arrangements be made.

30. Formal RRP for the development of TVEs and non-state enterprises have now been established in three areas: Fuyang Prefecture in Anhui Province, Wenzhou City in Zhejiang, and a new one in Zhebu City's Zhoucun County in Shandong Province. The emphasis in this newly introduced RRP will be on enterprise shareholding (joint stock) systems--systems designed in particular for enterprises currently owned or controlled by local governments.

31. During its visit to the Fuyang experimental zone, the mission noted that the majority of the 20 subprojects in this RRP are being implemented according to schedule. The industrial zones with their preferential policies to encourage new rural enterprises have undergone remarkable development in the last seven months. The subprojects to remove artificial restrictions in rural markets have been successful in the pilot counties and these reforms are now spreading rapidly within Anhui.

32. There are early indications that the number of enterprises, their output and profits have continued to increase at a significant rate in spite of the macroeconomic instability which also has affected Fuyang Prefecture. New enterprises are continuing to be set up to exploit new market opportunities, although there are signs that some of the markets into which TVEs first entered are reaching maturity. Fuyang's experimental zone office has introduced two new enterprise models--both for joint

ventures with foreign companies--but the enterprise structure subproject as a whole seems to be some way off from completion. Some of the RCRD staff involved in the enterprise reform subprojects have general reservations about the feasibility of a rapid introduction of "modern contractual" relationships into rural society, although China's reform growth targets would suggest that such relationships, embodied in enterprise charters and contracts, and protected by law and local courts, are both imperative and inevitable.

33. Two aspects of the Fuyang RRP give rise to concern. The first is the continued operation of the non-governmental financial service associations without a secure asset base and with potentially destabilizing lending policies. The danger of collapse and erosion of confidence is great. This is discussed in the next Section. The second is that the monitoring system is not being implemented as planned. This is discussed in Section H below.

G. INVESTMENT SYSTEM & RURAL FINANCIAL MARKETS

-Program of General Reforms

34. The mission exchanged views with RCRD staff and the State Planning Commission about the newly organized State Investment Corporations, and with RCRD on the current status and issues in China's financial system. The latter discussions focussed on rural financial markets and trial rules and regulations for the non-governmental financial service associations (NGFAs) that have proliferated of late. We also discussed concepts and issues in land banking with participants at the Zhunyi seminar on LMS reform.

35. China's rural investment system and financial markets are currently going through a difficult period in the wake of severe credit curbs imposed to constrain inflationary pressures, and recent changes in the interest rate structure which were initiated mainly to restrict the rapid draw down in deposits and to depress overall credit demand. These measures also are having an effect on the performance of the financial sector RRP's.

36. A key element of the general program for reform of the rural investment system is the formal review of rural financial market policies and preparation of trial rules and regulations for the indicated in paras. 32 and 33 of the Policy Letter. Since RCRD does not appear to have sufficient in-house resources, the mission indicated that it would recommend to Bank management that these tasks be carried out either through its economic and sector work program for China, or under future lending for agricultural credit such as the proposed Fourth Rural Credit Project. In

either event, the mission conveyed its views that involvement of the People's Bank and other major financial institutions would be required. RCRD agreed to inform the Bank of its proposals shortly.

-Progress in the Experimental Zones

37. As a result of economic uncertainty, the pace and impact of the Guanghan, Sichuan and Fuyang, Anhui RRPs in rural finance have noticeably slowed down. However, in Guanghan, much progress has been made towards introducing the contract responsibility system for management of local, governmental financial institutions. The result has been a genuinely increased autonomy in decision-making and business operations, and a linking of wages/remuneration with unit performance. There are, however, several areas in which the experimental design could be strengthened, including (a) methods for determining salary and wage incentives, (b) more flexibility in the interest rate structure, (c) interbank settlement procedures and (d) the internal organization of State-owned banks. To accommodate current uncertainties, the mission recommended that contractual targets for deposits, loans and profits for individual units within the Guanghan RRP should be subjected to frequent review and adjustment, since any rigidities in this regard could quickly prove counterproductive. This is an important consideration, since the Agricultural Bank of China has already adopted the contract responsibility system nationwide, and subsequent refinements will no doubt be influenced by staff performance within its Guanghan branches. The mission also recommended that a more detailed review be undertaken early in 1989, after operational performance data for financial institutions participating in this RRP become available for the three consecutive years (1986-1988) that elapsed since implementation began.

38. The Fuyang, Anhui experiment with NGFAs still represents the main experiment under State Council guidance for broadening rural financial markets and improving their dynamism and flexibility. However, the mission noted several worrying developments which underscores the urgent need to establish sound financial standards for these institutions and delineate the broader financial sector policy issues that will have to be addressed during future expansion of the NGFA system.

39. The management, technical and financial standards of the NGFAs in Fuyang require urgent attention. These entities appear to be operating more or less without informed advice from the experimental office, and limited regulation by provincial and central banking authorities. The latter, in any event, should be positioned to encourage NGFA development without imposing undue restrictions, while at the same time monitoring the NGFA's

decisions and performance to insure that these operate according to sound financial principles. The mission found that several of Fuyang's NGFAs have been concentrating their loan portfolios on politically-mandated investments having doubtful viability, and have a financial resource structure that is nearly risk free as far as the "shareholders" are concerned. If these fail (and some of the 7 NGFAs in Fuyang are approaching insolvency), the impact on investor confidence and the reaction from the already beleaguered State banks could sweep away this important institutional innovation. The result would be a loss of a benchmark experiment in the provision of informal financial services, which could lead to an untimely postponement of benefits from the inherent flexibility which the NGFAs--if managed intelligently--can provide.

40. The establishment of the Land Financing Company (MLFC) in Meitan, Guizhou is a remarkable development since contracts for land use rights will be used for the first time to secure loans for purchasing use-rights and to support agricultural development. This is the first institution of its kind in China of which we are aware, and its evolution and performance should be monitored with interest since it could serve as a model for the future development of land banking throughout China. The MLFC's conceptual framework is sound, though additional thought needs to be given to evolving financial instruments for raising longer term capital, reducing reliance on budgetary allocations for medium- and long-term loans, and to the MLFC's lending policies per se'. The mission offered to assist with this endeavor during future RSAL supervisions and other missions to review/prepare Bank operations in China's rural financial sector.

H. MONITORING ARRANGEMENTS

41. In this subject matter area, the mission concentrated on developments within the experimental reform programs. We were given an opportunity to discuss in detail the progress being made in establishing monitoring and evaluation (M&E) systems for the Xinxiang, Yulin, Meitan, Fuyang and Guanghan RRPs, and also received some information pertaining to the Southern Jiangsu RRP. It was decided to defer extensive discussion of M&E arrangements for tracking the diffusion of reforms at the national level and for reviewing other RRPs' M&E efforts until the next supervision mission. By that time, RCRD will have prepared the first semi-annual progress report based, in part, on the M&E reports from the various experimental reform offices.

General Issues

42. There are two general issues concerning M&E arrangements for the RRP's, which the mission recommends RCRD should address on fairly short order, since these arrangements are still being established and placed into effect.

- (i) It is not clear whether the need for clearly separating the M&E function from the general management function in the experimental reform offices is adequately appreciated. There is some danger that the RRP management and M&E roles of staff will become indistinguishable with a resulting lack of focus and objectivity, both needed for objective reporting and a continuity of performance on the M&E side. The issue (in all of the RRP's) is really one of recognizing the need for attaching a permanent M&E unit to each of the experimental offices, having the primary purpose of ensuring that the data-gathering agencies are reporting on time with the needed information, and each provided with desktop computers and necessary budget. The mission strongly urges RCRD to give these recommendations serious consideration.
- (ii) While it is perhaps too early for definitive judgement, there are grounds for believing that M&E training for the RRP's may need to include a wider audience and have greater technical content. Leaders below the county level may need to be better briefed in the objectives and methodological principles of M&E so that they in turn can ensure appropriate actions/responses by cadres and farmers. It is particularly important that the difference between M&E's information needs and the statistical agencies routine reporting formats be clearly understood and appropriate modifications be embedded in the M&E reporting formats. Greater technical ability among M&E staff to design and conduct surveys is also likely to be needed in order to cope with the (necessary) complexity of the RRP's indicator systems.

The Grain System RRP's

42. In Xinxiang, good progress has been made to organize a system of monitoring indicators, but the organization for monitoring still lacks coherent organization, needed staff and financial resources, and data processing equipment to carry out M&E in a scientific and satisfactory way. Similarly, in Yulin City a monitoring system has been established, but it is not well organized and equipped. In particular, the system lacks the needed manpower and financial resources to monitor the impact of the reform, particularly on grain consumption patterns among

different income groups (there is no Urban Economic Sample Survey Team operating in Yulin City and its environs).

The Land Management RRPs

43. The effort which has gone into the design of M&E for the Meitan RRP is impressive. A land system "building, monitoring and population" research group has been set up under the auspices of Meitan's Leading Group for rural reform, and organized by Guizhou's Provincial Bureau of Statistics. This group has produced a document listing over 200 monitoring indicators in six main categories (general situation, changes in land use, attitudes/behavior/responses, economic benefits, social impacts and ecological effects). Many of these indicators require the collection of data which is not normally collected by the existing information channels. Staff recruitment is in hand to establish a network of statistical personnel at the grassroots level as well as an early warning system to detect LMS problems before they become too widespread. Some training of local leaders in M&E principles has already been undertaken and more has been programmed. Another county in Guizhou Province--Fenyang--has been selected as a control for the Meitan RRP and will provide comparative data. There is no doubt that M&E of the Meitan RRP is being taken very seriously by the authorities at both the provincial and county levels.

44. In the Southern Jiangsu RRP, leaders from 30 villages and five townships responsible for rural economic management have attended a training session on data collection, having particular reference to the monitoring of performance indicators during the 1988 Autumn harvest. It appears that a format for M&E reporting has been developed, but the mission was not able to review a copy at the time of the briefing.

The Rural Enterprise RRPs

45. The mission was only able to review M&E arrangements for the Fuyang RRP, which are much less satisfactory than those reported above. The decision to place responsibility for subproject coordination and monitoring with the various counties concerned, and staff shortages in the experimental office have led to the abandonment of plans to carry out some important enterprise surveys. There also appears to have been no systematic effort made (yet) to monitor the effectiveness of prefecture-wide changes in certain key policies or administrative actions taken as part of the reform program. For example, the impact of new regulations and procedures to reduce interference by local cadres in the operation of free markets has not been systematically checked, nor has anyone followed-up applications for model enterprise charters to see the extent to which the new charters

are actually being used. This failure/inability to monitor RRP "inputs" is potentially quite serious and should be urgently rectified.

The Financial Market Experiments

46. Monitoring systems for the two financial sector experiments (i.e. Guanghan, and Fuyang) are presently being set-up with RCRD's assistance. Detailed reporting formats are being finalized by the local experimental offices, which RCRD intends to append to the first semi-annual progress report to the Bank next January.

47. The mission was informed that M&E in the Guanghan RRP will focus both on quantitative and qualitative assessments of the financial performance of the involved intermediaries and staff productivity improvements. M&E will be based on semi-annual reports from the specialized banks and annual reports from nonbanking financial service companies. The socioeconomic impact of the RRP and exogenous macro-effects on the performance of participating institutions will be assessed annually based on statistical information compiled by the local statistical office, supplemented by special surveys. The M&E indicators will fall under three broad headings:

- (i) overall monetary indicators,
- (ii) financial performance indicators, and
- (iii) miscellaneous quantitative indicators.

The analytical (and reporting) frames would be by type of participating institution. In this connection, the mission recommended that the current four-category format be revised as follows to better reflect the nature of the participating institutions, viz. state-owned specialized banks, nonbanking state-owned financial institutions, collective institutions, and credit organizations which do not provide services to the general public (e.g. cooperative funds). The mission also urged that a systematic attempt be made to isolate the effects of inflation and macro-level policy directives from effects deriving from the design of the RRP, when monitoring unit performance and staff incentive systems.

48. Monitoring arrangements for Fuyang's NGFAs are still being devised. The mission was informed that the experimental office at Fuyang (which needs to be strengthened) plans to monitor the three initial NGFAs set up under the RRP, using financial indicators such as increases in deposits, loans and profits, and miscellaneous quantitative indicators. The experimental office also would review progress made in refining "stocks and

ownership" concepts, and the introduction of financial standards for the NGFAs banking operations.

I. DISBURSEMENTS

49. As of November 21, 1988, the equivalent of about US\$ 243.0 million have been disbursed from the loan and credit, leaving respective balances of about US\$ 57.0 million in the loan account and a zero balance in the credit account. This represents an extremely rapid draw down of loan and credit proceeds, which were expected to disburse over a 12 to 18 month period. On the other hand, the urgency for rapid draw down is appreciated in view of the pressures being placed on China's foreign accounts and domestic budgetary resources. (The possibility that part of the counterpart proceeds may be allocated to specific and scheduled budgetary expenditures for agriculture development is endorsed.)

50. Thus far, a total of ten withdrawal applications have been received, of which the first nine have been accepted and disbursed against, save for payments made before the loan was signed (cf. below), and a few items where inconsistencies showed in the withdrawal applications. The Ministry of Finance has been notified of details. Further, the proceeds of Category 3 in the loan and credit agreements have been reallocated to Category 1 as per MOF's telexed request of September 19, 1988. However, disbursements against Application No.10 are being withheld to retain undisbursed amounts sufficient to reimburse ICB procurement of an amount "at least not less than US\$ 50 million" as indicated in MOF's telex to the Bank's Director of China Operations dated October 7, 1988.

51. We regret that some confusion was caused by the Bank's disbursement letter for this operation, which stated that payments made after May 18, 1988 would be eligible for reimbursement. As with investment project agreements, however, the Bank's General Conditions are the legal referent--as indicated in Section 1.01 of the RSAL's Loan and Credit Agreements. (These stipulate that only payments after the date of Loan/Credit signing (July 15, 1988) are eligible for reimbursement unless retroactive financing has been authorized. Retroactive financing was neither applied for nor authorized for the China-RSAL.) The mistake occurred because of end-fiscal year pressures...we apologize for the inconvenience this may have caused.

J. PROCUREMENT

52. During appraisal and loan negotiations for the RSAL, it was generally understood that procurements in the amount of US\$ 125-150 million would be carried out under the loan/credit using serial international tendering ("serial ICB") procedures. It was further anticipated that these tendering procedures would be used mainly for fertilizer procurements by China's Chemical Industries Import- Export Corporation, known as SINOCHEM. This seemed an appropriate arrangement, given SINOCHEM's preeminent position in China's fertilizer imports vis-a-vis other importers such as the International Tendering Corporation.

53. Further, we appreciate that a genuine attempt was made by the RCRD and CATIC to implement these procedures: first, through advertisement in the Development Business section of "Development Forum", and second, through notifications to foreign embassies in Beijing. But we were advised that only 9 requests for registration applications were received, and only two had been returned by end-September. This is puzzling, since fully two and one-half months had elapsed since the advertisements and notifications were issued.

54. The mission was advised that SINOCHEM is reluctant to attempt serial ICB in the face of rising fertilizer prices. The mission emphasized that this argument is somewhat specious, and referred to the recent Indian fertilizer procurement experience under its Emergency Drought Relief Loan. (Like China, India is a major fertilizer importer-- capable of influencing prices if careless procurement is practiced.)

55. However, we were gratified to learn that Government intends to procure at least US\$ 50 million under the RSAL using serial ICB procedures, though it is unfortunate that more will not be attempted in view of the savings that normally are associated with ICB procurements. We also are concerned with SINOCHEM's ability to continue to operate as a trading company under the current stringent financial conditions, rather than behave more responsibly as one of the Government's most important procurement agencies.

K. SEMIANNUAL REPORTS

56. It was understood during loan negotiations that semiannual reports for the RSAL would be furnished commencing January 1989. A format was presented by RCRD during the mission's visit, which will be more than adequate. The mission suggested, however, that additional sections be added to encompass the monitoring arrangements being set up for the RRP's, including a summary of

procurement and disbursement activity under the loan and credit agreements.

L. NEXT SUPERVISION

57. The scope of the next supervision must necessarily be more comprehensive than the present one was. Originally scheduled to visit China in February 1989, we propose to postpone the next mission to May or June of 1989, to give sufficient time to RCRD and authorities in the experimental zones to implement changes and improvements currently being considered. Mandated by a need to review the impact of macroeconomic adjustment measures being adopted by the State Council, and with the benefit of more elapsed time for implementing the RRP's, the next mission would also carry out the formal program review scheduled during Loan Negotiations for May/June 1989. It thus will be expected to review progress with the overall reforms in greater detail, as well as visit RRP's not reviewed during this first supervision. A corollary responsibility would be to discuss a format and design for the proposed Second RSAL.

58. In spite of current setbacks, China's rural reform endeavors have global importance. We in the Bank are convinced that RCRD's programs will succeed, that the momentum for rural reform can not be reversed, and feel privileged to assist with this historically significant undertaking. We only hope that the current instability will be viewed in China as presenting an opportunity: one which can be used to set in place previously unpalatable reforms to enable China to move more squarely towards indirect macro-management and control of rural economic activities. The reverse, a wholesale retreat to traditional administrative measures, would merely destabilize the rural economy. It would impede the operation of forces already unleashed without being able to bring these under some form of indirect regulation, and thus would likely aggravate current macroeconomic problems. Worse, such measures would most definitely postpone progress towards meeting the needs of a Socialist Market Economy.

Richard Burcroff II
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December 16, 1988