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China and the World Bank: How a Partnership Was Built
by

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ABSTRACT The World Bank played an important role in China’s economic transformation since the late 1970s. China used the World Bank well and the Bank was responsive to China’s needs. The Bank did not recommend early or comprehensive market liberalization or privatization, as it did in some other transition economies, but supported China’s pragmatic - learning-by-doing – approach to economic reform. It pushed at the margin for essential institutional and policy reforms, presenting perspective based on international experience, while providing technical assistance in numerous areas, often through Bank-supported projects. As the Chinese gained expertise, confidence and access to international capital markets, the role of the Bank in China inevitably shrunk. China now uses the Bank mainly for selective technical, institutional and conceptual innovations for development. China and the World Bank both gained from their interaction.

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The facts of China’s phenomenal economic growth during the past 27 years are better known than the underlying efforts and struggles. There are no close parallels in history for China’s cautious, incremental transition from plan to market. The process was set in motion at the Third Plenary Session of the 11th Central Committee of the CCP in December 1978 when Deng Xiaoping had emerged as the pre-eminent leader and persuaded fellow-leaders to adopt a fundamental change in direction for China’s development.¹ A Soviet-style Ten-Year Development Plan (1976–85) which had been approved less than year earlier was scuttled in favor of an interim “Adjustment Plan” favoring consumption over investment growth and light manufacturing over heavy industry. Agricultural support prices were raised and the re-introduction of family farming combined with a restoration of rural markets (which had already started as local initiatives in Sichuan and Anhui) was endorsed. In addition, four Special Economic Zones were opened in 1979 to attract foreign investment and create “windows” on the outside world. Market reforms were extended to urban areas and state-owned enterprises in 1984.

A more or less comprehensive national reform agenda did not emerge until late 1993; a year after the Fourteenth Party Congress adopted the “Socialist Market Economy” as a conceptual framework for China’s development. In the meantime, the reform process deepened and became increasingly self-propelled, driven by market forces and international commitments, including China’s accession to the World Trade Organization (WTO) in December 2001. China’s unique approach to managing its economic transition and development is sometimes referred to as the “Beijing Consensus”² approach. The concept does not have a precise meaning; it is mainly used to contrast China’s pragmatic, institution-oriented approach with the so-called “Washington Consensus”³ policy-oriented-quick-liberalization approach.

China’s reform process was facilitated by a pro-active relationship with multilateral agencies, including the World Bank and the International Monetary Fund (IMF). Both institutions provided unique opportunities for China to learn from the experience of other countries in a professional and politically neutral international setting.
Although China was a founding member of the World Bank and the IMF at the Bretton Woods conference of 1944 and of the General Agreement on Trade and Tariffs (GATT) of 1947, it did not begin to draw benefit from these organizations until China’s representation on the Boards of the two Bretton Woods agencies was shifted from Taipei to Beijing in 1980 and China became a member of the WTO (successor to GATT) in 2001.

China has not used any of the IMF’s financing facilities. However, it drew $597.7 million from its reserve tranche at the IMF in 1986 to shore up the country’s international reserves. China’s relationship with the IMF was centered on economic consultations and technical assistance in the development of macroeconomic institutions, policies and statistics. The relationship with the World Bank quickly became very broad and deep, covering most sectors of the economy, social and regional development, environmental protection as well as macroeconomic reforms. China became the World Bank’s largest borrower and one of the largest recipients of technical assistance in the early 1990s before the program began to shrink towards the end of the decade.

The China-Bank partnership became strong and important to both sides. It survived serious conflict over a controversial anti-poverty project in Qinghai around the turn of the century. Naturally, the nature of the relationship changed over time. The relative importance of the Bank for China declined as the economy matured, Chinese experts gained expertise and international experience, and China gained access to world capital markets and many additional sources of advice. China lost access to the Bank’s soft-loan window (IDA) in 1999. Around the same time commitments for loans on standard (IBRD) terms had to be scaled back to avoid “over-exposure” to China on the Bank’s balance sheet. The smaller, lower-profile role of the Bank in China since that time is a sign of success, not of failure. From the late 1990s China relied on the Bank primarily for selected technical, institutional and conceptual innovations in development. A complete account of the China-Bank partnership would fill many books. This essay describes how the relationship started and developed into a partnership from 1980 through the mid-1990s by highlighting selected events. It is divided into two parts:
The Role of Joint Studies, Conferences, Project Financing and Technical Assistance

This part describes efforts on both sides to develop the relationship. It illustrates how the World Bank contributed to reform policy thinking and institution building through its analytical work and policy dialogue. It explains how Bank-supported projects served as vehicles for technical assistance and institution building.

Economic Re-Centralization and the Emergence of Modern Macroeconomic Management - the Dalian Conference of 1993

This part is a mini case study on the role of a conference in 1993 (organized jointly by the World Bank, the Ministry of Finance and the State Commission for Reform of the Economic System) in the search for cures for China’s “stop-go” pattern of economic growth and inflation spikes in the 1980s and early 1990s. The conference was instrumental in building a consensus for partial fiscal and financial re-centralization and changes in macroeconomic management.

The Role of Joint Studies, Conferences, Project Financing and Technical Assistance

Not long after the establishment of full diplomatic relations between the United States and China (1 January 1979), there were indications that the government in Beijing wished to resume the representation of China on the Board of the World Bank. The World Bank’s first official mission to China to discuss Beijing’s request was led by its president, Robert McNamara in April 1980. The mission was received by Deng Xiaoping who told the mission: We are very poor. We have lost touch with the world. We need the World Bank to catch up. We can do it without you, but we can do it quicker and better with you. The change in China’s representation in the World Bank was arranged with amazing speed; in May 1980 the Board approved Beijing’s request.

McNamara saw a historic opportunity, but also realized that helping China reorient its development model would present enormous and unprecedented challenges
for the World Bank. In personally leading the Bank’s first official mission to China, he brushed aside U.S. government reservations about an early return by the PRC government to the World Bank. He thereby established credibility for the Bank as an independent multilateral agency which was very important for the Chinese. The early years were devoted to knowledge building and the establishment of professional relationships between Bank experts and Chinese counterparts through joint studies and relatively simple projects. The studies and projects became larger and more complex over time. The Bank’s reputation for independence was reinforced when Barber Conable, President of the World Bank from 1986 to 1991, approved a mission to China over the objection of the U.S. only weeks after the Tiananmen massacre of June 4th, 1989. The purpose of this mission was to discuss how the economic reform momentum could be maintained in spite of the political turmoil. At that time many countries had withdrawn their embassy staff from China and imposed sanctions.

Though anxious to receive large amounts of financial support as quickly as possible after rejoining the World Bank in May 1980, the Chinese showed patience and understanding for the Bank’s need to carefully select priority projects, appraise them thoroughly and understand their sectoral context before submitting them for Board approval. China also understood, though many leaders were initially disappointed, why it was not possible for the Bank to provide large amounts of concessionary IDA funds immediately.

Not only did China accept the need for up-front economic and sector studies, it actively participated in them. The country had been closed to the outside world since the early 1950s and was essentially a black box for the World Bank in 1980. Only a handful of China’s political leaders and senior civil servants had had international exposure and few understood western economics. The Bank was seen as a valuable source of technical advice, international experience and information on how other countries had succeeded or failed in their development efforts. The Bank was cast in the role of a guide. Since it was perceived as an independent, politically neutral organization, it was able to serve as a kind of “air-lock” between China and the western world during the initial stages of reform. Both sides took the relationship seriously and carefully prepared for it. Getting to
know China’s economy, its problems and development options was very much a joint exercise in the beginning.

The Chinese sent a mission around the world to study the experience of other developing member countries with the World Bank, following which the State Council (China’s cabinet) assigned responsibility for dealing with the Bank to the Ministry of Finance. MOF quickly built an administrative infrastructure within the ministry and across government agencies to manage the relationship. The State Planning Commission (since 2003 the National Development and Reform Commission) also played a key role in the relationship, particularly in defining project priorities. This ensured that the Bank’s program became an integral part of China’s development plan. Initially, the Ministry of Foreign Affairs also received Bank missions, but its involvement in the program remained small and was soon terminated. Few, if any member countries, equipped themselves so purposefully and so effectively at all levels for dealing with the World Bank as China did.

The role of studies and conferences in the cooperation program

Two urgent tasks faced the Bank after the resumption of China’s membership in May 1980: (a) to agree with the Chinese on project priorities for Bank support, and (b) to understand the broader economic and sectoral context of such projects. The Bank undertook these tasks in parallel. In June/July 1980, a mission led by Shahid Husain, Regional Vice President for East Asia, visited China to discuss project priorities and procedures for project appraisal, supervision, procurement and the disbursement of funds. There was no administrative infrastructure in China for processing World Bank loans at that time. The Husain mission reached agreement with the Chinese on key procedural and administrative principles and on the need for an overall study of the Chinese economy. For the first time since 1949, a “western” agency was invited to make a comprehensive study of China’s economy, with the active participation of Chinese experts. The mission also agreed to send technical experts to assess China’s capacity to prepare and implement projects suitable for Bank support.
In the fall of 1980, the Bank sent its first economic mission to China. Thirty two Bank staff (economists, agronomists, engineers, health experts, education experts and other sector specialists) participated at various times, from October through December. In addition, 11 leading China experts from various U.S., European and Japanese universities prepared background papers. The mission was led by Parvez Hasan, one of the most experienced economists in the Bank at the time, and Edwin Lim. The Chinese organized a counterpart team which included Zhu Rongji (China’s PM from 1998 – 2003), who had just been politically rehabilitated and worked as an economist at the Institute of Industrial Economics. The size and importance of the Bank’s first economic mission to China have few parallels in the history of the institution.

The Bank team was surprised to find serious weaknesses in China’s Soviet-style “material balance” projections used for central planning purposes. For example, the team predicted that China would become a net-importer of oil around the mid-1980s if China did not invest in new extraction technologies, discover new reserves and bring them into production. The report also stressed the need for a comprehensive strategy to improve energy efficiency. The government was taken aback by these observations; it had just signed a long-term agreement for major oil exports to Japan in the expectation that China would have oil surpluses indefinitely. In fact, oil and other raw material exports were then regarded China’s best hope to generate enough foreign exchange earnings to pay for the imports that would be needed for the country’s modernization. In the event, China became a net importer of oil in 1993.

Mission findings were reflected in a 1,000-page multi-volume report entitled “China: Socialist Economic Development” which was submitted to the Bank’s Board before the first project loan was presented for approval in June 1981. The report analyzed China’s economic situation and planning methods, covering most sectors of the economy and tracing some of the country’s economic history since the establishment of the Peoples Republic of China in 1949. It was translated into Chinese and made required reading at economic faculties. A summary of the report was discussed at the highest levels in government. Two years later, in 1983, the Chinese agreed to the unrestricted distribution of the report. This was a breakthrough toward greater openness. Although Chinese counterparts had collaborated in its preparation, the final report was the
exclusive responsibility of the Bank. It was mainly retrospective in nature, exploring why China had fallen so far behind in terms of technology and living standards. Recommending patience and caution, the report sketched the direction in which solutions for China’s economic problems could be found. The Bank’s report was consistent with, but went beyond conclusions that had already been reached by some of China’s leading economists at the time such as Xue Muqiao, Yu Guanyuan, Liu Guoguang, Ma Hong and Dong Furen. 17

The tone and thrust of the report are reflected in the following paragraph which appears on page 19 of its Summary and Conclusions: “Thus the appropriate response to the present problems may be increased attention to designing a balanced and integrated program of reforms for the next few years. This need not aim at more than a modest interim stage of reform. Nor need it imply that reform should be implemented quickly, which in fact seems inadvisable, given the present structural imbalances, gross price distortions and weaknesses of financial institutions and instruments. But better account should be taken of the linkages between different aspects of reform, and of the need to progress on different fronts at a mutually consistent pace and in an appropriate sequence. It is also important to recognize that the current effort to regain central control of investment and prices could go too far: experience in both China and other countries suggests that the central planner is always “partially ignorant” and that attempts to plan everything directly and rigidly from above can result in gross inefficiency and sometimes even a breakdown of the system.” 18 Although “institutional economics” was not as popular in 1980 as it is today, the report clearly reflects acute awareness of institutional constraints on rapid reform.

Contrasts between the reform-approach proposed by the World Bank in China in the early 1980s and in Russia in the early 1990s are striking. The main reason for the sharp differences was undoubtedly the political background - communism as a political movement had been discredited in the former Soviet Union, which was not the case in China. Moreover, the COMECON trading system of the Soviet Bloc countries had collapsed. Bank economists dealing with Russia were under enormous pressure to come up with quick solutions. Many were undoubtedly influenced by the Latin American experience of the 1980s when the emphasis was on “getting prices right” (through the
quick liberalization of markets) and macroeconomic stability. Under the so called “Washington Consensus” approach to economic reform, as endorsed by the Bank in Latin America, there was much less emphasis on institutional reform than there was in China, especially after 1991. The Bank was under less pressure in China, because there was a functioning economy and a functioning government that knew what it wanted from the Bank. It encouraged the Bank to take a long-term view of China’s reform needs - policies and institutions - and to share relevant international experience.

Initially, the Chinese were very interested in the experience of East European countries such as Hungary, where efforts to subject the state-dominated economy to market mechanisms had started in the late 1960s. To facilitate the learning process, the Bank organized a conference with East European experts on such reforms – the Muganshan conference of 1982. At the end of the conference the Chinese concluded that the East European economic reforms were more price adjustments than real market reforms and began to look beyond Eastern Europe for their reform strategy. This reorientation is reflected, for example, in the Bashan boat conference of 1985, also organized by the World Bank. At this 4-day conference, which was held on a boat sailing the Yangtze River from Chongqing to Wuhan, senior officials and government economists learned first hand from seven prominent international economists about the functioning of modern market economies and the experience of other developing countries.

The next formal World Bank economic report on China was submitted to the Board four years after the first one, in 1985. The focus of this report had been agreed during a visit to China in 1983 by then World Bank President Tom Clausen (McNamara’s successor) in meetings with Deng Xiaoping and PM Zhao Ziyang. Deng was interested in the Bank’s assessment of the feasibility of a government plan to quadruple national income by 2000 and invited the Bank to offer suggestions on how this ambitious goal might be achieved. Thirty one World Bank experts and consultants participated in the economic mission of 1984 which was led by Edwin Lim and Adrian Wood (as deputy). Many others, including Chinese experts, provided background papers and other inputs.

Unlike the first economic report, this one was mainly forward looking and focused on the management of economic transition. It dealt with all major sectors of the
economy and stressed the need to develop institutions and policy instruments for indirect macroeconomic management. The report concluded that a quadrupling of national income by 2000 was possible under certain conditions. The Chinese again agreed to the unrestricted distribution of the report, this time without delay. In fact, the report, like many later Bank economic and sector reports on China, was translated into Chinese and sold to the public in bookstores throughout the country. Although links between foreign advice and China’s policy decisions are always hard to trace, there can be little doubt that this second economic report, like the first one, was very influential in China.

The tone and thrust of the Bank’s second economic report on China are reflected in the following quotes from its Summary and Conclusions: “China’s economic prospects will depend…on success in reforming the system of economic management, including coordinated progress on three fronts. First is greater use of regulation by markets to stimulate innovation and efficiency. Second is stronger planning, combining direct with indirect economic control. Third is modification and extension of social institutions and policies to maintain the fairness in distribution that is fundamental to socialism, despite the greater inequality and instability that regulation by markets and indirect controls would tend to cause.” Whilst recognizing the need for careful transition management, the report warned of the dangers of incomplete reforms: “Very few countries have combined state and market regulation in such a way as to produce rapid and efficient growth and fewer still have also managed to avoid intolerable poverty among substantial segments of their populations.” The last comment was prescient indeed. After the initially falling, from the mid-1980s social inequality in China increased enormously. It is one of the top government concerns at the start of China’s Eleventh Five Year Plan in 2006.

Although private house ownership in urban areas was recommended as a powerful stimulant of household saving and economic development, private investment and private sector development in general (except in agriculture and with respect to foreign direct investment) was not explicitly discussed in the report. The word privatization was not part of the Bank’s vocabulary in the dialogue with China at that time. In later World Bank reports on China the importance of private sector development was emphasized. With respect to the role of foreign investment, the Bank’s second
economic report on China says: “…China seems wise to encourage direct foreign investment, less for the foreign capital or advanced technology it brings than for the demonstration effect of modern management techniques. The example of, and competition from, well-run foreign companies can help domestic firms identify weak links in management, product design, material supply, and so on, and spur them to make changes they might otherwise never consider…This requires foreign and joint ventures to be spread…among a wide range of localities and activities, rather than confined to special zones or particular sectors.”

After 1985 the World Bank produced an economic report on China almost every year. Each one reflected actual developments and tried to anticipate the next round of reform needs while keeping perspective on the overall economic picture. Over the years, economists and sector specialists in the World Bank and the International Finance Corporation (IFC – the Bank’s subsidiary for loans to and equity investment in private enterprises in developing member countries) produced hundreds of reports on various aspects and sectors of the Chinese economy. Often, the underlying studies were undertaken at the request of Chinese counterpart agencies who almost always participated in them. Many reports were translated into Chinese, published and made available to the public through libraries and book stores; others served only as inputs into the dialogue and remained in draft. World Bank reports were more widely distributed and used in China in the 1980s and early 1990s than in any other member country.

As China’s appreciation of the importance of private sector development grew and private foreign financing became more easily available, the role of IFC expanded and the World Bank withdrew from sectors where the private sector could take over (e.g. telecommunications, commercial ports, conventional thermal power plants and highways). At the same time, the central focus of the Bank’s program for China shifted from infrastructure to rural development, health and education, poverty reduction, institutional development (including legal system development) and environmental protection. The geographic location of projects gradually shifted from coastal to less developed interior provinces, especially towards the end of the 1990s. This also applies to IFC-supported projects which were initially concentrated in Sichuan.
Many Bank-sponsored sector studies became the basis for investment projects that would subsequently receive financial support from the Bank and/or other donors. This applies to projects for the modernization of China’s railways, electric power generation and distribution, sea ports, inland ports and waterways, highways and bridges, telecommunications, rural water supply, urban water supply and waste water treatment, urban ring roads and traffic management, agriculture, rural health care, the eradication of communicable diseases, higher education, vocational training, primary education and teacher training, labor market development, financial sector and fiscal reform, the reform of state-owned enterprises, environmental protection, pension reform and poverty reduction in backward areas.

The World Bank Institute (previously Economic Development Institute - EDI) contributed significantly to building the Bank-China relationship through numerous courses and training programs for Chinese officials, in Washington and around the world. A China-specific EDI program (financed by the United Nations Development Program - UNDP) provided a variety of courses tailored to China’s requirements in English and in Chinese. The Bank also organized a special 1-year training program (financed by UNDP and the Ford Foundation) for senior Chinese economists at Oxford University. Many alumni of these various World Bank sponsored training programs are now in senior government and research positions in China.24

*Project priorities and project procedures*

The Chinese indicated to the McNamara mission of April 1980 that they were seeking financial and technical assistance for projects in agriculture, light industry, heavy industry, energy and transport, especially ports and railways. The mission suggested including higher education and overseas training.25 A few months later the Husain mission, which was received by acting Premier Zhao Ziyang (who was soon to become PM and later General Secretary of the CCP) and Finance Minister Wang Bingqian, agreed to prepare five projects for the first few years: in higher education, agriculture, ports and industrial reform. As mentioned, the mission also reached agreement on the need to undertake a base-line study of China’s economy and on key operational issues
such as contract and bidding procedures (including the preparation of bidding documents in English), the use of foreign consultants and the supervision of project implementation.

The mission was encouraged to find that China wished to reduce the national investment rate from the (then) unusually high level of 33% of GDP (planned for the Soviet-style Ten-Year Plan that was shelved) to around 25% as soon as possible. The interim “Adjustment Plan” adopted at the end of 1978 favored consumption over investment growth and light manufacturing over heavy industry. It was thought that these new priorities would put pressure on state-owned enterprises to use resources more efficiently. Efficiency at that time was primarily thought of as technical efficiency. It was only later that the broader concept of allocative efficiency (through greater reliance on market forces) gained wide acceptance. It is of interest to note that the problem of over-investment and under-consumption is once again the subject of intense debate in China at the start of the 11th Five-Year Plan in 2006.

As agreed during the Husain mission and as part of its preparatory activities, the Bank also sent a group of experienced project engineers to assess China’s capacity to prepare and implement projects suitable for World Bank support, in compliance with Bank accounting and procurement requirements. This mission, led by Kirmani, found that China had achieved a much higher level of technical capacity for planning, designing and implementing even very large projects, than most World Bank borrowers. What was found lacking, however, was a capacity for innovation, economic cost-benefit analysis, modern accounting standards and project management techniques.

Three of the toughest challenges faced by the Bank were to convince the Chinese of:

1) The need to engage foreign consultants for technical advice in certain circumstances, even if the fee that had to be paid was very high (by Chinese standards);

2) The need for and the advantages of international competitive bidding (ICB) for the procurement of equipment and civil works contracts under World Bank-supported projects; and
3) The merits of appointing (and paying for) an “independent engineer” to supervise the implementation of civil works projects and facilitate conflict resolution between owner and contractor.

The Chinese did not become convinced of the merits of ICB until a Japanese firm underbid a Chinese state-owned company by 30% for the first major infrastructure project supported by the Bank. Before 1980, China’s technical ministries were owners as well as consultants, contractors, manufacturers, suppliers and operators of the projects they undertook. To organize competitive bidding and international contracts complying with World Bank norms, the government created several specialized procurement agencies serving the need of individual ministries and agencies. The Chinese had to learn from scratch how to prepare project specifications and bid invitation documents (in English), how to evaluate bids and how to award contracts according to international standards. The Chinese initially resisted the use of highly paid foreign consultants, but later accepted the need for it on a (highly) selective basis.

Following the Kirmani mission, the Bank designed its projects to systematically address the institutional and other weaknesses that had been identified. In this way the projects became primary vehicles for a large flow of technical assistance from the Bank in many sectors of the economy. In the process of developing an initial “pipeline” of projects suitable for Bank support, both sides were greatly assisted by training programs for Chinese project staff financed by UNDP. Later, training programs for local staff were included as an integral feature of almost all World Bank-supported projects in China.

The first investment project submitted for Board approval (June 1981) was a higher education project. This “University Development” project, which had been suggested by the Bank a year earlier, provided finance for equipment and materials to upgrade 26 universities and a large number of scholarships for study abroad. The second project, “North China Plain Agriculture” was approved a year later. It provided irrigation and drainage facilities as well as agricultural support services for large areas of farmland where productivity had sharply fallen due to excess soil salinity. The third project (approved in November 1982), supported the modernization of “Three Ports”: Shanghai/Huangpo, Tianjin and Guangzhou. It included the provision of container
handling facilities which facilitated rapid trade growth. The first three projects were implemented on schedule and achieved their objectives. Together with the Bank’s first economic report on China, they laid the foundation for what was to become the largest and one of the most successful programs in the history of multilateral development assistance. In 1993 China became the World Bank’s largest borrower and remained so until the late 1990s (not counting the large loans for balance of payments support that were made to South Korea and some other countries in the wake of the Asian financial crisis of 1997-’98).

The Bank’s program in China became very large indeed in the 1990s. To manage the program, the government established project units all over China, at the central, provincial, municipal and county-level. The number of Chinese staff on government payrolls involved in managing the Bank’s program was estimated at 10,000 when the program was at its peak in the second half of the 1990s. During those years, there were rarely fewer than 100 World Bank staff/consultants in the field in China at any point in time to help prepare or supervise projects, or to undertake studies. The number of Bank-supported projects under implementation simultaneously – employing hundreds of thousands - was about 125.

With the exception of one quick disbursing “adjustment” loan in the late 1980s, all World Bank loans for China financed investment projects or technical assistance. Such loans typically disburse over a 5-8 year period, depending on the nature of the project. Loan conditionality was linked to agreed project objectives. There were relatively few serious compliance problems. On one occasion when the municipal water authority of Shanghai initially refused to raise water tariffs as required under a Bank-supported waste water treatment project, the problem was resolved when the Bank (informally) threatened to suspend disbursements for the project. On another occasion, when a Bank supervision mission discovered procurement irregularities in an agricultural project in Guangdong, disbursements for this project were suspended and the relevant Guangdong project authority was required by the Bank – under standard legal remedies and with full support from the central government in Beijing - to repay immediately the amount that had already been disbursed. The quality of project implementation in China was on average very high according to the World Bank’s own internal ratings. World
Bank loans to China were always serviced on time. Whenever local project authorities in China were unable to pay, the Ministry of Finance made good on its guarantee to the World Bank.

Perhaps the greatest contribution to China’s development and modernization through Bank-supported investment projects has been institution building, i.e. the development of rules, systems and organizations for managing and supervising projects in accordance with sound economic, technical, accounting and engineering standards. For example, China’s State Auditing Department was initially established to audit the accounts of World Bank supported projects in China. State procurement and bidding laws were modeled after World Bank guidelines (with some exceptions). Bank reports on housing and social security reform in early and mid-1990s were particularly influential, both in terms of institution building and policy development. In the mid-1990s the Bank provided financial support from a modest grant facility – together with the Ford Foundation – to kick start the China Center for Economic Research at Peking (Beijing) University; CCER has since become a world class center for economic research and teaching.

Since the resumption of membership in 1980 until the middle of 2005, the World Bank supported some 270 projects in China for a total in loans of about US$40 billion (about $30 billion on relatively hard IBRD terms and about $10 billion on soft IDA terms). Whilst these amounts are large, it should be noted total World Bank lending to China accounted for less than 1% of investment in China since the first loan in 1981. (On a per capita basis, smaller developing member countries received much more World Bank financial support than China did.) The Chinese contributed the equivalent of about $60 billion from their own resources. The average total cost of Bank-supported investment projects (as distinct from technical assistance projects) in China was around $400 million. There are few parts of China that did not benefit from Bank-supported projects.

Since the start of its operations in China in 1985 until the middle of 2005, IFC lent for and invested equity capital in over 100 private sector projects for a total amount of about $1.6 billion from its own resources ($934 million in loans and $673 million in equity) and mobilized another $626 million from other sources through syndications.

**Economic Re-Centralization and the Emergence of Modern Macroeconomic Management - the Dalian Conference of 1993**

Like the earlier Muganshan and Bashan boat conferences, the Dalian conference of June 1993 was a pivotal event and building block in the evolution of China-Bank relations. The conference marked a turning point in the national debate on two major issues: (a) the appropriate degree of economic centralization for China and (b) the management of aggregate demand in China’s semi-reformed economy. Many reports on China’s reforms since 1978 rightly emphasize the importance and benefits of economic decentralization. Few focused on the partial re-centralization of 1993/94 which followed the Dalian conference.

In the early 1990s some central government leaders began to think that China’s irregular, stop-go pattern economic performance of the 1980s - with spikes of high investment and high inflation - was due to excessive administrative decentralization. By delegating fiscal and financial powers to lower-level governments, while at the same time transferring ownership of most state-owned enterprises (SOEs) to those governments, Deng Xiaoping had been very successful in stimulating growth, as was his intention. But the system had also led to a loss of control by the central government over investment planning by lower level governments and local financing. Excessive local credit expansion had to be reined in by Beijing from time to time to avoid inflation spiraling out of control. In the absence of more sophisticated macroeconomic policy instruments, Beijing had to rely on direct administrative controls which worked quickly, but contributed to the stop-go nature of the growth pattern. To correct this problem, a partial
re-centralization of administrative controls was thought to be needed, but it was recognized that this would be politically very unpopular in the provinces.

Enormous energy and political capital was invested in efforts to reach agreement with provincial governments on how to restore financial discipline in the system. Vice Premier Zhu Rongji was a central figure in directing China’s economic reforms, including a major realignment of central/local economic powers. Through consultations and technical assistance projects the World Bank became substantially involved in redesigning China’s institutional framework for macroeconomic policy and control. The Dalian conference marked a breakthrough in this process.

Temporary economic uncertainty followed by economic overheating

Before continuing the story about the Dalian conference of 1993, it is useful to recall certain political and economic developments of the late 1980s and early 1990s. Uncertainty about China’s future after the Tiananmen massacre of June 4th, 1989 was reinforced by the fall of the Berlin Wall towards the end of that year and events that led to the disintegration of the Soviet Union two years later. These were traumatic developments for China. Deng Xiaoping believed that the demise of the Soviet Union was related to a lack of economic growth. He was keen to demonstrate that China’s economy could restore growth momentum and that reforms would not be reversed, as many foreign observers expected. Major efforts to stimulate growth after the economic slump of 1988-‘90 through domestic and foreign investment were soon to bear fruit. In 1991 the economy began to pick up. Following Deng Xiaoping’s much-publicized “southern excursion” to Guangdong, Hubei and Shanghai in January and February of 1992, both public and private foreign investment exploded, creating the hottest economic boom in modern Chinese history. GDP growth in 1992 reached an unprecedented 14.2% and remained well above 10% during the next 3 years.

Opportunities and capital for investment seemed limitless. Some coastal provinces experienced labor shortages. Much of urban China and even some rural areas had the appearance of a construction site, as would happen again in the early years of the 21st century. As had happened before (during the 1980s), local branches of state-owned
commercial banks and their subsidiaries extended credit to finance local investment well beyond levels authorized in the national credit plan. In addition, foreign direct investment (FDI) from overseas Chinese and around the world poured in like never before in response to the wave of confidence triggered by Deng’s speeches and the resumption of rapid growth. European, American and Japanese enterprises also increased their investments in China in the early 1990s.

Local CCP and government leaders often vied with each other for leadership in promoting growth through new investment projects. In many areas the entire party apparatus was mobilized for economic development. But an adequate institutional framework for project appraisal, risk analysis, market regulation and protecting the financial integrity of financial institutions had not yet developed. Many became concerned about the government’s apparent inability to prevent a recurrence of the stop-go economic cycles of the 1980s. Excessive administrative decentralization was suspected to be factor in this, but the links between excess investment and excess credit expansion at the local level and national macroeconomic imbalances in the form of inflation or current account deficits were not well understood by political leaders.

The leadership was united in its fear of high inflation and the social dislocation it can generate, but could not agree on what to do. Some felt that even higher investment growth would eliminate supply bottlenecks and thus cure inflation. Others believed that investment growth and credit expansion were already excessive and that brakes had to be applied without delay. But what kind of brakes? Since already about half of total investment and production was outside direct state control, the administrative tools which had been effective in redressing macroeconomic imbalances in the 1980s, were feared to be no longer sufficient. They would at least have to be supplemented with new, untested indirect macroeconomic policy instruments.

Zhu Rongji (who in July 1993 became Executive Vice Premier and Governor of China’s central bank, replacing Li Guixian who was dismissed for inadequate supervision of the financial system) felt that the economy was dangerously overheated due to excessive investment financed by uncontrolled credit expansion. Already in 1992 he had given instructions to the State Commission for Restructuring the Economic System (SCRES) to undertake a series of studies on macroeconomic regulation with the
objective to drastically reform China’s system for macroeconomic management.\textsuperscript{31}
Several of these studies were undertaken jointly with World Bank economists. Zhu complained bitterly about irresponsible investments sponsored by lower level governments and the lack of control over credit expansion. Several provincial leaders suffered his wrath - sometimes through instant dismissal - when found lacking in good judgment during Zhu’s frequent inspection tours.

Without Zhu’s personal prestige, decisiveness and adroit use of both foreign and domestic economic advisors, including the World Bank, China’s response to the overheating of the early 1990s might have been misdirected. China could have lost economic control and landed in a Latin American-style inflationary spiral. If that had happened, the reform process would have halted and China might not have been able to avoid a financial crisis. Zhu was, of course, not alone in this. He was supported by President Jiang Zemin and other leaders as well a group of Chinese technocrats who understood macroeconomics in a market setting.

\textit{The Dalian conference and its prelude}

In early March 1993, a group of Chinese economists, including advisors to Zhu Rongji\textsuperscript{32} met in Cambridge Massachusetts for a 3-day workshop on China’s economic reforms. The event was jointly sponsored by the Harvard Institute for International Development (HIID), the World Bank and the Development Research Center of the State Council (DRC) with funding from the Ford Foundation. Workshops of this kind played an important role in the evolution of China’s thinking on economic reform and institutional development. Typically the Chinese would prepare discussion papers to seek feedback from foreign participants. The Chinese always made sure that they were in the driver’s seat in those exchanges; they did not blame foreigners when things went wrong as a result of their decisions. The Cambridge workshop focused on China’s unfinished reforms, the growing macroeconomic imbalances and the risk that inflation might get out of hand. It raised awareness of the problems, but reached no firm policy conclusions. It was agreed to continue the discussion in Dalian in June.
The *Dalian conference* was co-hosted by MOF, SCRES and the World Bank. Participants included many of the same people who had attended the Cambridge workshop in March and representatives of the IMF, UNDP, the Peoples Bank of China, the Hainan Institute for Reform and Development and the Korean Development Institute. A few weeks before the conference, the World Bank office in Beijing had been informally asked by the government to invite, as a World Bank consultant, the famous Taiwanese economist Li Kwoh-Ting (father of the island’s economic miracle in earlier decades). Li accepted immediately. He had not visited the mainland since 1948. Although he was already 83, he participated actively in the 3-day conference. Afterwards he met privately with several top leaders.

All participants in the *Dalian conference* were invited to meet with Vice Premier Zhu Rongji beforehand. Zhu was particularly interested in hearing the views of foreign participants, because, as he explained citing an old Chinese proverb: “*Foreign monks know more than local monks*”. On behalf of foreign participants, Shahid Javed Burki, Director of the Bank’s China Department did not hesitate to explain that the economy had indeed become dangerously overheated and that forceful remedial action was urgently needed.

The same conclusions were reached at the conference. At the end a small group of Chinese participants met privately with Zhu to submit their recommendations to him.33 A few weeks later, in July 1993, top CCP leaders reached consensus on the nature of the inflation problem and agreed on a macroeconomic stabilization program aimed at a gradual reduction of the economic overheating. This program - summarized in 16 points - was ultimately successful in achieving a “*soft landing*” of China’s economy in 1996. It was the first macroeconomic stabilization plan that relied, at least partially, on indirect policy instruments. It had far-reaching implications for macroeconomic management and institutional change in the years that followed and contributed to a partial re-centralization of fiscal and financial controls.
Domestic and international reactions to the 16-point macro-stabilization program of July 1993 were highly favorable. So favorable, that investor confidence and consumer spending actually increased, driving inflation even higher before a gradual cooling of the economy began in 1994. Another reason for delay in the program’s effectiveness was the weakness of existing macroeconomic institutions. Local bank branches and even central bank branches were effectively still controlled by local governments and the fiscal system remained chaotic. The interbank market did in effect operate as a credit channel outside the credit plan. And so called “leadership projects” received funding no matter what the official credit plan said. Although broad agreement on the need for institutional change had been reached, several specific macro-management questions had yet to be decided:

- How to control local investment growth and credit expansion while ensuring that credit would continue to flow to non-commercial, state-directed projects such as e.g. the 3-Gorges project?
- How to create a modern tax system and establish firm rules for the collection and sharing of revenues and expenditure obligations between the central and local governments?
- How to finance future budget deficits after it had been decided – in the interest of fiscal discipline - to discontinue access to central bank credit for this purpose?
- How, when and at what level to unify the confusing and distortive multiple exchange rate system.

These and other complex issues were the subject of intense debate within the government during the fall of 1993. The World Bank participated in several of the workshops that were organized by the Chinese to seek foreign advice. Technical committees in Beijing spent weeks in seclusion preparing decisions that would be submitted for approval to the Third Plenum of the Fourteenth Central Committee of the CCP in November. An 8-page assessment of China’s macroeconomic situation and need for additional reforms by the World Bank’s resident senior economist in Beijing, Ercheng Hwa, impressed Zhu Rongji, who asked the Bank to publish the entire piece in the
People’s Daily, which was promptly done. It contributed to the national debate on reform priorities.

In November 1993, the Third Plenum adopted a comprehensive package of 50 interrelated economic reform “Decisions”, thus setting the stage for a new and decisive phase of China’s market reforms. The “Decisions” of November 1993 gave specific content to the main conclusion of the Fourteenth Party Congress that was held a year earlier, namely to create a “Socialist Market Economy”. For the first time since the start of the reforms in December 1978 China had defined the goals and the methods of its economic transformation at least in general terms. The Dalian conference was an important building block in the process that led to this point. The Third Plenum of November 1993 triggered follow-up institutional changes and policy action in numerous areas, including the following four:

1) **Fiscal reform.** On 1 January 1994, for the first time in China’s history, a National Tax Administration agency came into being, while a modern value added tax, a personal income tax, several other tax reforms and clear central-local government revenue sharing formulas were introduced. Previously all taxes, except customs, were collected by local governments and shared upwards according to formulas that were not transparent and often negotiated. A (new) requirement that the state had to borrow all funds needed to cover the budget deficit on capital markets – not from the central bank - led to a rapid development of the primary and secondary bond market.

2) **SOE reform and privatization.** The Plenum’s decision to establish a “Modern Enterprise System” through the corporatization of SOEs and other reforms led to enactment of the PRC’s first Company Law in 1994. The assumption was that corporatization would require a clear definition of corporate ownership and thus facilitate the professionalization of SOE management. In 1995 it was decided to “hold on to the big SOEs and to let the small ones go”. The official acceptance of privatization as part of the reform strategy was accompanied by growing support for domestic private enterprise and the protection of private property. From the mid-1990s, the key challenge of SOE reform was taken much more seriously than before as is illustrated for example by the fact that SOE employment peaked in
1995. It dropped by no less than 45 million jobs between that year and 2003. From 1995 all net-employment growth in China has been due to non-state enterprises, including domestic private companies.

3) **Exchange rate reform.** Also on 1 January 1994, China’s multiple exchange rate system was unified at the then prevailing free market rate of RMB 8.7/U.S.dollar and the Foreign Exchange Certificate (FEC), a special currency for foreigners that could only be bought at the official (overvalued) exchange rate, was abolished. These actions removed two important sources of corruption and market distortion while facilitating the elimination of dual pricing and dual retail outlets (for foreigners and locals). A few months later, on April 1, an interbank foreign exchange market was established in Shanghai.\(^{38}\)

4) **Banking reform.** To facilitate the reform of China’s four major state-owned commercial banks, three state-owned “policy banks” - the China Development Bank (modeled after the World Bank and the Japan Development Bank), the Export-Import Bank and the Agricultural Development Bank were established on various dates in 1994. These “policy banks” were designed to assume responsibility for the financing of state-directed programs and projects so that the existing state-owned banks could concentrate on becoming genuine commercial banks. Efforts to separate policy lending from commercial lending were derailed by the Asian financial crisis of 1997/8 and have not yet been fully achieved. In the first half of 1995 the PRC’s first Central Bank Law and first Commercial Bank Law, which had been under discussion since late 1993, were enacted. Both laws, though general in nature and requiring further refinement, strengthened central government control over the economy. Two years later (1997) the central bank was reformed such that local governments would cease to have any control over its local branches.\(^{39}\)

The macroeconomic institutional and policy reforms of the early and mid-1990s made China’s reform process irreversible and integral in scope. The World Bank played a support role in shaping several key decisions and in training Chinese staff responsible for managing the new institutions. Meanwhile, World Bank technical assistance in policy
development and institution building through projects continued. Most notable was the work on pension reform, urban housing reform, energy market reform, environmental protection, labor market development, social safety net development, interest rate liberalization and external trade liberalization. Following the breathtaking economic reforms of the early and mid-1990s, the next milestone in China’s economic transition and in becoming a key player on global markets was the accession to WTO in December 2001.

China undoubtedly benefited from World Bank assistance, but the Bank also gained much from the interaction. In my opinion the three most important lessons for the World Bank are:

1) That “second-best” solutions are often superior to first-best solutions in a transition economy;
2) That long-term vision on the part of the government, political stability, pragmatism and trust between local and foreign partners are essential;
3) That the World Bank can reinforce, but not substitute for, a national commitment to reform and development.

Washington DC, 24 March 2006
After noting that the normalization of relations between China and the U.S. was an important achievement, the Communiqué issued after the Third Plenum of December 1978 includes i.a. the following “new economic measures”:
- to actively expand economic cooperation on terms of equality and mutual benefit with other countries;
- to boldly shift authority, under guidance from the leadership, to lower levels so that the local authorities and industrial and agricultural enterprises will have greater power of decision in management;
- to tackle conscientiously the failure to make a distinction between the Party, the government and enterprise administration;
- To reduce the number of meetings and the amount of paperwork and to conscientiously adopt the practices of examination, reward and punishment, promotion and demotion.

An excellent description of China’s unique approach to reform can be found in Thomas G. Rawski, Reforming China’s Economy: What have we learned? The Chinese Journal, No.41, January 1999.

The term “Beijing Consensus” was coined in 2004 by J.C. Ramo in an essay for The Foreign Policy Centre (a European think-tank launched under the patronage of British PM Tony Blair), The Beijing Consensus: Notes on the New Physics of Chinese Power.

The term “Washington Consensus” was coined by John Williamson of the Institute for International Economics in 1990 to refer to the lowest common denominator of policy advice by Washington-based institutions to Latin American countries as of 1989. Such advice emphasized the importance of fiscal discipline, trade and price liberalization, deregulation in general, a competitive exchange rate, the privatization of state-owned enterprises and securing property rights. It focused mostly on policies, not on institutions.

Events and considerations surrounding China’s reentry into the Bretton Woods organizations are described in Harold K. Jacobson and Michel Oksenberg, China’s Participation in the IMF, the World Bank, and GATT. Toward a Global Economic Order. Ann Arbor, the University of Michigan Press, 1990.

This is a routine transaction available to all member countries.


The official name of the World Bank is International Bank for Reconstruction and Development (IBRD). The International Development Association (IDA) was established in 1960 to provide loans on highly concessionary terms to the poorest developing countries. IDA funds are replenished every three years by donor countries. IBRD finances its capital needs on capital markets around the world on a commercial basis.

An insightful personal account of the development of China-Bank relations in the early years is provided in Edwin Lim, Learning and Working with the Giants. Chapter 5 in S. Gill & T Pugatch (editors), At the Front Lines of Development. Reflections from the World Bank, The World Bank 2005.

China had been a member of the IMF and the World Bank from the time they started operations in 1946. However, when the PRC was established in 1949, China’s representation on the boards of these institutions effectively migrated with the Nationalist government to Taipei.

Personal communication from Caio Koch-Weser the World Bank’s first Division Chief for China after it rejoined in May 1980 and participant in the initial meeting with Deng Xiaoping as Mr. McNamara’s personal assistant.
MOF established a World Bank Department with a divisional structure that mirrored the organization of the China Department in the World Bank in Washington.

Since the withdrawal of Soviet advisors from China in 1960, there had been almost no direct involvement of foreign advisors in China’s economy until the start of market reforms in the late 1970s. Thanks to Deng Xiaoping’s personal leadership and pragmatic thinking, the suspicion of western economic advisors, which was still fairly common then, was soon overcome.

They were Randolph Barker, Wlodzimierz Brus, P.C. Chen, Mark Elvin, Shigeru Ishikawa, Nicholas Lardy, Dwight Perkins, Thomas Rawski, Ashwani Saith, Peter Schran and Christine Wong.

Edwin Lim played an important role in developing the Bank’s China program in the 1980s. He became the Bank’s first Resident Representative in China (1985) in which capacity he served until 1990.

Not long after the mission, Zhu became Deputy Director of the Technical Transformation Department of the State Economic and Trade Commission.


They were Hungarian economist and Harvard professor Janos Kornai, Yale Professor James Tobin (who was awarded a Nobel prize a few years later), Otmar Emminger, former President of the Deutsche Bundesbank, Michel Albert, head of the French state insurance company and former head of the national planning office, Oxford professor Sir Alexander Cairncross, Alexander Bajt, a Yugoslav expert on “self-management” and Leroy Jones, an American expert on the planning experience of South Korea.

The second economic report consisted of a main volume, China: Long Term Development Issues and Options, which was published by The Johns Hopkins University Press (1985) and six supplementary volumes on education, agriculture, energy, transport, economic projections and economic structure. The Chinese translation was prepared and published in China.

Rural house ownership has always been private in China, even during the period of collective agriculture. Urban house ownership, however, had become 100% public – through the Danwei or Work Unit system – in the 1950s when remaining private enterprises were gradually absorbed into or converted into state-owned units. The privatization of China’s urban housing stock did not start until about 1996.

For further details see Edwin Lim, Learning and Working with the Giants. Chapter 5 in S. Gill & T. Pugatch (editors), At the Frontlines of Development. Reflections from the World Bank. The World Bank 2005.

Contrary to many reports (e.g. the New York Times in an editorial on 31 March, 1999), the World Bank is not involved in the 3-Gorges project. It was never proposed for World Bank financing and hence not rejected either. World Bank’s only role was to chair (in 1987) a conference of dam experts from around the world to discuss a feasibility study of the project that had been financed by the Canadian International Development Agency. The government finally decided to go ahead with this project in 1993 using its own
financial resources. It chose the higher of two dam height options. The 1987 conference had expressed a preference for the lower dam height option.

26 China is exceptional in this regard. From the early 1980s, quick disbursing “adjustment” loans became common for many other developing member countries. China resisted this trend, because: (a) it did not need balance of payments support; and (b) it considered the technical assistance embodied in World Bank projects as or more important than the loan.

27 Unlike the World Bank, IFC lends without a government guarantee and can also invest equity capital in the projects it supports.

28 During these visits Deng encouraged local officials to accelerate development and to intensify market reforms. He rejected social egalitarianism as something of the past and stated that “to get rich is glorious”.

29 Fear of inflation is deeply ingrained in China’s leaders; they realize that high inflation undermined the authority of the Nationalist government during the civil war (1945-1949) and was an important factor underlying the demonstrations on Tiananmen Square in Beijing (and in other Chinese cities) in 1989.

30 As part of the government reforms of 2003, SCRES was discontinued as a separate agency and integrated into the National Development and Reform Commission.

31 The person in charge of those studies was Lou Jiwei, Director of SCRES’ Macroeconomic Department. He later edited a number of those studies for publication in English, World Bank Discussion Paper No. 374: Macroeconomic Reform in China - Laying the Foundation for a Socialist Market Economy, Washington DC, 1997.

32 Zhu Rongji liked to brainstorm with bright young Chinese economists in various agencies, avoiding protocol and bureaucracy. For the analysis of macroeconomic, financial and fiscal issues he relied in particular on Lou Jiwei, Guo Shuqing, Li Jiange, Zhou Xiaochuan, Wu Xiaoling and Xu Shanda. He also relied on more senior advisors such as Wu Jinglian. Zhu had parallel informal networks of internal advisors for other policy areas (also at the provincial level) that allowed him to be well informed and well prepared for difficult decisions.

33 Selected papers and proceedings of the Dalian conference were published by the World Bank in Discussion paper No. 222 (1993) edited by Peter Harrold, E.C. Hwa and Lou Jiwei.

34 For example, in an op-ed article in the Wall Street Journal of July 29, 1993, David Malpass contrasted China’s effective economic reform program with Russia’s inability to get to grips with its problems: “China’s latest economic measures will allow the private sector to expand, whereas Russia’s approach prevented it. As a result, there is a good chance China will move forward with a stable currency, lower inflation and continued rapid growth.”

35 China’s tax reforms of 1994 had been under preparation for several years with technical assistance from the IMF and the World Bank.

36 The Company Law was amended October 2005 (effective 1 January 2006) to strengthen corporate governance, give better protection to minority shareholders and lower minimum capital requirements for the establishment of new companies, including individually owned ones.

37 This is also reflected in a series of Constitutional amendments. Article 11 of the 1988 Constitution said: “The state permits the private sector of the economy to exist and develop within the limits prescribed by the law.” The 1999 Constitution said: “The non-public sector of the economy comprising self-employed and private businesses within the domain stipulated by law is an important component of the country’s socialist market economy. The current (2004) Constitution says: “The state protects the lawful rights and interests of
the non-public sectors of the economy such as the individual and private sectors of the economy. The state encourages, supports and guides the development of the non-public sectors of the economy and, in accordance with law, exercises supervision and control over the non-public sectors of the economy."

38 The new unified exchange rate initially appreciated from 8.7 to 8.3 RMB to the U.S. dollar. This happened in spite of the fact that inflation in China was much higher than in its main trading partners and was mainly due to the significant strengthening of China’s trade balance in 1994. The exchange rate was maintained at the 8.3 (plus or minus a small margin) from May 1995 and at 8.28 from the end of 1997 until 21 July 2005, when China announced a small (2.1%) appreciation and a de-linking from the U.S. dollar. Although China announced at the time that the RMB would be linked to a basket of currencies, a de-facto US dollar linked seems to have been pursued thus far.

39 Before 1979 China’s central bank was an agency under the Ministry of Finance. It was established as a separate institution under the State Council in 1984. The Central Bank Law of March 1995 stipulates that “the aim of monetary policy is to maintain the stability of the value of the currency and thereby promote economic growth”. The IMF and the World Bank contributed to the preparation of the Central Bank Law and the Commercial Bank Law of 1995 through background papers and seminars in which top international experts participated. The reform of China’s central bank in 1997 brought local branches under the control of 7 regional central bank offices