

ASIAN DEVELOPMENT BANK

TAR:PRC 37627

**TECHNICAL ASSISTANCE
TO THE
PEOPLE'S REPUBLIC OF CHINA
FOR
WORLD TRADE ORGANIZATION-POLICY REFORM SUPPORT TO
THE MINISTRY OF RAILWAYS**

April 2004

CURRENCY EQUIVALENTS

(29 March 2004)

| | | |
|---------------|---|------------|
| Currency Unit | – | yuan (CNY) |
| CNY1.00 | = | \$0.1208 |
| \$1.00 | = | CNY8.2770 |

ABBREVIATIONS

| | | |
|------|---|--------------------------------------------------------|
| ADB | – | Asian Development Bank |
| GATS | – | General Agreement on Trade in Service |
| km | – | kilometer |
| MOR | – | Ministry of Railways |
| NDRC | – | National Development and Reform Commission |
| OECD | – | Organisation for Economic Co-operation and Development |
| PRC | – | People's Republic of China |
| TA | – | technical assistance |
| WTO | – | World Trade Organization |

NOTES

- (i) The fiscal year (FY) of the Government and its agencies ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. The Government of the People's Republic of China (PRC) has requested that the Asian Development Bank (ADB) provide technical assistance (TA) to the Ministry of Railways (MOR) to support policy reform related to accession to the World Trade Organization (WTO). A Fact-Finding Mission visited the PRC in December 2003, and reached an understanding with the Government on the TA's objectives, scope, terms of reference, cost estimates, financing plan, and implementation arrangements. The TA is included in the ADB 2004 country program for the PRC.¹

II. ISSUES

2. Economic growth in the PRC was rapid over the past two decades, reaching 9.1% in 2003. The rapid economic growth has resulted in a 9.2% annual growth in passenger transport and a 7.1% growth in freight transport from 1978 to 2002. During that period, railway freight grew from 35 billion tons/kilometer (km) to 1,552 billion tons/km, equivalent to an annual growth rate of 4.4%, and passenger traffic grew at 6.6% annually. Despite this growth in traffic, the railway lost modal share for both freight and passengers. By late 2002, the PRC's railway system comprised 72,000 route-km, and carried about a third of the PRC's freight and passenger traffic.

3. The Government's railway development policy focuses on (i) removing constraints and expanding the railway system, (ii) encouraging construction of joint venture local railways to promote the development of local economies, (iii) improving the railway system's efficiency by using new technology and modern management tools for planning and operations, (iv) reducing operating subsidies through appropriate pricing and commercialization of services, (v) initiating institutional and structural reforms to increase MOR's autonomy and accountability, and (vi) encouraging nongovernment investment in infrastructure and related services.

4. The Tenth Five-Year Plan (2001–2005) identifies transportation, including railway development, as a priority. The plan envisages (i) building 6,000 km of new lines to access previously unserved areas, with the network reaching 74,000 km; (ii) providing 3,000 km of double lines, and electrifying 5,000 km of key lines to increase capacity; and (iii) increasing operating speeds on 5,000 km, with the total length of such lines reaching 15,000 km. The plan for the railway sector includes an investment of CNY350 billion, including CNY270 billion for capital construction and CNY80 billion for rolling stock. To complement expansion of that capacity, the Government has emphasized the need to accelerate reforms in the railway sector.

5. ADB's strategy for the railway sector focuses on (i) expanding the railway system by constructing new lines in unserved areas that are less-developed and poor; (ii) modernizing and increasing the capacity to improve transport efficiency on key routes of the national railway system; (iii) commercializing railway operations to sustain efficient operations; and (iv) increasing railway competitiveness in the transport sector through restructuring and reform.

6. Japan is the major source of external financing in the PRC railway sector, followed by the World Bank and ADB. Since 1979, Japan has provided about ¥558 billion for 15 railway projects to expand rail transportation capacity. Since 1984, the World Bank has provided nine loans totaling more than \$2.2 billion for (i) eight national railway projects to expand railway capacity on high-priority corridors, modernize system-wide technology, and strengthen institutional capabilities; and (ii) one local railway project. ADB has focused on the development

¹ The TA first appeared in *ADB Business Opportunities* on 10 January 2004.

of railways in less-developed inland provinces to promote sustainable economic growth and reduce poverty. ADB has provided 11 loans totaling \$2.06 billion to finance the construction of about 1,754 km of provincial railways operated by joint ventures with MOR, and 4,138 km of new railway lines under four national railway projects.

7. Policy dialogue has been a major element of ADB assistance to the railway sector, and has complemented the lending operations. Since 1989, nine TAs totaling \$4.2 million have been provided for institutional development of local railways, tariff and organizational studies for the Jing Ju railway, enhancing commercial and business operations, marketing and business development, developing human resources, and improving systems of financial management and accounting. Progress has been achieved as MOR has adopted a structured approach to railway reform. A new management concept, the Asset Operating Liability System, was introduced as a pilot project in 1999. Under this system MOR entered into management contracts with railway administrations to improve profitability. The management contracts helped improve the operational and financial performance of the railway administrations. The system has since been extended to all 14 railway administrations. Separation of core and non-core businesses is a key element of MOR's restructuring program. The total number of employees in the core transportation business has been reduced from 1.89 million in 1997 to 1.48 million in 2002. In the non-core transportation business, five large companies employing 616,500 staff have been divested. To provide jobs for redundant staff, by the end of 2002 MOR had set up 7,681 diversified businesses (independent of the core transportation business), employing more than 400,000 staff to supply equipment, goods, and services to the railway industry. In 1998, MOR initiated a cost-sharing scheme for health insurance and pensions for railway employees. Since 2000, 44 educational institutes and 10 universities have been transferred to local governments and 120 branch lines comprising 7,800 km of route have been separated to improve productivity and reduce operating losses.

8. MOR has taken several measures to improve the operational and management information systems for the railways, including the development and introduction of the Transportation Management Information System; computerized ticketing systems in 700 stations and 7,000 ticket sales points, accounting for 95% of the passengers; and use of an interline revenue settlement system. MOR will introduce a state of the art dispatch management information system in all 14 railway administrations and 70 major trunk lines by 2005, and will introduce centralized traffic control on several trunk lines by 2007. Consistent with growth in multi modal transport, container transport in the railway sector has grown at three times the rate of ordinary freight traffic. MOR plans to set up an independent container company by the end of 2005, and plans to build 18 large container terminals by 2007.

9. Although the State Council regulates the tariff changes, MOR has been given flexibility to levy charges and fix tariffs within a defined range. In 1991, MOR was permitted to levy a separate construction surcharge to most commodity tariffs, which is credited to a separate railway construction fund. In 1993, the Government approved the policy of "new line, new tariff" to generate revenue for cost recovery and to service the debt incurred to finance construction of new lines. MOR was also authorized to levy a separate charge on traffic moving on electrified tracks. On the passenger side, MOR can levy a surcharge of 50% on fully airconditioned train services, and can charge 30% higher fare during the peak season. In 1999, the freight tariff structure was reclassified, and a new commodity-based tariff structure and additional charges for freight loading and unloading were introduced.

10. MOR is in a transition phase from building transport capacity to institutional development. The Government has broadly defined the framework of railway restructuring to

separate government functions from enterprise functions; separate rail from non-rail functions; rationalize staff in core transportation, spinoff peripheral operations, and noncore operations; and reform the railway investment and financing system. ADB has enhanced its policy dialogue with MOR, the National Development and Reform Commission (NDRC), and the Ministry of Finance (MOF). The World Bank and the Organisation for Economic Co-operation and Development (OECD) have also been engaged in dialogues on many policy issues concerning the PRC railways. OECD² considered possible approaches to restructuring the PRC railways. The conclusion was that, considering that rail reform takes time, determination of the reform path for the PRC railways should start now if the railway sector is to be effective by 2010. There is broad agreement on reforms in the transport sector for further railway development. MOR is preparing a Railway Development Plan that will set major goals to 2020, in consultation with NDRC. The reform agenda that MOR has proposed for this plan seeks to (i) study and learn from worldwide experience, (ii) clearly identify core operations and separate core and non-core transportation businesses, (iii) rationalize and reduce staff, (iv) reform the railway investment and financing system, and (v) establish specialized transportation companies.

11. The PRC's December 2001 accession to WTO poses new challenges to the railways. Competition among various modes will intensify, and the structure of transport demand will change. Under the WTO rules, the General Agreement on Trade in Service (GATS) sets a common rule governing trade in services among member countries. The agreement includes provisions on obligations, general principles, and exceptions. GATS includes important obligations on monopoly regulation, franchises for service provision, national treatment, market access, and domestic regulation. Disclosure is a key principle of multilateral liberalization because it makes it easier for service providers to access and compete in markets of WTO member countries. As part of the agreed obligations for market liberalization, GATS stipulates that when market access is granted, the member countries must treat foreign and local services and service providers equally within the commitment framework.

12. The Government is committed to following WTO rules and to opening railway freight markets and other services such as warehousing and freight forwarding to foreign partners. This necessitates a study that will help service providers identify business opportunities. That involves determining what commitments the PRC has made under WTO in the railway and related sectors, and reviewing the regulations, domestic legal systems, and laws on investment and nondiscrimination to enable service providers to identify business opportunities. There is also a need to study how MOR can accelerate changes in railway management, transform the operating mechanisms of railway enterprises, and establish policies and regulations to regulate market competition. Such a study will include review of previous studies by MOR, the PRC Government, and multilateral institutions; review of experiences of other international railways; and consultation with other stakeholders such as MOF, NDRC, the State Council, and government officials. During the 2003 country-programming mission, the Government requested that ADB provide a TA grant to examine the impact of WTO accession on other railways, and to help MOR prepare a policy reform plan consistent with its overall restructuring as described in the Tenth Five Year Plan.

² Summary and recommendations of the Organisation for Economic Co-operation and Development (OECD) and Development Research Center seminar on Railway Reform in Beijing 28–29 January 2002.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

13. The objective of the proposed TA is to help MOR review potential impacts of the PRC accession to WTO, assess MOR's preparedness to address these impacts, and recommend action and policy reform support to meet these challenges. To achieve this objective, the TA will review the impacts of WTO accession on the PRC railway sector and examine (i) management functions and how to separate enterprise and government functions; (ii) access to railway markets, including the current status of the PRC railway in the transport market, and challenges it faces due to competition and pricing; (iii) analyses of differences and gaps between current railway management functions (including regulations) and methods, based on WTO rules; and (iv) the suitability of laws and regulations for safety, access to railway markets, service quality, price, and investments. The study would enable utilization of the experiences in reform of other international railways, and would involve active participation of the PRC railway management. A policy reform plan that MOR can implement will be the output. Appendix 1 gives the TA framework.

B. Methodology and Key Activities

14. ADB will engage a team comprised of an international consulting firm assisted by domestic consultants, using the quality and cost-based selection methods in accordance with ADB's *Guidelines on the Use of Consultants*. The TA will require about 26 months of consulting services spread over 7 months. It will comprise about 14 person-months of international and 12 person-months of domestic consultants. The international consultants will have expertise in (i) transport policy, regulations, and legal issues for railways; (ii) transport economics, including fiscal planning and pricing; and (iii) railway transportation and management. The international consultants will be encouraged to use domestic consultants with expertise in (i) railway policy, regulations, and legal issues; (ii) transport economics; and (iii) railway transportation and management. Key activities will include review of the existing studies by MOR, the Government, other multilateral institutions; data analysis; and consultation with other stakeholders, including MOF, NDRC, and government officials. An overseas training program, a workshop, and a seminar will be organized to learn from experiences of other international railways, and to disseminate findings of the TA. The consultants will procure equipment in accordance with procedures acceptable to ADB. Appendix 2 gives terms of reference.

C. Cost and Financing

15. The cost of the TA is estimated at \$515,000 equivalent, comprised of \$325,000 in foreign exchange and \$190,000 equivalent in local currency (Appendix 3). ADB will provide \$400,000 to cover the entire foreign exchange cost and \$75,000 equivalent of local currency costs. ADB will finance the TA on a grant basis from ADB's TA funding program. MOR will provide the remaining \$115,000 equivalent in local currency for counterpart staff, office facilities, and support services.

D. Implementation Arrangements

16. MOR, as the Executing Agency (EA), will appoint suitable counterpart staff who will supervise and coordinate day-to-day TA activities, including monitoring of progress, resolving problems, arranging meetings, and liaising with concerned government agencies, including

MOF and NDRC. MOR and other appropriate ministries will provide policy guidance to the consultants. MOR and concerned ministries will meet to discuss the consultants' report at inception, interim, and final draft stages. A workshop and a seminar will be held to review findings at the interim and final stages of report preparation. Those meetings will include representatives of MOR, MOF, NDRC, other relevant agencies, ADB, and the consultants. A final report will be published when the TA ends.

17. The consultants are expected to begin work in July 2004 and to complete activities by January 2005. The Government and MOR have agreed to provide assistance required for TA implementation. MOR will make available to the consultants (i) all relevant reports, including rules and regulations, studies, and information required for TA implementation; (ii) offices and qualified counterpart staff; and (iii) other needed assistance, including liaison with the Government and local authorities.

IV. THE PRESIDENT'S DECISION

18. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$400,000 on a grant basis to the Government of the People's Republic of China for World Trade Organization-Policy Reform Support to the Ministry of Railways, and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

| Design Summary | Performance Indicators/Targets | Monitoring Mechanisms | Assumptions and Risks |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Goal</p> <p>To promote an efficient, reliable, and competitive railway transport system</p> | <ul style="list-style-type: none"> ▪ Review of operating data ▪ Operating ratio of less than 1 | <ul style="list-style-type: none"> ▪ People's Republic of China (PRC) railway statistics | |
| <p>Purpose</p> <p>To develop a policy reform plan to enhance the competitiveness of railway transport due to World Trade Organization (WTO) accession</p> | <ul style="list-style-type: none"> ▪ Increased traffic volumes <ul style="list-style-type: none"> (i) Freight-kilometer (ii) Passenger-kilometer ▪ Enhanced customer satisfaction | <ul style="list-style-type: none"> ▪ PRC railway statistics ▪ Reduced travel time | <p>Government commitment to development of railway infrastructure and reform of Ministry of Railways (MOR)</p> |
| <p>Outputs</p> <ul style="list-style-type: none"> ▪ Technical assistance (TA) study completed ▪ Enhanced management skills | <ul style="list-style-type: none"> ▪ TA report and recommendations submitted by January 2005 ▪ Training program completed by November 2004 ▪ Workshop after interim report in October 2004, and final draft report in December 2004 | <ul style="list-style-type: none"> ▪ Consultants' technical assistance completion report ▪ Asian Development Bank (ADB) and Government review of consultants' reports ▪ ADB mission report | <ul style="list-style-type: none"> ▪ Policy reform plan is consistent with the Tenth Five Year Plan and will have government support ▪ MOR is willing to adopt/adapt lessons learned from international experiences ▪ Government nominates qualified and competent staff |
| <p>Activities</p> <ul style="list-style-type: none"> ▪ TA inception ▪ TA interim review and workshop ▪ TA final review and seminar ▪ Training program | <ul style="list-style-type: none"> ▪ Starts July 2004, and is completed August 2004 ▪ Starts September 2004, and is completed October 2004 ▪ Starts December 2004, and is completed January 2005 ▪ November 2004 | <ul style="list-style-type: none"> ▪ TA consultants' inception, interim, and final reports ▪ ADB inception mission, interim review mission, and tripartite meeting | <ul style="list-style-type: none"> ▪ Coordinated inputs from Government ▪ Government and ADB monitor TA implementation closely |

| Design Summary | Performance Indicators/Targets | Monitoring Mechanisms | Assumptions and Risks |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Inputs</p> <ul style="list-style-type: none"> ▪ ADB consultants ▪ Training <ul style="list-style-type: none"> Overseas training program Workshops and seminar ▪ MOR counterpart funding ▪ Total funding | <p>ADB total: \$400,000</p> <ul style="list-style-type: none"> \$279,000 <ul style="list-style-type: none"> ▪ International, 14 person-months, ▪ Domestic, 12 person months \$35,000 \$17,000 \$115,000 \$515,000 | <ul style="list-style-type: none"> ▪ ADB's TA disbursement documents | <ul style="list-style-type: none"> ▪ Qualified consultants can be hired in a timely manner ▪ Good government cooperation and timely availability of counterpart staff ▪ Key officials are available, and can participate in study tour and workshops ▪ Counterpart funding is available in a timely manner |

ADB = Asian Development Bank, MOR = Ministry of Railways, PRC = People's Republic of China, TA = technical assistance.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. Objective

1. The objectives of the proposed technical assistance (TA) are (i) to help the Ministry of Railways (MOR) review the potential impacts of the People's Republic of China's (PRC) accession to the World Trade Organization (WTO), (ii) to assess MOR's preparedness to address those impacts, and (iii) to recommend actions and policy reform support needed to meet these challenges.

2. To achieve this objective, the TA will review the impacts of WTO accession on the PRC railway sector and examine (i) the existing management functions, and how to separate the enterprise and government functions; (ii) access to railway markets, including the PRC railway's current status in the transport market and the challenges due to competition and pricing; (iii) the differences and gap analysis between the current railway management function, including regulation, and methods based on WTO rules; and (iv) the suitability of laws and regulations for safety, access to railway markets, service quality, price, and investments. The study would capitalize on other railways' experiences with reforms. The PRC railway management would participate actively. The output will be a policy reform plan for MOR to implement.

B. Scope of Work

3. The consultants will:

- (i) Ascertain commitments that the PRC has made under WTO in the railway sector and related sectors. Review the actual and expected impact of WTO accession on the transport sector in general, and on railways in particular. Examine how WTO accession will affect the structure and performance of the railway transport industry and services, particularly examining effects on railway freight markets, warehousing, and freight forwarding to foreign partners and service providers.
- (ii) Review the regulatory changes brought about by WTO commitment in December 2001, which opens the railway sector to foreign investment in freight transport and other transport-related services. Review the regulations, domestic legal system, laws on investment, and nondiscrimination policies to enable service providers to recognize business opportunities.
- (iii) Research MOR's reform process, including relationships between the Government and MOR, and the 1991 Railway Law.
- (iv) Review the institutional framework and capacity for formulation and implementation of policies and regulations at the Government and MOR levels.
- (v) Review MOR's organizational structure. Examine alternate organizational structures for separation of enterprise and management functions, and compare their merits and faults. Recommend an appropriate regulatory and institutional framework and organizational structure.
- (vi) Review the status of railways in the PRC transport system, and identify major challenges facing MOR.
- (vii) Review the market demand for each transport mode in terms of competition and complementarities. Identify the strengths and weaknesses of railways in the transport market, and the complementarity of railways with other modes of transportation. Examine the potential of railways in the context of competition and cooperation, and how WTO accession will impact that potential. Suggest ways to consolidate market demand in the railway sector.

- (viii) Formulate commercial objectives of the railway, particularly emphasizing financial and operational performance indicators. Develop the necessary regulatory framework and a time-bound implementation plan to help MOR undertake commercial operations and improve efficiency.
- (ix) Review and analyze differences and gaps in current railway management functions, including regulation, and methods, based on WTO rules. Identify key weaknesses of management functions and recommend actions for further improvement.
- (x) Review current rules and regulations for railway safety, access to markets, service quality, pricing, and investments. Identify differences in international standards and MOR procedures.
- (xi) Review and assess current marketing policies and practices with particular emphasis on profit motivation, capacity to react to change, and ability to recognize shifts in market conditions. Identify areas for further improvement, considering WTO requirements. Recommend actions to improve marketing.
- (xii) Review policy reforms the Government has initiated to enhance the railway sector's core competencies. Rationalize the organizational structure to improve efficiency, commercialization, responsiveness to users, and private sector participation. Build on previous studies by relevant agencies such as MOR, Government, ADB, World Bank, and the Organization for Economic Co-operation and Development. Prepare action plans identifying short- and medium-term actions. Identify areas for further long-term studies.
- (xiii) Review the history of MOR's tariff reform and tariff studies by MOR and the World Bank. Examine current policies, considering WTO requirements.
- (xiv) Review lessons learned from the experiences of other countries on the impacts of WTO accession on the policies, regulations, industrial structures, and performances of their railway sectors. Arrange and implement overseas training for concerned government officials (the training program and participants selected will require ADB approval).
- (xv) Organize a workshop at the interim report stage to discuss findings, and a seminar at the draft final report stage to disseminate outcome of the work. That includes drafting a paper for publication, after ADB approval, summarizing key findings.

C. Reporting Requirements

4. The consultants will submit the following reports: (i) an inception report 3 weeks after services begin, (ii) an interim report after 12 weeks, (iii) a draft final report after 20 weeks, and (iv) a final report, including key findings and two pages of recommendations, after 6 months. Five copies of each report, in English and Chinese, will be provided to MOR; two copies each will go to the TA Division of the Ministry of Finance and the National Development and Reform Commission; and five copies, in English, will go to ADB. The final report will be edited for bilingual publication. All reports will be submitted both as hard copy and electronically.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

| Item | Foreign Exchange | Local Currency | Total Cost |
|--------------------------------------------------------|---------------------|-------------------|---------------|
| A. Asian Development Bank Financing^a | | | |
| 1. Consultants | | | |
| a. Remuneration and Per Diem | | | |
| i. International Consultants | 240.0 | 0.0 | 240.0 |
| ii. Domestic Consultants | 0.0 | 39.0 | 39.0 |
| b. International and Local Travel | 10.0 | 2.0 | 12.0 |
| c. Reports and Communications | 2.0 | 8.0 | 10.0 |
| 2. Equipment ^b | 5.0 | 0.0 | 5.0 |
| 3. Training, Seminars, and Conferences | 35.0 | 17.0 | 52.0 |
| 4. Miscellaneous Administrative and Support Costs | 0.0 | 2.0 | 2.0 |
| 5. Representatives for Contract Negotiations | 5.0 | 0.0 | 5.0 |
| 6. Contingencies | 28.0 | 7.0 | 35.0 |
| Subtotal (A) | 325.0 | 75.0 | 400.0 |
| B. Government Financing | | | |
| 1. Office Accommodation and Transport | 0.0 | 40.0 | 40.0 |
| 2. Remuneration and Per Diem of Counterpart Staff | 0.0 | 50.0 | 50.0 |
| 3. Others | 0.0 | 25.0 | 25.0 |
| Subtotal (B) | 0.0 | 115.0 | 115.0 |
| Total | 325.0 | 190.0 | 515.0 |

^a Financed by the Asian Development Bank's Technical Assistance Special Fund.

^b Includes computer hardware and software, photocopier, facsimile machine, and other equipment to be procured under the consultants' contracts. Ownership will be transferred to the Government upon completion of the technical assistance.

Source: Asian Development Bank estimates.