Country Assistance Program Evaluation

People's Republic of China

Independent Evaluation ADB
Country Assistance Program Evaluation
August 2015

People’s Republic of China

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Reference Number: CAP:PRC 2015-07
Independent Evaluation: CE-32
(i) In this report, “$” refers to US dollars.


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<tr>
<th>Director General</th>
<th>V. Thomas, Independent Evaluation Department (IED)</th>
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<tr>
<td>Director</td>
<td>B. Finlayson, Independent Evaluation Division 2, IED</td>
</tr>
<tr>
<td>Team leader</td>
<td>K. Thukral, Principal Evaluation Specialist, IED</td>
</tr>
<tr>
<td>Team members</td>
<td>N. Subramaniam, Principal Evaluation Specialist, IED</td>
</tr>
<tr>
<td></td>
<td>B. Graham, Senior Evaluation Specialist, IED</td>
</tr>
<tr>
<td></td>
<td>L. Hauck, Senior Evaluation Specialist, IED</td>
</tr>
<tr>
<td></td>
<td>M. Vijayaraghavan, Senior Evaluation Specialist, IED</td>
</tr>
<tr>
<td></td>
<td>K. Hewitt, Evaluation Specialist, IED</td>
</tr>
<tr>
<td></td>
<td>S. Palle Venkata, Evaluation Specialist, IED</td>
</tr>
<tr>
<td></td>
<td>L.N. Guevara, Evaluation Officer, IED</td>
</tr>
<tr>
<td></td>
<td>M. Fortu, Associate Evaluation Analyst, IED</td>
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### Abbreviations

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<thead>
<tr>
<th>Abbreviation</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<td>ADBI</td>
<td>Asian Development Bank Institute</td>
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<td>ANR</td>
<td>agriculture and natural resources</td>
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<td>CAPE</td>
<td>country assistance program evaluation</td>
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<td>CAREC</td>
<td>Central Asia Regional Economic Cooperation</td>
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<td>COBP</td>
<td>country operations business plan</td>
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<td>CPS</td>
<td>country partnership strategy</td>
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<td>CSP</td>
<td>country strategy and program</td>
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<td>DMF</td>
<td>design and monitoring framework</td>
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<td>EARD</td>
<td>East Asia Department</td>
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<td>EIRR</td>
<td>economic internal rate of return</td>
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<td>financial internal rate of return</td>
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<td>GDP</td>
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<td>GHG</td>
<td>greenhouse gas</td>
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<td>GMS</td>
<td>Greater Mekong Subregion</td>
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<td>HSP</td>
<td>health and social protection</td>
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<td>IED</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>KPS</td>
<td>knowledge products and services</td>
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<td>LIC</td>
<td>local investment corporation</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<td>NDRC</td>
<td>National Development and Reform Commission</td>
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<td>NSO</td>
<td>nonsovereign operations</td>
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<td>OCR</td>
<td>ordinary capital resources</td>
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<td>PCR</td>
<td>project completion report</td>
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<td>PPP</td>
<td>public–private partnership</td>
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<td>project preparatory technical assistance</td>
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<td>PRC</td>
<td>People’s Republic of China</td>
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<td>PRCF</td>
<td>Regional Cooperation and Poverty Reduction Fund</td>
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<td>PSM</td>
<td>public sector management</td>
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<td>PSOD</td>
<td>Private Sector Operations Department</td>
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<td>PVR</td>
<td>project completion report validation report</td>
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<td>RAMP</td>
<td>risk assessment and management plan</td>
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<td>regional cooperation and integration</td>
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<td>Regional Knowledge Sharing Initiative</td>
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<td>SMEs</td>
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<td>state-owned enterprises</td>
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<td>TA</td>
<td>technical assistance</td>
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<td>UMIC</td>
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<td>WACC</td>
<td>weighted average cost of capital</td>
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<td>World Bank Group</td>
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<td>WMIS</td>
<td>water and other municipal infrastructure and services</td>
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<td>XARR</td>
<td>extended annual review report</td>
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<td>XVR</td>
<td>extended annual review report validation report</td>
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</tbody>
</table>
Contents

Acknowledgements vii
Executive Summary ix
Management Response xxi
Chair’s Summary: Development Effectiveness Committee xxv

Chapter 1: Introduction 1
A. Objective 1
B. Approach 1
C. Limitations 2
D. Report Layout 3

Chapter 2: Country Context 4
A. Introduction 4
B. The People’s Republic of China Growth Phase 4
C. Development Challenges 9
D. Government Strategies 13

Chapter 3: ADB Strategies 17
A. Country Strategies 17
B. Relevant ADB Initiatives for the Future 22
C. On-the-Ground Presence 23
E. Other Key Development Partners’ Programs 25

Chapter 4: Programming and Portfolio 28
A. Country Programming 28
B. Portfolio under the Country Program 29
C. Subregional Cooperation Program 37

Chapter 5: ADB’s Value Addition in Economic Transformation 38
A. Factors Influencing ADB’s Value Addition 38
B. Value Addition in Meeting Strategic Objectives 40
C. Tracking Value Addition from ADB Support 44
D. Risk Mitigation 44

Chapter 6: Evaluation of Sovereign Operations 45
A. Relevance 46
B. Effectiveness 50
C. Efficiency 53
D. Sustainability 57
E. Development Impacts 59
F. Overview of Assessment Ratings 62

Chapter 7: Evaluation of Nonsovereign Operations 64
A. Evaluation 64
B. Conclusion 69
Chapter 8: Other Evaluations 70
A. ADB Performance 70
B. Performance of the Borrower, Executing Agencies, and Implementing Agencies 70
C. Regional Programs 71

Chapter 9: Outlook 73
A. Key Influences for the Future 73
B. Key Enablers for ADB 74
C. Suggestions for Development Cooperation 76

Appendix: List of Linked Documents 79

Supplementary Appendixes

1. Regrouping of Loans and Technical Assistance Projects for Sector and Thematic Assessments
2. Sector Assessment (Finance Sector)
3. Sector Assessment (Public Sector Management)
4. Sector Assessment (Social Sectors)
5. Transport Sector Data Analyses
Acknowledgements

This country assistance program evaluation (CAPE) is a product of the Independent Evaluation Department (IED) of the Asian Development Bank. The evaluation was led by Kapil Thukral. Team members included Benjamin Graham, Kelly Hewitt, Lauren Hauck, Maya Vijayaraghavan, Nathan Subramaniam, Srinivasan Palle Venkata, Lawrence Nelson Guevara, and Myrna Fortu.

Consultants engaged for the study were Alan Douglas Poole, Christine Wong, Denise Encarnacion, Gunter Hecker, Hong Miao, Langnan Chen, Li Mou, Liya Liu, Marie Gail de Sagon, Pengfei Xie, Ruel Janolino, Steve Tabor, Xiangming Fang, and Yingchun Lee.

We acknowledge the comments and inputs from external peer reviewers Deepak Bhattasali (formerly of the World Bank) and Yijiang Wang (Professor of Human Resource Management, University of Minnesota, on sabbatical to Cheong Kong School of Management, Beijing) on earlier drafts of the CAPE report. We also acknowledge comments from the internal peer reviewers Farzana Ahmed, Henrike Feig, and Toshiyuki Yokota. Christine Wong and Gunter Hecker provided significant inputs in drafting the CAPE report and addressing comments from peer reviewers.

Mission coordinators Wanjun Zhang, Jing Chi and Yuanyuan Tan played a critical role in arranging meetings and interviews for the CAPE team in Beijing and other provinces (Guangxi, Hunan, Inner Mongolia, Tianjin, Xinjiang, and Yunnan).

The team wishes to thank government officials and representatives of other development partners who participated in interviews as part of the collection of qualitative data to inform sector assessments and other background papers.

The team is grateful to Asian Development Bank’s Management and staff in Manila (in particular the East Asia Department) and the People’s Republic of China Resident Mission in Beijing who made themselves available for interviews, provided invaluable inputs, and facilitated field work. Their inputs and support helped strengthen the evidence base for the CAPE report. Nevertheless, IED remains fully responsible for the report.

The evaluation was conducted under the overall direction of Vinod Thomas and Bob Finlayson, and benefited from their inputs at every stage of the evaluation. The team acknowledges inputs provided from Hemamala Hettige and Walter Kolkma of the IED leadership team.

To the knowledge of the management of IED, there were no conflicts of interest of the persons preparing, reviewing, or approving this report.
Executive Summary

For more than three decades beginning in the early 1980s, the People's Republic of China (PRC) has experienced uninterrupted growth. By 2010, the PRC had been transformed into an upper middle-income country. It is now the world's second largest economy, the largest exporter of merchandise and the fifth largest exporter of commercial services. Massive development challenges have accumulated along the way, most notably related to governance and fiscal imbalances, environmental degradation, and social inequalities. The government has chosen to slow down growth and address these challenges. Difficult reforms are required across many dimensions, and as the International Monetary Fund has noted, for the PRC, the main risk is failure to implement reforms to address financial risks, rebalance the economy, and tap new sources of growth.

Asian Development Bank (ADB) is currently preparing its country strategy for the PRC for 2016–2020. The Independent Evaluation Department (IED) has evaluated the performance of ADB’s country strategies from 2006 to 2013, and noticed a strategic repositioning of ADB's support program as follows: (i) a reduced overall share of support for infrastructure sectors, with a corresponding increase mostly in the agriculture and natural resource (ANR) sector; (ii) diversified infrastructure sector support with a reduced share for transport; (iii) within the transport sector, a phase-out of support for expressways and a ramping-up of support for sustainable transport options, logistics and safety; (iv) an emphasis on innovations in the design of investment projects in ANR, energy, transport, and urban development; and (v) greater emphasis on knowledge support across all major areas of engagement.

This evaluation is intended to inform ADB’s decision on the type of support program it provides to the PRC during the 5 years to 2020. There are two key inter-related questions that need to be considered: (i) why might the PRC continue to seek ADB support; and (ii) why might ADB continue development cooperation with the PRC over the next 5 years?

Why the People's Republic of China Might Continue to Seek ADB Support?

The PRC’s interest in continuing a partnership with ADB is based on the experience of their partnership to date and the value addition it can provide in future, albeit with changes. Financing has been a part of this relationship, but increasingly policy interactions and knowledge exchange will be decisive. ADB’s development experience is useful to the PRC. The PRC is likely to seek continued collaboration, but its content and intensity will probably depend on the leveraging any financing would bring, and perhaps more importantly, the value addition from lessons of experience and innovations.

The PRC has achieved rapid economic growth since the early 1980s, fueled by investment in infrastructure and export-oriented manufacturing. The PRC has now nearly exhausted the potential for acquiring technology from abroad in many industrial segments. The demographic dividend is beginning to disappear and old age
dependency is increasing. Growth of total factor productivity has slowed during the 12th five-year plan period (2011–2015).

Rapid growth has also been associated with serious problems and daunting challenges. Social inequalities between urban and rural areas and between coastal and inland areas remain large despite government efforts to address them since the early to mid-2000s. The natural environment has been degraded enormously as a consequence of rapid industrialization, urbanization, and intensified agricultural production. The PRC’s contribution to carbon emissions and climate change has risen sharply. Institutional capacities have lagged behind the needs of a socialist market economy. Governance challenges remain and fiscal imbalances have increased following the stimulus package introduced in late 2008.

The Third Plenary Session of the 18th Central Committee of the Communist Party (Third Plenum) of November 2013 sought to introduce policies to effect comprehensive changes to the PRC’s growth model. It provided broad guidance for the introduction of structural reforms to redefine the relationship between government and the governed, and between government and the market. Markets are to be given a decisive role in resource allocation to increase labor and capital productivity, promote competition, reverse environmental degradation, and improve governance.

Although the Third Plenum resolution set a target date of 2020 for these reforms to be accomplished, there continues to be a lot of uncertainty about how they will be implemented. The government has chosen to reduce gross domestic product (GDP) growth targets to implement the comprehensive and deep reforms needed to change economic direction. It aims to achieve and maintain momentum in its reform drive and simultaneously to pursue economic growth.

Most importantly, productivity gains will be necessary to enable the government to pursue these objectives simultaneously and to ensure continued social harmony and stability and environmental sustainability. However, institutional capacities to undertake the reforms differ widely across the country, and the central government has limited capacity to monitor the implementation of reform measures at the provincial and local levels.

The national political will to undertake the reform program is not in doubt. But the task is enormous and complex. Social, environmental, institutional, fiscal, and other problems of a continental scale need to be addressed at the same time. The interlinkages among these reforms add to the challenge—as well as the opportunity. A key challenge is managing the high levels of local government debt. This has resulted from a reliance on extrabudgetary resources to finance investment in infrastructure and urban development, especially following the stimulus package of 2008. Local investment corporations were set up to coordinate and finance construction, and typically they relied upon bundled bank loans and the shadow banking system. The central government tolerated the rising systemic risks while GDP growth rates were high. In recent years, the government has estimated the scale of the problem, and believes risks from local debt are manageable. Clearly, debt management affects all other aspects of the reform program, and short-term concerns often stand in the way of reforms needed to achieve medium- and long-term objectives.

Many policy and supporting regulatory directions of the Third Plenum resolution propose reforms that appear to converge with generally accepted models of economic governance in developed countries. Some of these reforms are designed to
increase labor mobility by making changes to the residency registration (hukou) system; extending financial services to encourage investment in small and medium-sized non-state enterprises and to increase household consumption; improving the competitive environment for state-owned enterprises; improving the education and health care systems; cleaning and protecting the environment and efficiently utilizing natural resources; and strengthening governance and institutional capacities to provide public goods and services, including policies, rules and systems.

Within this agenda, the PRC perceives continuing value added from its relationship with ADB. Lessons and continued support to reduce poverty and social inequalities will contribute to programs to reduce the risk of social unrest and promote stability. The PRC is also experiencing severe ecological challenges, which ADB can help address in areas such as declining water resources, desertification, deforestation, acid rain, biodiversity loss, and climate change.

The starting point for such a comprehensive reform program is unique to the PRC. So the evolutionary path towards converging systems of governance will also be unique. The government recognizes the need to innovate and create new knowledge in economic, social, environmental and institutional dimensions. It treats innovation as a policy matter in the Third Plenum resolution, and knowledge as a factor of production at par with labor and capital. Despite the uniqueness of the program of reform envisaged, many of the issues the government will need to address have been experienced in other countries, and the PRC can benefit from examples of good international practice. The government has expressed its willingness to learn from the experience of other countries.

**Why ADB Might Continue Development Cooperation with the People's Republic of China?**

Just as a strengthened knowledge role by ADB would be useful to the PRC, the experience that ADB gathers in the PRC in coming years can be used by ADB in the support it offers to other countries in the Asia and Pacific region. ADB can share with these countries its experience in facilitating and brokering regional cooperation, supporting environmental protection, addressing climate change, and providing development support to lagging areas where poverty is most prevalent.

ADB’s role as an honest broker in fostering regional cooperation is likely to gain in importance as the PRC pursues its ambitious South–South cooperation agenda, which extends beyond ADB’s borrower countries. Neighboring countries are likely to value ADB’s involvement in their dealings with a strong economy such as the PRC.

The PRC is the world’s largest energy consumer and emitter of greenhouse gases. The government has committed itself to reducing carbon-dioxide emissions per unit of GDP from 2005 levels by 40%–45% by 2020, and to capping greenhouse gas emissions by 2030.

Soil, water and air pollution are adversely affecting the public well-being in myriad ways. The PRC’s ecological challenges have regional implications. Degraded grasslands lead to dust and sandstorms affecting its eastern neighbors. Industrial effluents are discharged into rivers that flow into open seas and affect marine life. Agricultural products treated with chemicals or that are unsafe for consumption pose risks to consumers within and outside the PRC. The international community will...
benefit from ADB’s support to the PRC as it takes measures to reduce these negative
global and regional spillovers.

Despite rapid economic growth, the PRC still has the second largest
concentration of people living in poverty—it is estimated that in the late 2000s there
were more than 150 million people living below the poverty line of $1.25 per day. The
poor are mainly located in more than 500 designated poverty counties in lagging
central and western provinces and in autonomous regions with significant ethnic
minority populations. Significant rural–urban disparities persist despite massive
government programs to address them over the past 10 years. Helping address these
issues falls squarely within ADB’s agenda.

**ADB’s Experience Working with the People's Republic of China**

This country assistance program evaluation (CAPE) is focused on assessing the
performance of ADB’s strategies and portfolio from 2006 to 2013 (the CAPE study
period). The portfolio during the study period helped achieve the objectives outlined in
the country partnership strategies (CPSs). The CPS objectives were in turn aligned with
the government’s development priorities as defined in the 11th and 12th five-year plan
periods. The PRC achieved high GDP growth rates during the study period. While there
was considerable progress improving access to basic public services, there was little
rebalancing away from industry towards services and consumption. Environmental
quality continued to deteriorate. Municipal governments came to rely on
extrabudgetary resources for infrastructure development. Reflecting these key
developments, ADB support began to move toward addressing environmental, social
and governance issues while the infrastructure focus was reduced.

**Portfolio Overview**

The total value of ADB’s portfolio of sovereign loans, grants and technical
assistance (TA) in the PRC during the study period was $13.3 billion, and it included
$171 million in TA. The sovereign portfolio mainly consisted of projects in the
infrastructure (85%) and ANR (14%) sectors. Infrastructure sectors included transport
(36%), urban development (32%) and energy (17%). This allocation was significantly
different from the portfolio mix during 1998–2005, when the transport sector alone
accounted for close to 70% of projects. Other significant changes in the sovereign
portfolio during the study period included a rise in the ANR sector share to 14% and
the beginning of lending operations in education.

ANR and the infrastructure sectors accounted for 72% of all TA support for
policy, advisory and capacity development in the PRC. Other non-infrastructure sectors
accounted for 28% of all TA support. TA support for public sector management (PSM)
was significantly higher than for the finance and education sectors, although these
sectors were among the core areas of operation under ADB’s Strategy 2020.

The value of the nonsovereign (including private sector) operations portfolio
was $4.1 billion and it is a result of strong collaboration between the East Asia
Department (EARD) and the Private Sector Operations Department (PSOD). The
nonsovereign portfolio included clean energy (56%), clean water (22%), and
sustainable transport (17%), reflecting ADB’s strategic priorities and the strengthened
enabling environment for the private sector in these sectors.
ADB supported the PRC under the Central Asia Regional Economic Cooperation (CAREC) and Greater Mekong Subregion (GMS) programs. The PRC is both a beneficiary of and a contributor to these regional programs.

ADB’s knowledge products and services (KPS) included policy notes it prepared at the request of the government. Some knowledge products were based on TA projects. Others were prepared by EARD and other ADB knowledge units. ADB and Ministry of Finance (MOF) jointly framed a knowledge-sharing platform strategy in 2009, and a regional knowledge sharing initiative and several thematic knowledge hubs were established.


The CPSs closely followed the recommendations of the previous CAPE in 2007. ADB’s sovereign portfolio was diversified to support a large number of sectors and subsectors, and to focus on supporting the lagging provinces of the central and western PRC. Nonsovereign (including private sector) operations showed a generally rising trend. Lending and nonlending operations provided important value additions to meet the CPS objectives.

The country program is rated successful. This overall assessment and its components look at relatively static aspects of past performance within standard criteria. There are considerable differences within this overall result across projects and room for improvement. Moreover, the discussion shows that the future is not best addressed by repeating the previous experience, even if it was rated successful.

The program was relevant, reflecting the government’s ownership of the country program. It was effective, as many ADB interventions achieved their targets and provided value addition through demonstration effects and policy support. The program was efficient, as with a few exceptions, ADB’s loans achieved required rates of economic returns. The program is likely sustainable, given government commitment to reforming public financial management, regulating shadow banking activity, improving sustainability of asset management, subsidizing public goods, and meeting shortfalls in cost recovery for public services. However, the poor fiscal situation of provincial and municipal governments remains a concern. Development impacts were rated satisfactory, as the CPS objectives and priorities are being achieved—although precise project-specific development impacts (such as the extent to which good practices were internalized, or policy was implemented across the country) are difficult to ascertain.

The PRC Government contributed to meeting CPS objectives, while ADB remained flexible and responsive to the PRC needs. ADB’s sovereign portfolio was based on a list of candidate loan and TA projects provided by the government each year. The candidate projects broadly conformed with the CPS objectives, and continued relevance was built into the country programming process. ADB appreciated the importance of being responsive to the PRC’s needs as they emerged over time. It recognized the uncertainty in the scope and the pace of reforms, and this was reflected explicitly in CPS 2011–2015.

ADB increased its focus on providing knowledge and introducing innovation. The need for flexibility during the study period made it difficult for ADB to focus on a smaller number of sectors, while the relatively small scale of ADB’s operations made it difficult to maintain continuity across all areas of engagement. Given these circumstances, ADB began to be selective within each sector, with a view to focusing
on innovation and value-addition. This value-adding support was provided through loans, TA projects, and KPS that were in line with the PRC's economic transition objectives and with its South–South cooperation agenda.

**ADB offers a wide range of knowledge products and services to the PRC, but their benefits are generally not known.** ADB’s KPS contributed to all of the CPS objectives and various areas of reform in the PRC. ADB is not in a position to track policy-making processes or to monitor the extent its knowledge publications were useful to the PRC agencies. Since 2010, EARD has spearheaded the creation of knowledge sharing hubs and platforms, but it is too early to gauge their benefits.

**The country programming process for TA projects has become more participatory in recent years and this has potentially increased the scope for value addition.** ADB instituted an arrangement in 2013 to make the country programming process more participatory for TA projects. A TA workshop with central and local government officials, executing and implementing agencies, academics and think-tanks now precedes the country programming mission. An envelope of candidate TA projects is discussed at the TA workshop. Following the TA workshop in 2014, proposing agencies are required to identify the knowledge gaps the proposed TA projects will address and the expected value addition of the proposed TA. At the TA workshop in 2015, it was agreed that third-party vetting of TA proposals would be required before consultation with ADB.

**A participatory approach in the design of loan projects can add value by supporting innovative project designs.** With the institution of a workshop in 2012 to discuss newly introduced projects in the pipeline for ADB loan support, there is increased likelihood that ADB can influence project design before agencies complete the feasibility study. Before 2012, ADB made significant value addition to some infrastructure projects, although for most projects its contribution was to expand the original scope to include features covering safety, social inclusiveness and/or a green approach. In the case of ANR projects, new knowledge and grant resources available internationally, coupled with poor institutional capacities in the PRC, made it possible for ADB to contribute significantly to project design. ADB made significant contributions to project design where it supported (i) loans with capacity development components that helped executing and implementing agencies meet certain needs; (ii) TA projects with the objective of broadly outlining investment projects that had high levels of innovation; and (iii) mutually reinforcing clusters of loans and TA projects that were used to support innovative project designs. In all loan projects, ADB has contributed by comprehensively addressing environmental and social safeguards.

**The ADB loan portfolio was effective in achieving targeted outputs and outcomes.** Of the 89 loans approved during the study period, 20 had closed by February 2015. Completed energy, transport and urban development projects met or exceeded expectations. Investigations did not reveal any evidence that a significant number of ongoing projects will turn out to be less than effective. Corrective actions were initiated in a project where the technical design of one of the project components required improvements.

**The effectiveness of technical assistance needs to improve.** The government and executing agencies appreciated the TA support that was provided for policy development across all sectors of ADB engagement. Although it is difficult to establish a direct link between TA outputs and government policy, it is likely that high-quality TA outputs directly informed and influenced policy. ADB’s value-added contributions were
sourced from international consultants, but executing agencies at all levels of
government felt the benefits such consultants provide could increase substantially if
they are familiar with the context and circumstances, and they are required to devote
less time to reporting and more to planning, strategizing, and developing innovative
programs of support based on perspectives provided by good international practices.

The PRC counterparts appreciated the added flexibility provided by facility TA. Unlike traditional TA projects which are approved with a well-defined scope of work, a facility TA allows the scope of a proportion of subprojects to be defined at a later date. The government appreciated the flexibility this allowed; and the fact that subprojects (under the umbrella of the facility’s approval) could be approved relatively quickly. The effectiveness of facility TA could be improved if consultant procurement time frames were shortened and if ADB could assign adequate staff to work simultaneously on multiple subprojects at various stages of the subproject cycle (design, processing, implementation, and monitoring of outputs and outcomes).

The ADB portfolio is efficient overall but there were delays in the implementation of many loan and TA projects. Loan project implementation was often delayed on account of land acquisition problems, or the need to coordinate some subprojects with activities undertaken by other development agencies. Most policy advisory and capacity development TA projects experienced significant delays for reasons that can be attributed to either one or all of the stakeholders involved in implementing the TA: ADB, the counterpart agencies, and the consultants. Cost overruns were often associated with time overruns, and in recent years, the lack of timely availability of additional counterpart funds has contributed to these delays, or even to the cancellation of some subprojects. This is consistent with the fiscal deficits experienced by many local governments in recent years. Economic internal rates of return remained above the threshold for all completed loan projects, and are projected to remain above the threshold for all but one ongoing project.

Financial sustainability is an important concern for many loan projects in the portfolio. The government’s development priorities and high level of project ownership have contributed to the sustainability of the ADB portfolio. Although the financial viability of all loan projects was established upfront and reaffirmed at closing for completed projects, the attractive financial rates of return computations for many projects assumed the continued availability of government financial (subsidy) support. Many ongoing loan projects will require continued government support to remain viable. Financial sustainability is likely to improve with government moves to encourage private participation in public utility projects.

Lack of continuity made it difficult for loan project clients to internalize good international practices. ADB extended loans in 26 provinces that included all provinces in the central region and all but one in the western region. Even in the same province, the client executing and implementing agencies were often different parties for projects in the same sector, particularly for urban development projects. As a result, it was difficult for ADB to monitor progress on the internalization of good international practices on procurement and safeguard systems.

Positive development impacts have accumulated but it will be important to assess the extent of unintended and undesirable impacts. It is difficult to assess the development impacts of lending and nonlending operations. ADB has not tracked the extent ADB-supported infrastructure projects have contributed to extensive urbanization (urban sprawl) and their reliance on easily procured land. The absence of a
government mechanism to monitor progress in implementing policy or internalizing new knowledge across provinces makes it difficult to assess the development impacts of TA and knowledge support. The ownership of concerned government agencies, and the consistency between CPS objectives, government reform priorities and the design of interventions are positives, but unintended and undesirable impacts must be weighed as well.

**ADB’s PSM and governance support can be strengthened with better diagnostics and programming instruments.** The PSM and governance focus in ADB’s country strategies and operations has responded to (i) the evolving the PRC policy and development landscape; and (ii) ADB’s own institutional evolution and the growing focus on mainstreaming of governance, knowledge work and capacity development. Over time this support has been spread thinly over many areas, although many TA projects provided appropriate support for public financial management and provincial economic planning processes. In addition to undertaking sector-level governance risk assessments, as prescribed under ADB’s Second Governance and Anti-Corruption Action Plan, a stand-alone PSM sector assessment and road map would help to sharpen ADB’s support in this critical area for the next CPS period.

**Nonsovereign operations have greatly increased and demonstrated value addition.** Collaboration between EARD and PSOD has helped to ensure that PSOD can capitalize on EARD’s work, and that EARD is aware of and able to promote PSOD’s work. Most PSOD projects that built on EARD’s assistance to strengthen the enabling environment for the private sector have performed well, although policy changes affected some projects in the PSOD portfolio. PSOD’s value addition to private sector operations was derived from: developing financial structures to finance many small public–private partnership projects; enhancing corporate governance and safeguard practices; promoting environmental sustainability, local currency financing, direct value-added cofinancing through B loans and other mechanisms; and contributing to banking sector reforms. A small number of PSOD staff are managing the PRC transactions. While operational risks have been successfully managed to date, spreading limited staff resources thinly over a continuously growing portfolio is not a sustainable long-term approach.

**ADB has supported regional cooperation but results need to improve.** The PRC is a beneficiary of many regional TA projects under the ADB country program and two regional cooperation programs (CAREC and GMS). The government has contributed financially to the CAREC and GMS programs by setting up a fund to support regional TA projects. ADB and the PRC have cofinanced two investment projects in the GMS area. ADB is recognized for its role in facilitating a dialogue and building consensus among its member countries to push forward the regional cooperation agenda. Greater synergies within ADB among the principals connecting these regional programs would help strengthen results.

**ADB’s on-the-ground presence has grown in recent years, yet the staff complement in the PRC resident mission remains half of the staff resource levels of EARD at headquarters.** The PRC Resident Mission has been strengthened over the past 5 years, reflecting the need for ADB to engage closely with the government on a large number of issues, and to manage a large portfolio. Specialists in public–private partnerships, transport, procurement, legal matters, and knowledge sharing have been out-posted from ADB headquarters. Two international staff and several national staff have been recruited locally. The resident mission’s total staff complement (including
Suggestons for Future Development Cooperation

The PRC’s rising financial strength has become increasingly evident in recent years. The PRC is a donor to the Asian Development Fund, has set up the Regional Cooperation and Poverty Reduction Fund (the PRCF), and has announced a $40 billion Silk Road Fund, a $3 billion aid package to GMS member countries, and a $46 billion package of assistance to Pakistan. It has the world’s largest foreign exchange reserves. Additionally, the PRC has spearheaded the establishment of two new multilateral development banks.

The PRC’s annual investments in fixed assets have exceeded $4 trillion per year since 2011 and they are several thousand times larger than ADB’s support. Yet the PRC can still derive benefit from ADB’s support in the coming years and so can ADB.

Key Enablers for ADB

ADB appreciates that knowledge and innovation will be key elements of its support to the PRC as it implements reforms across many dimensions, raises factor productivity, and pursues its South–South cooperation agenda. ADB recognizes that it needs to provide a certain level of financial support if it is to wield influence on the PRC’s development.

In order to sharpen its focus on brokering and creating knowledge and making innovative interventions, ADB will need to manage associated risks, broaden the scope of its high-level policy dialogue with the government, accelerate the implementation of the “One ADB” approach, and deploy adequate staff resources.

Risk management. To the extent ADB supports knowledge-intensive and value-adding innovative interventions, it will need to consider the risk of being less successful more often and make a greater effort upfront to understand the specific context and requirements of each intervention. For loan projects, ADB will need to consider and manage the risks associated with the development of the innovative project designs it proposes. For TA projects, ADB will need to have a good understanding of the critical success factors of the good international practices it promotes as well as the PRC’s institutional capacities, organizational cultures and other contextual factors.

Policy dialogue. ADB must broaden the scope of its high-level policy dialogue with the PRC Government so it is in a position to deploy a range of instruments and modalities that are suitable for different purposes. For example, results-based lending can help set up or build on existing monitoring systems for government programs that comprise investment with minor or no safeguard implications. Policy-based lending can provide policy and regulatory support to address issues that are sufficiently well-defined. TA loans can use ordinary capital resources (OCR) for TA support and to augment limited TA resources. ADB can consider conducting policy dialogue with the PRC and other upper middle-income country (UMIC) governments on using OCR funds for reimbursable TA.

“One ADB” approach. Given the need to deliver high-quality knowledge products and services in a timely manner, ADB needs to continue to explore approaches that optimally utilize its staff knowledge, and improve coordination and
communication among EARD, the other knowledge departments, and the ADB Institute. The “One ADB” approach is designed to achieve these objectives; it was pioneered by EARD for the PRC and it needs to be accelerated there. A CPS knowledge management plan for 2016–2020 could provide the broad contours of a “One ADB” pilot program.

**Staffing.** The need to manage a portfolio that is knowledge-intensive and has high innovation content will require EARD and PSOD to be resourced commensurately. Sufficient staff with sector and or thematic expertise will need to be allocated for this work.

**Suggested Areas for Development Cooperation**

Two elements will be key to the ADB–PRC partnership in coming years: (i) making improvements based on past experience; and (ii) shifting the focus, even if past interventions have been successful, in response to changing needs. The cooperation program may need to look very different from that of the past. ADB has experience in making changes. For example, in line with changing the PRC needs, ADB began increasing support for the agriculture, natural resources, and social sectors in the mid-2000s, although its support since the 1990s had been focused on physical infrastructure development. In future, such shifts need to be far stronger and more decisive.

*Strengthen the role of ADB as an honest broker in fostering cooperation within CAREC and the GMS and in the PRC’s relations with other ADB members.* This role is likely to become more important as the Silk Road Fund and other PRC-aid packages bring in more connectivity infrastructure. ADB will have the opportunity to leverage its own resources by partnering with the PRC to cofinance connectivity infrastructure and other cross-border investments. This will likely make ADB’s honest broker role more challenging, although the CAREC, GMS and other countries in the Asia and Pacific region would be more likely to rely on ADB in dealing with an unequal partner such as the PRC. ADB would need to continue to be selective in facilitating projects and programs that clearly show poverty reduction benefits, pollution control, climate change, and other regional public goods benefits in the concerned CAREC, GMS and other ADB borrower countries.

*Vastly increase support for addressing climate change and protecting the environment.* ADB’s memoranda of understanding with the government on environmental protection and addressing climate change provide a good basis for continued cooperation in these areas. In consultation with the government, ADB can identify certain well-defined areas where it can make visible contributions to the government’s programs. This will require a mix of activities that, when combined, can demonstrate ways of achieving an inherently clean, resource efficient and/or climate-friendly growth path. For example, ADB can work toward demonstrating the following: (i) air and water quality improvement in a selected city, and/or (ii) reducing negative regional spillovers caused by discharge of industrial effluents into a river that ultimately flows into the open sea; and/or (iii) supporting the establishment of a national carbon emission trading regime.
Focus on reducing social inequalities and poverty. ADB can support these objectives at three levels.

(i) In line with the government’s approach to reducing inequalities faced by the population in the countryside, ADB can support infrastructure investment, along with measures to increase access to finance and to affordable utility and social services.

(ii) In designated poverty counties, mostly in central and western provinces, ADB can design and support pilot projects to integrate development-oriented poverty reduction programs with subsistence support, and help establish systems to enable government programs to improve targeting of poor households.

(iii) In urban areas, ADB can support the government in addressing issues that have arisen because of the residency registration system, such as providing migrants with equitable access to affordable and reliable public utility services, and equitable access to social services, including education and healthcare.

Support tracking the implementation of the reform program. The government acknowledges it lacks a system to gauge the extent to which the central government’s reform initiatives are followed and implemented at provincial and local levels. Through a mix of TA and loan support (including the results-based lending modality), ADB can help establish and/or build upon existing monitoring systems.

Intensify support for public sector management. Given the importance of fiscal management and capacity building at provincial and local levels in the ongoing reform program, ADB needs to remain focused on these two PSM areas. It can articulate this requirement formally in a PSM sector assessment, strategy and road map to provide clarity on the extent, modality and provincial coverage of PSM support, and the likely results.

Continue PSOD’s private sector finance and EARD’s policy dialogue. Total factor productivity for non-state enterprises has grown faster than that for state-owned enterprises, which provides a good rationale for ADB to continue nonsovereign and private sector operations in the PRC. For the continued growth and success of ADB’s operations, it needs to consider (i) strategically engaging with the government through EARD on high-level policy matters to strengthen the enabling environment required to sustain private sector development; (ii) continuing to monitor market conditions for the issuance of local currency bonds, with ADB acting as either an onshore or an offshore borrower; (iii) continuing to monitor the yuan internationalization program with the objective of launching local currency complementary loans; (iv) targeting strategic equity investments in companies and financial institutions, subject to the availability of qualified ADB staff dedicated to managing them; and (v) targeting equity investments through funds in order to contribute to the achievement of ADB’s development objectives in the PRC.
Management Response

On 7 September 2015, the Director General, Independent Evaluation Department, received the following response from the Managing Director General on behalf of the Management:

1. Management appreciates the Country Assistance Program Evaluation (CAPE) for the People’s Republic of China (PRC). Sovereign and nonsovereign programs in the PRC are rated “successful”, and the evaluation further suggests that operations/interventions provided significant innovation and value addition. This is encouraging.

2. Management’s response focuses on the six areas of development cooperation suggested by the CAPE.

   a. **Strengthen the role of ADB as an honest broker in fostering cooperation within CAREC and the GMS and in the PRC’s relations with other ADB members.** *Management agrees.* ADB has been facilitating regional cooperation activities for many years under both these subregional programs. The interventions covered physical connectivity, trade and investment facilitation, and the promotion of regional public goods. PRC has been an active and constructive member of both programs. Recognizing PRC’s and other countries’ (e.g., South Korea and Japan) intentions to substantially enhance infrastructure investment in the region, ADB will try to promote these subregional programs as effective platforms to further engage PRC and other countries to deepen cooperation across relevant areas. A new regional economic cooperation and integration operational plan is under preparation within ADB. This is expected to serve as the basis for coordinating the programs, and financing more regional cooperation activities in both subregions.

   b. **Vastly increase support for addressing climate change and protecting the environment.** *Management agrees.* This agreement comes with two provisos. The first is that Management will retain flexibility in terms of the type and nature of interventions. The examples given in the report are interesting possibilities, but may not necessarily be the ones ultimately adopted. The second relates to the term “vastly”. While a major strategic priority of the new Country Partnership Strategy 2016-2020 currently under preparation is indeed to support the PRC efforts to realize an “ecological civilization” through environmental sustainability and pollution control, as well as mitigation of and adaptation to climate change, the proportion of such assistance in the overall program is something to be determined through discussions with the government and not something ADB can unilaterally decide. Besides, the term “vastly” is highly subjective. With these caveats, ADB is working closely with the PRC authorities to develop a work program.

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1 Specific examples will not be reported in the Management Action Record System.
to implement the initiatives under the memoranda of understanding with the Ministry of Environmental Protection on environmental protection, and with the National Development and Reform Commission on climate change with strong intention/desire to substantially increase our assistance program in these areas.

c. **Focus on reducing social inequalities and poverty.** *Management agrees.* This agreement applies mainly to the direction and spirit of the recommendation. It does not imply acceptance of the suggested means. ADB will support the areas in which the government seeks ADB assistance. ADB hopes to continue or even expand assistance to address the types of inequalities where ADB has a comparative advantage and can be effective, in consultation with the government. To reduce inequalities in the PRC, ADB intends to support (i) infrastructure investment (e.g., clean water and sanitation, flood mitigation, and connectivity) in urban and rural areas; (ii) education programs, particularly TVET and higher education policy; (iii) access to affordable social services (e.g., elderly care) for the poor; and (iv) expansion of financial services for agricultural modernization and value chain development in rural areas. To directly support the efforts to reduce poverty, ADB intends to promote productivity, market connectivity, food safety, and climate resilience to address obstacles to rural development in the poverty counties.

d. **Support tracking the implementation of the reform program.** *Management disagrees.* The government has not requested ADB to track reform progress, which includes many areas falling outside ADB’s sectoral and geographic scope of operations in the PRC. The Third Plenum reform agenda aims to promote modernization of the national governance system and capacity, together with systematic, integrated and coordinated socioeconomic development and environment protection. While a template for reform implementation has been issued by the government, tracking its progress will be challenging. Notwithstanding the difficulties, ADB will continue to closely follow the government’s reform implementation progress in the areas of its operations, and support it through sector work and policy dialogue.

e. **Intensify support for public sector management.** *Management agrees.* This agreement is contingent on the government wishing to have ADB involved in this area, and does not imply acceptance of the means specified in the report. ADB has already conducted relevant assessments and published several reports on the subject, including “Money Matters,” and “Local Government Public Sector Management—Challenges and Opportunities.” ADB has also assisted the Ministry of Finance in preparing medium-to long-term fiscal reform road maps. Indeed under the new CPS currently under preparation, ADB intends to continue providing support in areas where the Government seeks assistance and ADB has comparative advantage. Yet, this is a delicate field, and careful discussion is needed with the authorities before any specific intervention can be included in the final business plan.
f. **Continue PSOD’s private sector finance and EARD’s policy dialogue.**  
*Management agrees.* This agreement applies to the principle of the recommendation, and not to the list of prescriptions in the report. The type of interventions must be flexible and in line with market conditions. ADB certainly intends to expand private sector (nonrecourse) operations in PRC. However, this strategy could be easily affected by country and transaction risk limits. With respect to policy dialogue, we expect to further expand and deepen it, at several levels. One of the goals is to strengthen the enabling environment for private sector participation. With respect to local currency bond issuance, ADB will closely monitor market developments and explore new opportunities to expand ADB’s local currency lending through offshore CNY bonds, as well as onshore complementary loan syndications. With respect to equity investment in companies and financial institutions, PSOD has achieved a high financial return in such operations and contributed to their growth, as well as to their corporate governance and safeguard practices. Further growth in this area requires more resources. With respect to private equity funds, although the performance of largely sector specific PRC-focused funds was mixed, more diversified funds performed better. The quality of fund managers also matters. As part of its recent efforts to strengthen ADB’s private equity business, PSOD has developed a new business strategy to enhance both financial returns and development impacts; and to improve fund investment results and operational efficiency.
Chair’s Summary: 
Development Effectiveness Committee

The Development Effectiveness Committee considered the Independent Evaluation Department report, Country Assistance Program Evaluation for the People's Republic of China (IN. 279-15) on 14 September 2015. The following is the Chair’s summary of the Committee discussion:

1. IED informed that the CAPE evaluated the performance of ADB’s country strategies from 2006 to 2013. Recognizing that opportunities and challenges are huge, IED proposed 6 recommendations based on its findings, changing needs of the PRC, and where ADB can add value. There had been extensive interactions and sharing of knowledge on PRC operations between IED Team, staff and Management during the preparation process.

2. DEC members commended IED’s positive and thorough evaluation. They highlighted that it is encouraging that ADB can still add substantial value in the PRC. They commented that it is the right timing for important discussions on how ADB can continue to deepen its partnership with PRC and maximize the development impact. They welcomed the strong cooperation between EARD and PSOD in PRC which can be viewed as a good example for other departments in ADB. DEC members agreed that the CAPE should serve as a valuable input in preparing the new Country Partnership Strategy (CPS).

3. **ADB relevance in PRC for the future**, DEC members noted that many ongoing loans are designed with innovative features (para. 145). They also welcomed ADB’s value addition in terms of using its procurement and safeguards policies for projects including where ADB’s financing is less than 5% of the total project cost. One DEC member noted that there are other projects where ADB has limited value addition (paras.138-139) and inquired whether ADB’s value addition was only limited to safeguard policies during project implementation. Staff provided good examples where ADB had contributed in achieving significant impact even when financing is small; for example, ADB’s investment in the energy sector was about 0.2% of total PRC investment but it helped reduce CO2 emissions by 3.5%.

4. **Main focus of future strategy.** DEC members commented that given the PRC’s size, ADB financing should be more focused. They agreed with IED’s recommendations to focus more on: (i) reducing poverty and inequality; (ii) addressing climate change and protecting environment; and (iii) fostering regional cooperation. However, on these broad areas of focus ADB could be more selective of sectors where it has comparative advantage and can have a demonstration impact or make a systemic difference. Although ADB’s financing package is small in relation to the size of PRC’s economy, ADB could try to find crucial reform issues that it could support but should also be
realistic with the impact of such support. Staff clarified that ADB can make a significant difference in sectors such as climate change. On poverty reduction issues, Staff mentioned that many ADB projects address infrastructure gaps at the cusp of rural-urban areas and they attempt to narrow rural-urban service delivery in accordance with the government’s objective of harmonious rural-urban development. In fact ADB is a pioneer in working with the private sector in developing water supply and waste water treatment projects as well as waste to energy projects with the private sector in these areas. ADB has and will continue to provide policy advice (for example on establishing a progressive and more equitable taxation system) on remaining poverty issues that limited project lending from ADB cannot resolve. ADB recognizes that in some respects, reforms may make the poor more vulnerable in the absence of fully developed institutions for managing social vulnerabilities. ADB will continue to work with PRC in establishing or strengthening such institutions and systems. Over the last few years ADB conducted advisory work at the macro level in PRC, such as strengthening of its social security system, redistribution of work, and streamlining taxation, among others, which had laid a solid foundation to continue productive dialogue with the authorities on future interventions.

One DEC member inquired on the extent of the consultation process on strategy and pipeline, as the CAPE contains different messages in this regard. Staff responded that consultation with the authorities are conducted at a very early stage of project selection, allowing the Bank to have a genuine choice regarding the main focus of its operations, as well as having a strong impact on the project and program design.

5. Monitoring IED’s recommendations. A DEC member inquired if IED’s recommendations are measurable and whether monitoring of these recommendations can be valuable. He urged IED and Management to consider drafting future recommendations from the compliance point of view. He opined that the phrasing of CAPE’s first and second recommendations were too broad. Follow up on these recommendations would not be feasible in the absence of clear indicators. In his view the second recommendation which says that ADB should “vastly increase support to address climate change…” is vague and subjective. He inquired whether “vastly increasing” financing in one area would mean scaling back in other areas given the limited resource envelope. The DEC Chair pointed out that given the size of PRC’s economy, IED’s recommendations should have been broader and more strategic. IED clarified that word “vastly increase” was used to emphasize the need to make substantial increase in support for managing climate change and environmental protection. Staff further clarified that measuring success in implementing IED’s recommendation may be difficult. For example, the CAREC initiative is to foster regional cooperation, but due to many factors, including some geopolitical factors, it would be difficult to attribute ADB’s contribution. As to the tracking of the reforms, the whole reform package involves many areas in which ADB is not involved. Staff tracks the progress in sectors where ADB is engaged in through regular policy dialogue. As the reforms are implemented through regulatory changes, PRCM monitors and reports on such development through the PRCM internal publication “New Legislation” which is shared widely within ADB.

6. Right modalities. One DEC member expressed skepticism that ADB can achieve something visible and make a real impact in PRC if policy-based lending (PBL) is used. In his view, some reform issues could be more suitably assisted via results-based lending (RBL) instead of PBL. DEC Chair commented that with PBL, ADB could encourage PRC Government to deepen reforms. Through the right reform packages the value addition of ADB could be well justified as a simple project financing may not be sufficient to
address the critical mass of the planned reform measures. PBL can be viewed as an opportunity to enhance ADB’s relevance. Staff clarified that the inclusion of PBL in the new CPS signifies PRC’s interest to deepen and broaden reforms to create new engines for growth. The Government invited not only ADB but also the World Bank to put together solid and implementable reform packages. KfW expressed an interest to cofinance with ADB the first PBL. For this first PBL, staff intends to identify clear investment needs of the agreed upon policy actions and support it with a financial package covering about 10% of the total program cost. Staff intend to present the scope of this PBL with key reform features during an Informal Board Seminar in October 2015. ADB is also in dialogue with the Government how to monitor and track use of ADB’s financial resources under the proposed PBL for specific investments (e.g. improve air quality by reducing air pollution and greenhouse emissions) as well under future PBLs and RBLs in general.

7. **Taking up learned lessons.** The CAPE provided good lessons, such as focusing on clustering ADB’s operations and designing projects through participatory approach. One DEC member commented on IED’s observations regarding delays and the slow pace of TA project implementation but preferred to see IED’s recommendation based on the lessons learned in avoiding further delays. DEC Chair regretfully noted that the CAPE did not adequately cover an evaluation of ADB’s knowledge cooperation with the PRC. He mentioned that IED had an excellent study on evaluating knowledge in 2013 and urged IED to include specific section on this matter in future CAPEs, in particular for middle-income countries. He inquired if IED intends to study how ADB could better use the existing knowledge hubs. Staff clarified that ADB’s share in financing of a project often is 30% or less. The reason for ADB’s participation in a project is mainly due to innovation and value addition and knowledge elements that ADB brings. The screening of projects and their selection go through several stages within the Government. Then, ADB jointly with the Government refines the projects list further to align them with ADB’s strategy. IED clarified that it only evaluated the system of knowledge products and services but not their content. The number of knowledge materials concerning PRC is huge and current IED resources are insufficient to evaluate their content exhaustively. IED only reviewed policy notes prepared by ADB at the request of the Government, and noted that they are used as food for thought by Government in policy-making. The established knowledge hubs have not yet evolved into centers of excellence, and the issue of sustaining ADB-supported knowledge hubs after the closure of ADB technical assistance support remains to be addressed. Although the broad mandate and objective of the regional knowledge sharing initiative (RKSI) is to share development knowledge and experience among countries, the mechanism for realizing this mandate is not yet clear, and that ADB would need to consult with the PRC government on this matter. IED observed that as the knowledge hubs evolve into centers of excellence, the RKSI would provide a good platform for knowledge exchange among countries in the region.

8. **Sources of IED’s findings.** Chair, DEC commented that CAPE is an official document but has some references from unofficial sources which may not show a true picture on the ground. He urged IED to use primary sources, mainly ADB’s own and DMCs’ official sources instead of quoting articles from newspapers. IED clarified that due to lack of official sources it used unofficial sources for references on recent events which took place less than 6 months ago (e.g. formal announcement of Silk Road Fund and aid package for Greater Mekong Sub region and Pakistan).

9. **Staffing in PRCM.** DEC welcomed Management’s recent efforts to outpost several staff. Deepening sector dialogue would only be possible by expanding PRCM’s
expertise with adequate number of staff. They noted that part of the success of Private Sector Operation Department’s operations in PRC is associated with its hardworking, competent and passionate staff in resident mission. Most of them speak Mandarin which helps their communication with counterparts. ADB has 1/10 of IFC’s staff in PRC for processing non-sovereign operations. Notwithstanding this, PSOD’s operations constitute about 70% in volume of IFC’s operations. PSOD staff has been also engaged in bringing good corporate governance practices. DEC members welcomed the Management’s intention to increase PSOD staff presence in the field, to ensure the sustainability of high levels of performance.

10. DEC members noted and also commented on the following issues:

(i) Cost and time overruns. Several projects in PRC experienced cost overruns. Some projects, mainly in agriculture sector, were implemented with delays of 1 year or more. DEC urged staff to be vigilant especially during the design stage of future projects bearing in mind that capacity of executing agencies in rural areas might be weaker in comparison to the earlier established EAs;

(ii) Speed of project processing. Many PRC projects are processed at slower pace than that prescribed by the Midterm Review action plan. Although this may be attributed to more thorough preparation, DEC urged staff to take necessary actions to improve the speed of processing projects;

(iii) Rural vs. urban areas of focus. The Board will consider the new CPS in Q1 2016 and will discuss among others the issue of urban-rural integration: how this will be carried in a harmonious way with focus on better service provisions to the poor. PSOD plans to support infrastructure improvements in small cities and good prospects exists for doing more PPPs. DEC urged EARD and PSOD to continue their good collaboration on this important issue.
1. This is the third country assistance program evaluation (CAPE) prepared by the Independent Evaluation Department (IED) for the People’s Republic of China (PRC). The first CAPE was prepared in 1998 and it assessed Asian Development Bank (ADB) support from 1987 to 1997. The second was in 2007, covering 1998 to 2005. This third CAPE focuses primarily on ADB’s engagement with the PRC during the period 2006–2013 (the CAPE study period), although it also refers to the PRC policy initiatives and ADB operations during 2014.

A. Objective

2. The CAPE covers a period during which the PRC has transformed itself into an upper middle-income country that will need to act preemptively to address new challenges to sustain and improve the quality of growth. The CAPE spans a timeframe when government policies have shifted from a focus on economic growth toward more balanced, equitable, and sustainable development. In late 2013, the government passed a landmark resolution at the Third Plenary Session of the 18th Central Committee of the Communist Party (Third Plenum) to give markets a decisive role in resource allocation and to change the relationship between the government and the governed. Within this setting, the CAPE aims to provide inputs to the forthcoming ADB country partnership strategy (CPS) for 2016–2020 scheduled to be finalized by early 2016, the beginning of the 13th five-year plan period 2016–2020.

B. Approach

3. The CAPE examines the strategies and programs that have guided ADB’s engagement with the PRC during the study period. It takes into account the following country partnership strategies and updates: the country strategy and program (CSP) for 2004–2006, the CSP update for 2006–2008, the CPS for 2008–2010, and CPS for 2011–2015. The CAPE takes into consideration the Third Plenum resolution when drawing lessons from past interventions and making forward-looking recommendations for CPS 2016–2020.

4. In view of the PRC’s economic strength and the comprehensive nature of its ongoing reform program, the CAPE examines ADB’s strategies and programs through an economic transformation lens. It highlights ADB’s value addition through the provision of loans, technical assistance (TA), and knowledge products and services (KPS). As ADB views regional cooperation as a means of fighting poverty and the PRC has ambitious plans to further South–South cooperation, the CAPE examines the broad implications of regional cooperation programs supported by ADB.
5. The CAPE approach and methodology is based on revised CAPE guidelines that became effective on 31 March 2015.¹ The evaluation framework prepared as part of the approach paper is provided in Linked Document 1.² This elaborates on the issues considered by the CAPE team under each standard evaluation criterion.

6. The CAPE team conducted sector and thematic assessments on the following: (i) agriculture and natural resources (ANR), (ii) energy, (iii) finance, (iv) KPS, (v) public sector management (PSM), (vi) regional cooperation and integration (RCI), (vii) social sectors comprising education and health and social protection (HSP), (viii) transport, and (ix) urban development.³ These sector and thematic assessments covered the following forms of ADB support: (i) loans, grants and TA projects approved during the study period under the country program; (ii) KPS prepared by East Asia Department (EARD), other ADB departments and the Asian Development Bank Institute (ADBI); and (iii) TA projects approved under the Central Asia Regional Economic Cooperation (CAREC) and Greater Mekong Subregion (GMS) programs, where the PRC is both a beneficiary and/or a contributor.

7. Given the large number of project approvals in support of nonsovereign (including private sector) operations, the CAPE examines this portfolio separately. This portfolio is managed by the Private Sector Operations Department (PSOD).

8. The CAPE draws on multiple sources of information derived from a review of project databases and documents available to the CAPE team, discussions with ADB staff at headquarters and the PRC Resident Mission, and findings from CAPE team missions to the PRC. An extensive analysis of databases and document reviews was supported by perception surveys conducted across central and local government agencies, development partners and other stakeholders.

9. The CAPE team met with officials from the National Development and Reform Commission (NDRC), Ministry of Finance (MOF), and several other government ministries and other stakeholders in Beijing. Field visits reflected the ADB’s portfolio’s focus on central and western provinces of the PRC.⁴ The CAPE team discussed strategy and sector issues with the PRC stakeholders in addition to specific issues on 12 loan projects and 60 TA projects. For the PSOD portfolio, the CAPE team discussed the status and outlook of eight nonsovereign operations (NSO) project approvals with four selected private sector clients as advised by and agreed with PSOD. The CAPE team also met with a law firm that has worked closely with PSOD to develop public–private–partnership (PPP) transactions.⁵

C. Limitations

10. The completed and ongoing program of operations in the PRC was too large to be comprehensively evaluated within the available time and budget. Meetings were held with most Beijing-based executing agencies and implementing agencies and with

² Evaluation Framework for Country Assistance Program Evaluation (accessible from the list of linked documents in the Appendix).
³ The urban development assessment covers most ADB interventions classified as multisector in addition to all loans and TA classified as water and other municipal services sector.
⁴ The PRC has 31 provinces, autonomous regions and large municipalities. In this CAPE, the term province refers to provinces, autonomous regions and large municipalities. The CAPE team met government officials and stakeholders in Tianjin, Guangxi, Hunan, Inner Mongolia, Xinjiang, and Yunnan.
⁵ The meetings were held primarily in Beijing, Shanghai, and Hong Kong, China.
selected agencies in other provinces. Back-to-office reports from EARD provided an important source of information; normally these documents were available up to loan or TA approval stage, although in some cases they were available for review missions during implementation.

11. Discussions on value addition or innovation are limited to issues considered in completed or ongoing ADB operations. As a result, this evaluation touches upon a limited set of innovative approaches that have been relevant to the PRC context in the CAPE study period.

12. Extensive research is required to verify whether or not the impact, outcome and output targets and indicators specified in project-level design and monitoring frameworks (DMFs) can be, or are likely to be, achieved by target dates specified in the DMFs. Such a review would require an intensive effort to compile and analyze project-specific data on all ongoing projects. The available time and resources for the CAPE study did not allow this level of analysis.

13. The sustainability assessment is primarily based on institutional aspects, and financial and debt servicing obligations. The CAPE does not address other sustainability factors, such as quality of construction work, and quality and performance of equipment and their influence on sustainability. It does not assess risks to sustainability arising from natural disasters and climate change; although it notes that such risks are identified upfront at the project level and the adequacy of associated mitigation measures assessed.

14. Available time and resources did not allow a full-fledged evaluation of regional TA projects under the Central Asian Regional Economic Cooperation (CAREC) and Greater Mekong Subregion (GMS) programs where the PRC is a beneficiary and/or contributor. The evaluation approaches ADB’s facilitation role from the perspective of the PRC. Similarly, the knowledge content of KPS is not evaluated.

D. Report Layout

15. Following this introduction, Chapter 2 describes the country context, development challenges, and future reform priorities for the PRC. Chapter 3 provides an overview of ADB’s CPSs, and other corporate strategies. Chapter 4 discusses the country programming processes, modalities and the portfolio under the country program, and provides a brief overview of ADB’s KPS, and the PRC related activities under the CAREC and GMS programs. Chapter 5 highlights value addition arising from ADB lending and nonlending products under its sovereign and NSO. Chapter 6 presents the findings of the evaluation of ADB’s sovereign operations in the PRC derived from the country program. Chapter 7 discusses the findings of the evaluation of ADB’s nonsovereign (including private sector) operations. Chapter 8 presents other evaluations on stakeholder performance and regional cooperation and integration programs. Chapter 9 discusses the outlook for ADB support in the coming years.

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6 Not all meetings sought during June and November 2014 missions to the PRC materialized as planned. MOF suggested that the CAPE team cancel a visit to Beijing planned for January 2015.
7 However, previous experience suggests that the contracting and procurement processes, and the rigorous testing and commissioning procedures normally followed in the PRC provide a reasonable basis for assuming that quality of construction and quality of equipment is good.
8 This is the subject of another ongoing evaluation of ADB’s regional cooperation and integration (RCI) activities.
CHAPTER 2

Country Context

A. Introduction

16. The PRC Government officially launched a new set of economic reforms at the third plenary session of the 11th Party Congress in December 1978. At the time, the PRC’s per-capita gross domestic product (GDP) was about $220 (in current US dollar terms). Following the December 1978 policy announcements, the PRC began to shift from a centrally planned economy to a socialist market-based economy.

17. Reforms began in the rural sector. Farmers began to be permitted to retain a 50% bonus on the above-quota sale of agricultural output to the state. The resulting boost in farm output built widespread support for the reform program. Industrial reforms followed when the government introduced dual-track pricing, which allowed firms to sell their above-plan output at market prices and retain part of the proceeds. Recognizing that the PRC had missed out on technological advances over a 30-year period, the government abandoned its previous autarkic model, began opening up the economy to international trade, and engaged in the global production chain for some consumer products. At the same time, there were simultaneous efforts to create a competitive environment for state-owned enterprises (SOEs), increase labor mobility, and reform the financial sector.

18. For more than three decades, the PRC has witnessed uninterrupted growth. By 2010, it had been transformed to an upper middle-income country (UMIC) and its per-capita gross national income (GNI) had reached $4,240 in current US dollars. However, growth rates have slowed in recent years; in 2012 and 2013 GDP grew by 7.7% per year, in 2014 by 7.4%, and in 2015 the government targets growth of about 7%.

B. The People’s Republic of China Growth Phase

19. The PRC economy began to take off at income levels that were lower than those in Japan or other newly industrialized Asian economies (Republic of Korea; Singapore; Hong Kong, China; and Taipei, China). With sustained GDP growth rates of

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12 The PRC’s international trade also benefited from the Plaza Accord of 1985, which required the European and Japanese currencies to appreciate against the US dollar (and subsequently the currencies of Republic of Korea and Taipei, China to also appreciate).
nearly 10% per annum (in constant local currency, Yuan, or CNY) from 1980 to 2013, GDP per capita multiplied 16-fold (Figure 1).

![Figure 1: People's Republic of China Gross Domestic Product Per Capita and Gross Domestic Product Growth](image)

Source: International Monetary Fund, World Economic Outlook Database.

20. The PRC has lifted more than 500 million people out of poverty since the early 1980s. At the same time, income inequalities have increased during this period, although some decline has been evident since 2008 (the Gini coefficient increased from 0.32 in 1990 to 0.473 in 2013 and 0.469 in 2014, and peaked at 0.49 in 2008). The PRC continues to have the second largest number of poor in the world.

21. Investment and exports have fueled this remarkable economic turnaround. Manufactured goods have accounted for the bulk of exports, and the share of value addition in the manufacturing sector has been 30%–35% of GDP each year, higher than in other developing and developed countries.

22. There is no uniform agreement on how the PRC has achieved its high levels of reform era performance. A favorable policy environment has been an important factor, especially (i) the gradual dismantling of the planned economy and a return to traditional entrepreneurial roots; and (ii) state-led capitalism from the 1990s which

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16 The incidence of poverty, defined as income of less than $1.25 per day has declined from 85% in the early 1980s to about 13% in the late 2000's (ADB. 2014. Technical Assistance to People's Republic of China for Support for the Thirteenth Five-Year Plan. Manila). This means more than 150 million people were classified as poor in the late 2000s. Life expectancy has increased from about 67 years in 1980 to more than 73 years by 2011 (Refer to: https://www.google.com.ph/#q=life+expectancy+in+PRC). Child mortality under 5 years has decreased from 54 per 1000 births in 1990 to 14 per 1000 births in 2012.: http://www.unicef.org/infobycountry/china_statistics.html


18 Since the mid-1990s, the share of value added in manufacturing to total GDP has been in the 10%–20% range for USA and some emerging economies (Brazil, India, the Russian Federation, and South Africa), and the 15%–25% range for Germany and Japan (see World Development Indicators).

19 Among the theories proposed to explain this outstanding performance are: pent-up growth on ending bad policies of the Maoist era; lifting the hand of the state (e.g., in mandating the allocation of labor on collective farms); improving incentives and unleashing entrepreneurship; and finding productive outlets for surplus labor.
focused on the development of large-scale infrastructure and urban investment projects, while allowing the physical environment to deteriorate. The benefits of these policies were reinforced by several other factors, including a world that was willing to support the PRC’s development.

23. **Demographic dividend.** The PRC has experienced a demographic dividend since the 1980s, largely due to sharply declining fertility rates in the 1970s and the one-child policy launched in 1979. Fertility rates have kept falling since the 1980s, dropping below the replacement rate (of approximately 2.1) by the early 1990s, and they have slipped further to about 1.6 in recent years. Although falling child mortality rates have partly offset the declining fertility rate, the dependency ratio has declined from 0.63–0.80 during the 1950–1980 period, to about 0.48 in 2000, and about 0.37 in 2014. The labor force increased by 1.9% per annum between 1980 and 2012, nearly twice as fast as the total population.

24. **Rural–urban mix.** The labor force’s contribution to economic growth has been enhanced by policies that allowed internal migration of labor to urban areas, which typically offered more productive job opportunities. The urban share of the population increased from less than 18% in 1978 to about 53% by 2012, and the employed labor force in urban areas grew from less than 24% to 48% of the total labor force during the same time period (Figure 2).

25. **Technology improvement.** Due to an emphasis on self-sufficiency at the local level, the country stagnated in terms of technology modernization until the late

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23 Demographic dividend refers to a situation where dependency ratio declines dramatically.

21 Howard Steven Friedman. 2014. China’s Dependency Ratio Turning Point. *The Huffington Post.* New York, September. Dependency ratio is defined as the ratio between number of people in the age groups of less than 15 years plus more than 64 years to the working age population in the 15–64 year age group.

22 Includes available employment and unemployment data. Employment data only is available over the entire time period. Unemployment data (available from 1990) refer to registered unemployed, and shows an unemployment rate of less than 1%.

23 Prior to 1978, the objective of making every village and town economically self-sufficient had severely restricted internal migration.

1970s. Coupled with new ways of managing processes, technology improvements and transfers began in the 1980s, and supported economic growth. Foreign investors established and scaled up training programs to improve labor productivity. Government policies to strengthen the education system, especially after 2003, enabled the labor pool to increase its employability and skill levels. Over a period of time, manufacturing has moved into high-technology industries (Figure 3). However, nearly 90% of high-technology exports also involved the import of high-technology components and assembly operations in 2003. This figure had been reduced to less than 80% by 2010, reflecting the PRC’s rising technological prowess.

26  **Export competitiveness.** Ongoing policies have made the PRC a very competitive base for manufacturing, which was initially set up in the eastern coastal provinces. First, a tightly managed exchange rate regime kept the yuan undervalued, which improved the competitiveness of low-end manufacturing and assembly operations in high-technology areas. Second, migrant workers in urban areas had to retain their rural household registrations. As a result, labor wages remained low until a minimum wage law was introduced in 2008. Since then, wages have grown quickly. Even when industry needed to expand inland in search of more labor, an excellent transport infrastructure made it possible for the PRC to maintain its export orientation. However, a combination of yuan appreciation and wage growth has meant the PRC is no longer the lowest cost country for labor-intensive products.

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25 In the early 1980s, the PRC’s technology base was so low that any capital investment in production processes (even if antiquated in some other countries) would upgrade technology in the PRC.
26 In contrast, the education system had been severely disrupted during the Cultural Revolution. This was an outcome of the Deng Xiaoping theory that is summed up by the slogan: “We should let some people get rich first, both in the countryside and in urban areas. To get rich by hard work is glorious.” Refer to Ahmed Shawki. 1997. China: From Mao to Deng. **International Socialist Review.** Issue 1, Summer. Online edition. http://www.isreview.org/issues/01/mao_to_deng_1.shtml
28 This includes labor migrations from rural to urban areas in the same province, and from rural areas of one province to an urban area of another province (normally, from a rural area of say, an inland central or western province, to an urban area of an eastern coastal province).
31 For instance, low-end garments are now produced in Bangladesh, Viet Nam and other low-cost countries.
27. **Regional mix.** Urbanization and industrialization have progressed rapidly in the eastern coastal provinces. Since the early 2000s, the prosperous eastern coastal region has hosted less than 40% of the population, yet it has produced more than 50% of national GDP, manufactured more than 80% of total exports, and attracted more than 75% of total foreign direct investment. Per-capita urban incomes in the eastern provinces are 1.4 times those in other provinces. The central and western provinces continue to lag and in the late 1990s average GDP per capita in these provinces was about 45% of that in the eastern provinces. Although the ratio had increased to about 55% by 2012, regional income and non-income disparities persist in these environmentally fragile areas, many of which have significant populations of ethnic minorities.

28. **Capital availability.** The financial system that has propelled the PRC’s growth since the 1980s can be described as follows: (i) state-owned banks, which have traditionally attracted household savings, were used to provide credit mostly to SOEs and firms that worked on state-approved projects; and (ii) direct investment by foreign companies and non-residents accompanied by a regime that required surplus hard currency earnings to be surrendered to the government. During the 1990s and 2000s, various financing channels evolved to meet the demand for credit from other enterprises (non-SOE firms) and individuals.

29. **External environment.** The PRC began reforming in 1978 with a focus on GDP growth and poverty alleviation, while keeping a low profile internationally. The PRC viewed international cooperation as an important ingredient of efforts to achieve its reform objectives. The country benefited from trade and external support in financing investment, transferring technology, upgrading skills, and accessing expertise and advice on a large number of economic and policy matters. This process enabled the PRC to integrate rapidly into the global economy, particularly after its accession to the World Trade Organization (WTO) in 2001. The government’s “go-out” policy of 1999 further contributed to this integration process, as well as the exceptionally buoyant global economy in the post-Cold War era. The PRC’s share of global GDP and trade has risen significantly since 2000 (Figure 4). Although global economic conditions changed rapidly following the 2008 global financial crisis, the PRC’s trade and financial relationships with many countries continued to deepen.

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35 http://www.stats.gov.cn/english/PressRelease/201402/t20140224_515103.html. The Central area includes 6 provinces: Anhui, Henan, Hubei, Hunan, Jiangxi and Shanxi; the Western area includes 12 provinces, autonomous regions and municipalities: Chongqing, Gansu, Guangxi, Guizhou, Inner Mongolia, Ningxia, Qinghai, Shaanxi, Sichuan, Tibet, Xinjiang and Yunnan; the Northeastern area includes 3 provinces: Heilongjiang, Jilin and Liaoning. The regions are as defined by the National Bureau of Statistics of China, 2014.

36 State-owned banks have been the major source of credit since the 1980s as capital markets (stock exchanges and bond markets) are still underdeveloped.

37 Government policies stated that, when export earnings exceeded outbound payments for equipment, consumables and other necessary items, surplus hard currency earnings (after repatriating profits as per rules, and after meeting working capital needs) had to be surrendered.

38 The PRC Government attaches importance to both inward and outward foreign investment, and launched the “go-out” policy in 1999 to promote investment by the PRC enterprises abroad, and to promote brand recognition of the PRC companies and products across the world.
C. Development Challenges

30. The PRC is already the world’s second largest economy, and it is poised to become the largest by the mid-2020s. The external environment for the PRC is bound to change as the country’s stakes and responsibilities in addressing global issues (such as climate change, energy security, food security and water security) increase.

31. Along with a combination of market forces, state intervention, and other factors, a tolerance for certain negative economic side effects has contributed to the PRC’s remarkable economic growth. Urban–rural and regional disparities continue, the physical environment is polluted and degraded, and the growth rate of total factor productivity (a measure of economic efficiency) has declined in recent years. 39

32. The PRC will need to move up the value chain to higher productivity areas if it is to sustain relatively high economic growth levels. This growth can be achieved through an intensive growth model that utilizes resources (land, labor, and capital) more efficiently. As part of this process, an urbanization program will require more intensive (not extensive or sprawling) cities to be designed and high value-added manufacturing options to be pursued, along with public utility services and social services that meet the needs of a rising urban population with increasing purchasing power and old age dependency. 40 As the demographic dividend disappears, it will be necessary to create an efficient, productive and dynamic human resource base that helps increase labor productivity. Capital productivity can be increased by deploying capital in activities and enterprises that utilize it more efficiently while the opportunity for continued rapid gains from technology catch-up diminish. Improved governance, public sector management, and fiscal management would facilitate economic growth in this scenario.

40 The working age population is projected to begin shrinking by 2015, and the old age dependency ratio is expected to double to 22%–23% by 2030.
33. **Fiscal imbalance.** Government revenues began to shrink in the 1980s as market prices began to replace administered prices, and non-state enterprises entered more industrial sectors. The government reformed the fiscal system in 1994 with the objective of reversing this declining revenue stream. It introduced a new tax system, and changed the assignment of fiscal revenues among various levels of government, but it did not do enough to revise fiscal expenditure responsibilities. As a result, fiscal deficits began to appear at the local government level by the early 2000s, and they have ballooned following the fiscal stimulus package introduced in 2008.  

34. Local governments, especially municipal governments, came to rely overwhelmingly on extrabudgetary resources to support accelerated urbanization. Local investment corporations (LICs) were set up as enterprises under municipal departments, to coordinate and finance the construction of facilities such as water supply, sewerage, and roads. Typically, LICs raise and bundle bank loans and other shadow bank financing. Increasingly, as land values rose, land became the principal asset backing the LICs.

35. The central government tolerated the resultant rising systemic risks while GDP growth rates remained high. In recent years, as GDP growth rates have decelerated, the government has estimated the scale of the problem, is paying close attention to local governments that have high debt levels, and believes risks from local debt are manageable.

36. **Urban and rural development.** Easy access to financial resources by LICs and from land has led to wasteful and inefficient investments, and reduced the amount of land available for farming. The urban population has grown by about 210 million during the period 2000–2010. A system to modernize agriculture and increase agricultural productivity appears increasingly necessary.

37. Urbanization has attracted the working age population to cities, leaving senior citizens and children behind in the rural areas. While labor has migrated to cities since the 1980s, the residency registration (hukou) system requirements have remained intact. This has resulted in a two-tiered society where cities restrict individuals’ eligibility to access vital and high-cost public services; one-third of urban residents (over 200 million people) are de facto second-class citizens because they lack urban registration.

38. By the late 2000s, most of the 150 million poor were located in the central and western provinces; often scattered in the deserts, mountains and plateaus of the western PRC. The poor account for about 20% of the total population of the central and western provinces and they are concentrated in more than 500 designated poverty counties. The central government has provided fiscal support to the designated poverty counties.

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41 A CNY4 trillion ($586 billion) stimulus package was announced by the State Council of the PRC on 9 November 2008 as an attempt to minimize the impact of the global financial crisis. The stimulus package was planned to support key areas such as housing, rural infrastructure, transportation, health and education, environment, industry, disaster rebuilding, income-building, tax cuts, and finance. The program was embraced by local governments and more than doubled in a short period of time. It was instrumental in pumping an amount equivalent to about 27% of GDP into the economy over a 27-month period. Christine Wong. 2011. The Fiscal Stimulus Programme and Public Governance Issues in China. *OECD Journal on Budgeting*. Vol. 2011/3. http://dx.doi.org/10.1787/budget-11-5kg3nhjqrj

42 Funding sources for shadow banking activity include trust funds, wealth management products, entrusted loans, financial leasing loans, microcredit companies, pawnshops, and individuals.


44 No further data updates are available.
counties since the early 1980s. These government programs aim to provide poor and needy households with food, clothing and other support for subsistence, in addition to supporting infrastructure development. Although economic growth rates of poor counties exceeded the national GDP growth rates from 2001 to 2010, the extent to which government programs have benefited these poor and needy households is not known.45

39. Labor and welfare. In the mid-2000s, the government launched and funded massive programs to improve the quality of social services in rural areas and to narrow the quality gap between rural and urban areas. These programs included free rural education covering about 140 million students, a rural cooperative medical scheme that has more than 830 million participants, and a universal rural pension scheme that has a potential beneficiary pool of more than 800 million. The central government has increased fiscal transfers to local governments to finance these programs.

40. Inequality in urban areas continues to be a problem, as many migrant workers are ineligible for corresponding urban medical and pension schemes. The lack of coverage of these schemes has been convenient for local urban municipal governments, given their inadequate resource base. As a result, despite more than a decade of equalization efforts in rural areas, and continued eligibility restrictions in urban areas, the gap between urban and rural public services remains large.46 Likewise, the gap across regions remains large.

41. Finance. As of late 2013, the PRC’s financial system is the fourth largest in the world and its capital market the sixth largest. The financial sector is still dominated by large state-owned commercial banks that finance a substantial portion of investment requirements of SOEs and LICs. The government influences resource allocation through a range of direct and indirect controls, and is perceived to be an implicit guarantor of many financial institutions.

42. The PRC’s financial system has been effective in mobilizing savings and financing the rapid expansion of investment since the 1980s. Credit growth has been very rapid. Total social financing—a broad measure of credit covering bank lending, funding from shadow banking, and equity—rose to more than $10 trillion by March 2014, doubling in dollar terms from September 2011.47 Rapid growth in lending to highly leveraged SOEs and LICs, the growth in shadow banking and an over-heated property market are sources of inter-linked systemic risk. The economic slowdown further exacerbates risks to the banking system. Further liberalization of interest rates and the opening-up of the banking sector could possibly have an adverse impact on the banking system. Lack of information sharing and coordination among fiscal, monetary, and financial regulatory authorities is also a cause for concern.48
43. Financial inclusion continues to be a policy challenge. Despite strong policy support for rural areas, SMEs, and microfinance, some 45% of the rural population, and the vast bulk of the country’s poor, do not have sufficient access to formal financial institutions, and are forced to rely on savings or informal sources of finance to meet their financing needs.

44. **State-owned enterprises.** The PRC has introduced competition gradually. The State Council issued its first formal competition policy instrument in 1980. This left state monopolies (SOEs) and price controls intact, although some state firms were fully privatized by the late 1990s. After the Asian financial crisis of 1997–1998, the fittest SOEs survived and began to influence policy. They made low dividend payments to the state, and reinvested their growing profits in massive additional capacity and new ventures. These payments buoyed government revenues and the tendency to divest the state interest in SOEs waned over the 2000s. The stimulus package of 2008 was channeled towards SOEs. To date, SOEs continue to dominate many sectors, and they have tended to crowd out private enterprise.

45. **Environmental degradation.** Rapid industrialization, urbanization and intensified agricultural production, coupled with insufficient attention to environmental pollution and degradation, have put the PRC’s natural resource base under stress. The government’s permissive stance towards environmental pollution has facilitated GDP growth, but the negative impacts of these policies have become increasingly evident. Underground water could not be used for drinking without treatment in more than half the cities in the PRC surveyed in 2013. Smog has reduced the amount of sunlight reaching crops and adversely affected agricultural output for more than a decade. Agricultural products treated with chemicals or that are unsafe for consumption pose risks to consumers within and outside the PRC. Overall the quality of life has been negatively impacted by environmental degradation. Negative spillovers have resulted. For example, degraded grasslands lead to dust and sandstorms affecting the PRC’s eastern neighbors, and industrial effluents discharged into rivers flow into the open sea.

46. The PRC is now the world’s largest energy consumer and greenhouse gas (GHG) emitter. It has committed itself to reducing carbon dioxide emissions per unit of GDP by 40%–45% from 2005 levels by 2020, and to increasing forest cover by 40 million hectares from 2005 levels. In November 2014, the PRC committed itself to capping GHG emissions by 2030. The mounting sense of urgency to limit GHG emissions and contain mean global temperature rise to a reasonable level lend a sense of urgency to

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49  The PRC Government allowed thousands of small, strategically unimportant SOEs to be shut down or merged with other SOEs.
50  For instance, the three state-owned airlines (Air China, China Southern, and China Eastern) which reported a combined loss of about CNY10 billion in 2008 were bailed out by the PRC Government, while privately-owned airlines went bankrupt.
51  Along with low labor costs in manufacturing industry, this accommodation has resulted in low operation and maintenance costs and increased international competitiveness. It has also helped attract foreign firms that faced mounting environmental compliance costs overseas.
54  Desertification resulting from improper grasslands management in the PRC leads to dust and sandstorms in northeast Asia, mostly affecting Mongolia, and reducing air quality in Japan and the Korean Peninsula. Effluents from industries located in Jiangsu, Shanghai and Zhejiang are discharged into the Yangtze River and flow into the East China Sea. Similarly, effluents from Guangdong-based industries reach the South China Sea.
55  http://www.nrdc.org/international/copenhagencaccords/
56  http://www.theguardian.com/environment/2014/nov/12/china-and-us-make-carbon-pledge
efforts by the PRC (and other large emitters) to reduce GHG emissions and increase carbon sequestration.

D. **Government Strategies**

47. **Eleventh Five-Year Plan.** The 11th five-year plan period (2006–2010) sought to address the PRC’s development challenges by presenting a balanced strategy that would build a harmonious and moderately prosperous (xiao kung) society and a socialist market economy that is energy-efficient and environmentally friendly. The 11th plan emphasized rural development under the new socialist countryside objective, and set out various measures with qualitative and quantitative targets. In meeting these targets, the market would play an important role and the government would provide the enabling environment. A more direct role for the government was envisaged in the provision of public health, compulsory education, social safety nets, and projects involving the poor. Although considerable progress was made in improving access to basic public services and conditions in rural areas, many other key objectives were not achieved. There was little rebalancing away from industry towards services and consumption. The lack of decisive rebalancing further widened urban–rural income inequality, despite strong government efforts.

48. **Twelfth Five-Year Plan.** The 12th five-year plan (2011–2015) came at a time when the guiding principle of “ecological civilization” had begun to gain momentum. The 12th plan clearly recognized the unsustainable elements of the PRC’s development programs, mainly: (i) economic growth that degraded the physical environment, and increased social conflicts and vulnerabilities in rural areas; (ii) an economic structure that focused on manufacturing and exports with insufficient attention being given to services and consumption; and (iii) continuing economic growth while institutional obstacles constrained scientific development, and the ability to innovate remained poor. The 12th plan sought to transform the growth pattern through an appropriate reconciliation of social, environmental and other conflicts.

49. **Third Plenum Resolution of November 2013.** The political will to introduce fundamental reform to address unsustainable elements in the PRC’s development came about following the change of leadership in 2013. The Third Plenum resolution of November 2013 marked a decisive break from the past by emphasizing that deep reforms to the structure of governance will be needed to achieve the goals set a decade earlier. The resolution provides broad guidance for introducing reforms to redefine the relationship between government and the governed, and between government and the market. Both government and the market are envisaged to play a role in guiding economic outcomes. Reforms have a target timeline of 2020. Since November 2013,

57 The new socialist countryside objective focused on increasing agricultural productivity, developing non-agricultural sectors and transferring rural labor to these sectors, reducing tax and fee burdens on farmers, improving rural infrastructure and environmental protection, boosting health care provision in the countryside, and extending 9-year mandatory education to poor regions and poor households with support by central and local governments.

58 Put forward first in 2007, “ecological civilization” is a guiding principle for future development that reflects a perception of the extremely high price paid by the PRC in its pursuit of rapid economic growth. It has gained momentum in recent years, after the government affirmed that the construction of a new ecological civilization will be an integral component of all aspects and processes in economic, political, cultural and social development.


61 It also seeks to address the balance of power between the state and the party.
the government has announced many policies and regulations in support of the Third Plenum resolution, and significant beginnings have been made in implementing many decisions.62

50. Some decisions in the Third Plenum resolution adopted in November 2013 are aligned with generally accepted international models of economic governance, including those on market-determined interest rates and exchange rates, and greater labor mobility. Decisions aimed at reversing environmental degradation, improving education and health care, and encouraging innovation indicate a convergence of the PRC’s regulatory frameworks with those of developed economies.

51. In a bid to encourage balanced development and information sharing, the Third Plenum calls for: (i) making officials accountable to their constituencies, by developing a system where officials would be required to address a multiplicity of objectives—rather than the sole goal of boosting short-term economic growth; and (ii) giving due recognition to the role that social organizations can play in the reform process, where the role of the government and the market is being redefined, and entrenched interest groups prefer to maintain the status quo.

52. The next five-year plan period. The Third Plenum resolution provided significant impetus for implementing reforms simultaneously in many dimensions. The government reiterated the 11th and 12th plan objectives of opening up the economy as an essential component of the reform program to help promote domestic development. Over the next five-year plan period, it seeks to (i) promote reforms through international cooperation to improve competitiveness, and stimulate the free flow of factors of production across international boundaries; (ii) promote learning from relevant international experience; and (iii) participate in international macroeconomic policy coordination and promote improved international economic governance structures.

53. Implementation of the tasks envisaged by the Third Plenum will be extraordinarily difficult given the complexities and links among a large number of vectors that need to be reformed. Linked Document 2 provides an overview of six broad economic reform themes: (i) fiscal management, (ii) financial sector reform, (iii) rural and urban development, (iv) labor and welfare system, (v) SOE reform and competition policy, and (vi) environmental protection.63 It also provides an overview of how their specific measures and tasks interact with the other themes.

54. The interlinked nature of the reform program makes it difficult to predict outcomes. For instance, residency registration system reforms will impinge on the outlook for (among others) industrial competitiveness, approach to urbanization, and central–local fiscal rebalancing. Intensification of agriculture will be necessary for the 2014 urbanization plan to succeed. Financial sector reforms will tend to push SOE reforms: market determined interest rates will adversely affect poorly performing SOEs, perhaps forcing some closures, but improving overall allocative efficiency. Incentives for increased consumption will come from reforms across many areas: residency registration system reform would raise the standards of living for migrant workers and free up some of their savings for consumption, and education reforms would help

62 The 60 articles of the Third Plenum resolution are referred to as decisions. They are a to-do list that is elaborated in more than 300 paragraphs in 16 sections.

63 People's Republic of China Government Strategies (accessible from the list of linked documents in the Appendix).
increase labor productivity and wages. The need to follow a consumption-led growth model will become more pronounced as environmental externalities begin to be accounted for in project appraisals, and reduce export competitiveness. Linked Document 2 provides examples of numerous links across the six reform themes. A difficulty for reformers will be the need to reconcile short-term considerations that may stand in the way of reforms that are needed to achieve medium and long-term objectives.  

55. The extent to which these reforms are actually being implemented across all provinces is not clear. There is no shared understanding of the rationale, objectives, and scope of the reform program. Institutional capacities to undertake these reforms differ widely across the country. The central government has limited capacity to monitor the implementation of reform measures at provincial and local levels.  

56. The need for innovation. The starting point of these reforms is unique to the PRC, so the evolutionary path to converge systems of governance will also be unique to the PRC. The government recognizes the need to innovate and create new knowledge in economic, social, environmental and institutional dimensions. It considers innovation as a policy matter in the Third Plenum resolution, and knowledge as a factor of production in the same way as labor, capital and other factors. Despite the uniqueness of the envisaged program of reform, many of the issues the government will need to address have been experienced in other countries, and the PRC can benefit from examples of good international practice. The government has expressed its willingness to learn from the experience of other countries.  

57. The need for new and innovative approaches to achieve reform objectives and meet peoples’ aspirations is clear. The government will need to implement measures aimed at increasing labor and capital productivity, strengthening the market for land, focusing more on regulation, and creating an enabling environment in which the market can function. In its efforts to reduce the debt to GDP ratio and to slow down credit-driven investment to drive growth, greater domestic consumption will need to fill the gap. Box 1 lists areas where innovative approaches are required to achieve the desired economic transformation.  

Such trade-offs can be illustrated by the following: (i) although better regulation of extrabudgetary financing of urban development and infrastructure projects will cut waste and improve resource allocation in the medium term (which in turn will improve growth prospects), in the short term it will slow down growth and the urbanization program; and (ii) allowing village communities and farmers to directly lease or sell their land use rights will promote fairness, and in the medium term improve allocative efficiency and income distribution, but in the short term it will impinge on the local government’s ability to raise finance for urban development and infrastructure projects.  

Coordination among central government ministries or among departments and bureaus at lower levels of government is weak. Coordination across different levels of government is similarly weak. The Third Plenum resolution of November 2013 seeks to allow rural land to be appraised and leased directly into the market by collectives (rather than their having to sell land rights only to the local government) and to develop a secondary land market for lease, transfer, and mortgage. This will restrict the extent to which local governments can acquire rural land rights for construction and urbanization. Farmer land-use rights over their small land holdings will be protected for a long (but unspecified) period of time, so as to enable them to lease out, transfer or mortgage these rights. This would meet the objective of accumulating land in commercially viable lot sizes for commercial farming and agriculture modernization. Farmers will also be given rights to possess shares in collective assets, and be able to sell and inherit shares.  

Given global growth prospects, external demand is not likely to grow as it did in the 1990s and until the global financial crisis of 2008. In January 2015, the International Monetary Fund reduced its global economic growth forecast for 2015 and 2016. See International Monetary Fund. 2015. World Economic Outlook Update. Beijing and Washington, DC. 15 January.
**Box 1: Innovations to Undertake Comprehensive Reforms**

Institutional innovation to bring about social fairness and justice.

Innovations to achieve rapid and equitable urbanization.

Innovations in the nongovernment and nonpublic sector economy in stimulating growth, increasing productivity, creating employment and modernizing agriculture.

Financial innovations to diversify financial markets and financial products for trade and investment, small and medium-sized enterprise finance, rural and agriculture finance.

Innovations to dovetail school programs with industry and research needs.

Technology innovations through the absorption of imported technology, and indigenous research and development.

Innovations in transitioning to a service-oriented government administrative and management system that goes by the rule-of-law.

Innovations in systems for assessing development achievements.

Innovations in social governance to safeguard the interests of the people.

Innovations in achieving the ecological civilization that is clean, green, resource efficient and climate friendly.

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**Note:**

\[a\] Reforming applied technology research and development institutions; encouraging small and medium-sized enterprises to undertake research and development; improving government mechanisms to support pioneering research, and strengthening mechanisms to identify research and development needs and priorities.

\[b\] Instead of evaluating achievements solely in terms of speed of economic growth, to also consider environmental damage, ecological benefits, overcapacity, scientific and technological innovation, safe production, debt growth, labor and employment, incomes, social security and the people’s health.


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58. **New normal.** This expression refers to a future development trajectory with growth rates that are significantly lower than levels achieved over the last three decades.\[68\] It signifies that the government has chosen to moderate GDP growth rates to make space to undertake comprehensive and complex reforms to address systemic, institutional, structural and other challenges. A slow-down in the PRC’s economic development has been evident since 2012, and the 7% growth target for 2015 is in line with this trend.

59. During the coming years, the government aims to achieve and maintain momentum in its reform drive and simultaneously to pursue economic growth and development objectives. It considers the three objectives to be equally important to ensure social harmony and stability. As the International Monetary Fund (IMF) has noted, for the PRC, the main risk is failure to implement reforms to address financial risks, rebalance the economy, and tap new sources of growth.\[69\]

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\[68\] This expression comes from the PRC government. For example, the report delivered at the Third Session of the 12th National People’s Congress on 5 March 2015, by Li Keqiang, Premier of the State Council, on the Work of the Government.

CHAPTER 3

ADB Strategies

60. The ADB–PRC partnership has been consistent with the PRC’s development strategies and with ADB’s corporate and sector strategies. ADB’s program initially focused on the eastern coastal provinces. Beginning in the early 1990s, ADB support had an infrastructure focus that reflected the PRC’s export-led growth priority. Following the government’s “go-west” policy in the late 1990s, ADB’s operations in the central and western provinces began to increase. When the government turned its attention to building a harmonious society in the early 2000s, ADB’s strategy and operations began to reflect that policy. Under the government’s leadership, ADB has coordinated its development strategies and programs with those of other development partners.

A. Country Strategies

61. The CAPE study period covers a timeframe where the PRC government policies shifted gradually toward balanced, equitable and sustainable development. This shift is reflected through the three ADB country strategies that span the study period from 2006 to 2013.

1. Overview of ADB’s Country Strategies

62. The country strategy and program (CSP) for 2004–2006 and its updates broadly define the ADB–PRC partnership up to 2007. The overall strategic objective of the CSP was pro-poor growth with assistance being organized under four thematic pillars. The shift to a pro-poor orientation was to be achieved mainly by allocating a dominant share of the program (which averaged $1.5 billion per year) to the poor interior provinces, thereby reducing regional disparities. Other strategic objectives of the CSP were the enhancing of the business climate to encourage greater private sector investment, promoting environmental sustainability, and regional cooperation.

63. The CSP update (2006–2008), published in July 2005, reaffirmed that ADB’s strategic objectives and operations in the PRC remained valid. As the CSP update (2007–2008) published in August 2006, noted, the 11th plan validated ADB’s existing strategic objectives and operations as stated in the CSP (2004–2006). The document further noted that ADB’s future operations in the PRC would (i) emphasize rural development, the environment, energy conservation, urban development, and regional cooperation; and (ii) provide greater knowledge in policy, law, and governance reform.

70 It was premised on a belief in the PRC that to become rich, one must build roads. From 1986 to 1990, the agriculture and industrial sectors accounted for a bulk of ADB’s lending program.
71 The PRC government’s renewed attention to the depressed northeastern provinces in the early 2000s was also reflected in ADB operations.
64. The country partnership strategy (CPS) for 2008–2010 built on ADB’s successful track record of investment and TA support, and sought to make it responsive to the PRC’s rapidly changing needs. The underlying theme driving the CPS was enhanced value addition through an emphasis on knowledge, innovation, and governance. It included four key strategic pillars: (i) inclusive growth and balanced development; (ii) resource efficiency and environmental sustainability; (iii) regional cooperation and public goods; and (iv) fostering an environment conducive for private sector development. It is noteworthy that the CPS emphasized sustainable urban development in ways that expanded livelihood opportunities for the poor.

65. The CPS 2011–2015 focused on ADB’s core areas of competence and country-specific comparative advantages. The CPS was based on the following three pillars: (i) inclusive growth, which promotes integrated rural and urban development through financial inclusion and natural resource management in ways that boost rural livelihoods, and quality municipal and social services in small and medium-sized cities; (ii) environmentally sustainable growth, where all ADB assistance was viewed through an environmental lens; and (iii) regional cooperation and integration, which helped strengthen the regional orientation of the country program. The CPS proposed to actively pursue drivers of change (knowledge solutions, private sector development, good governance and capacity development, and gender equity) to maximize development impacts. Partnerships were seen in the context of knowledge creation and sharing in South–South cooperation, as well as public–private partnerships to promote private sector development.

66. CPS 2011–2015 recognized the need for ADB to respond quickly to rapidly changing government priorities. It called for a review of ADB’s strategic priorities through regular consultations to ensure the country program remained responsive to the PRC’s rapidly evolving social and economic context. It noted ADB’s enhanced knowledge support to the PRC to address emerging issues at the request of the government, and it anticipated that ADB’s relationship with the PRC would increasingly be anchored on the sharing of innovation, knowledge, management experience and good international practices.

2. Evolution of ADB Country Strategy Objectives and Priorities

67. The three country strategies in the study period retained three broad key objectives (inclusive growth, environmentally sustainable growth and regional cooperation) although these objectives were articulated slightly differently in keeping with changing the PRC objectives. CSP 2004–2006 and CPS 2008–2010 had a fourth objective which was targeted at facilitating and encouraging the private sector; this objective featured in CPS 2011–2015 as a driver of change. The evolution of objectives in the three country strategies is evident from Table 1. Other ADB priorities and sector development strategies evolved during the study period. This evolution is elaborated in Linked Document 3, and it reflects (i) the PRC’s changing priorities as it embarked on creating a xiao kang society, addressing social and environmental concerns and finding ways to make markets work better, and (ii) the PRC’s rising economic strength and international presence and influence. It is noteworthy that CPS 2011–2015 is broadly

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76 Through investment in public infrastructure and policy advice to improve resource management and access to markets.
78 Through policy notes, observation and suggestions, and other knowledge products.
79 ADB Country Strategies (accessible from the list of linked documents in the Appendix).
consistent with the Third Plenum resolution that seeks to deepen reforms in a comprehensive way.

### Table 1: Key Objectives of ADB Country Strategies during the Study Period

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<td>Inclusive growth</td>
<td>Promoting pro-poor inclusive economic growth in poor interior regions; supporting rural development, greater participation of the poor in decisions that affect them</td>
<td>Promoting inclusive and balanced urban development in ways that expand livelihood opportunities for the poor through investment in public infrastructure and policy advice to improve resource management and access to markets</td>
<td>Promoting inclusive growth through integrated rural and urban development in lagging areas by improving access to finance, managing natural resources in ways that boost rural livelihoods supporting municipal and social services in small and medium-sized cities</td>
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<td>Environmentally sustainable growth</td>
<td>Strengthening environmental policy, legal, regulatory and institutional reform; Addressing air, water and soil pollution; encouraging clean technologies</td>
<td>Supporting sustainable management of rural ecosystems, economic instruments for environmental management, energy efficient infrastructure; integrated urban development</td>
<td>Viewing all ADB support through an environmental lens to further green the portfolio, promote sustainable use of natural resources, and mainstream climate change</td>
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<tr>
<td>Regional cooperation</td>
<td>Addressing policy and institutional barriers to regional cooperation; removing infrastructure constraints; encouraging private investment; strengthening regional economic surveillance and regional financial infrastructure</td>
<td>Enhancing cross-border connectivity, facilitating trade and investment, promoting regional public goods and financial integration, enhancing cooperation with Mongolia, sharing development experiences with other developing countries</td>
<td>Strengthening the regional orientation of the PRC country program to complement support under regional programs; strengthening capacity of governments in border areas and reinforcing efforts to reduce regional imbalances; strengthening knowledge sharing</td>
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<tr>
<td>Making markets work better/enabling environment for private sector development</td>
<td>Supporting the drafting of economic laws; instituting regulatory transparency and improved statistics and policies; removing infrastructure barriers faced by private sector; aiming at a substantial increase in private sector operations</td>
<td>Supporting PPP projects in lagging provinces, supporting development of the financial sector to meet private financing needs, providing policy advice to support SMEs and promoting financial sector reforms</td>
<td>Continue catalyzing private participation by supporting demonstration projects, improving financial and logistical services, and finding innovative financial solutions and arrangements*</td>
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* Italics denote that private sector development is not a CPS objective, but a driver of change.

68. **Other country partnership strategy priorities, themes and drivers of change.** The country strategies progressed from focusing on knowledge provision, dissemination, and transfer to emphasizing interactive sharing and partnerships, innovation, co-creation and cooperation. ADB support for governance work changed from broad support for the country’s transition from a centrally-planned to a market-based economy to a narrow focus on mainstreaming governance in core ADB operational sectors. Subsequently, the scope broadened again to support the government’s efforts to strengthen policy, legal, fiduciary and regulatory frameworks and practices. From being a core sector of operations in the two earlier ADB country strategies, the finance sector was re-categorized as a cross-cutting endeavor in CPS 2011–2015 to support private sector development and inclusive and environmental sustainability objectives. Linked Document 3 provides further details.

3. **Country Partnership Strategy Results Framework**

69. The three ADB country strategies implemented during the study period presented their results frameworks differently. CSP 2004–2006 contained sector road maps for six sectors and attempted to link the sector outcomes to CPS objectives. CSP 2008–2010 presented outcomes for the four CPS objectives; and sector level outcomes were presented in the context of the CPS objectives. CSP 2008–2010 referred to targets that would be specified in the government’s annual report to the National People’s Congress. CPS 2011–2015 presented results frameworks for four core sectors and showed the links to CPS objectives. CSP 2011–2015 provided quantitative targets for outcomes. Linked Document 3 provides an overview of the evolution of ADB’s sector-level support.

70. Only CPS 2008–2010 presented outcomes for knowledge and innovation, and governance. The other two country strategy documents did not—although these themes were discussed in CPS 2004–2006 and identified as drivers of change in CPS 2011–2015.


4. **Alignment of Country Strategies with ADB Corporate and Sector Strategies**

72. ADB’s corporate strategies and the PRC country strategies during the CAPE period were consistent with the broad framework for poverty reduction. The CSP, CSP

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80  CPS 2011–2015 called for public sector support to be provided to support PPPs in infrastructure finance, to support small and medium-sized enterprise (SME) development, and to foster financial reform. Support for improved access to microfinance and SME finance were to be part of ADB’s strategy to foster inclusive growth and to boost rural livelihoods, while encouragement of green financing was aimed at contributing to environmentally sustainable growth.

81  CSP 2004–2006 contained sector road maps for: agriculture and rural development, energy, transport (separately for road and railway), water, finance, and environment and natural resources.

82  These covered ANR, energy, finance, transport and urban development.

83  It appears that 2010 targets would have been announced after February 2008 when CPS 2008–2010 was published.

84  Contained sector results frameworks for ANR, energy, transport and urban development.

updates, and CPSs were broadly consistent with ADB’s corporate strategies relevant during the study period.

73. In addition to being in tune with the government’s priorities in the mid- to late 2000s, CSP (2004–2006) and CPS (2008–2010) were consistent with the priorities in ADB’s long-term strategic framework (LTSF) which was approved in 2001. The LTSF articulated three strategic areas of intervention: (i) sustainable economic growth, (ii) inclusive social development, and (iii) governance for effective policies and institutions. Its three strategic themes related to (i) promoting private sector, (ii) supporting regional cooperation and integration, and (iii) addressing environmental sustainability.

74. Strategy 2020, approved in 2008, sought to drive development by supporting and promoting private sector development and private sector operations, good governance and capacity development, gender equity, knowledge solutions and partnerships. CPS 2011–2015 was aligned with the priorities of the 12th plan that intersected with Strategy 2020. The two mutually reinforcing foci of inclusive growth were the expansion of economic opportunities and the provision of broader access to these opportunities. In order to make progress toward realizing environmentally sustainable growth, ADB aimed to support the use of environmentally friendly technologies, adoption of environmental safeguard measures, and establishment of institutional capacities to strengthen their enforcement. Paralleling its support for national programs to reduce poverty and raise living standards, ADB sought to step up regional cooperation and integration (RCI), which for the PRC was mainly implemented through the CAREC and GMS programs.

75. The country strategies were consistent with ADB sector strategies. The following observations on CPS 2011–2015 can be made. First, there was a focus on technical and vocational education and training to upgrade labor skills in the context of urban development, referred to in the CPS, which was one of the focus areas of the ADB Education Operations Plan approved in 2010. Second, the CPS objectives of improving overall energy efficiency and carbon emission intensity in the PRC economy were consistent with the ADB Energy Policy priority of promoting energy efficiency and renewable energy. As the PRC has near universal access to electricity, ADB’s energy policy objective of maximizing energy access was relevant largely in the context of power trading through regional cooperation to enhance energy security. Third, CPS support for improved access to finance by small and medium-sized enterprises and households, infrastructure finance and capital markets, was consistent with the financial sector policy. Fourth, the CPS appears to have gone further than the transport operational plan as it referred to the introduction of sustainable transport options, which the operational plan proposed be introduced only during 2016–

87 In defining ADB’s strategic objectives for the period 2001–2015, the LTSF built on the poverty reduction strategy of 1999, the private sector development strategy of 2000 and other ADB policies and strategies of the time, such as governance.
2020. Fifth, the water operational plan viewed water as a resource and as a service and the CPS incorporated both these aspects. Sixth, the CPS emphasized good governance and capacity development, which was consistent with the competitiveness, effective governance systems, sustainable finance systems, and knowledge and capacity development goals of the urban operational plan.

76. CPS 2011–2015 sought to position ADB to continue playing a catalytic role in the PRC’s development process by enhancing the operational focus on innovation and value addition. It recognized that this strategy called for (among others) attention to knowledge creation and knowledge sharing, and the sharing of good international practices and capacity development. These areas were aligned with ADB’s knowledge action plan. The CPS also covered three of four pillars of the Regional Cooperation and Integration (RCI) policy: it referred to transport connectivity and energy trading in the context of pillar 1 (cross-border infrastructure and related software), trade facilitation in the context of pillar 2 (trade and investment) and support for green finance in the context of pillar 4 (regional public goods).

B. Relevant ADB Initiatives for the Future

77. The medium-term review (MTR) of Strategy 2020 concluded in 2014 that the strategy remained valid, although ADB needed to rebalance and sharpen its operations in view of the changes taking place in the Asia and the Pacific Region. It called for a continued focus on infrastructure development, with increased attention to operations in social sectors. The review highlighted the need to respond to the new business environment, which is perhaps best characterized by: (i) responding to the changing development priorities of countries that attain upper middle-income status; (ii) increasing the role for the private sector in developing infrastructure, creating jobs, reducing poverty and supporting economic growth; and (iii) increasing the need for knowledge solutions to address complex challenges. Further details on the review recommendations are provided in Linked Document 3. The implications of these new priorities for ADB and its initiatives to improve its responsiveness to the new business environment merit attention.

78. “One ADB” Approach. The “One ADB” approach calls for seamless cooperation and coordination within ADB to facilitate the delivery of innovative and potentially transformative knowledge-intensive solutions that can address the development

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93 These initiatives include (among others) multi-modal logistics centers, logistics services, intelligent transport systems, nonmotorized urban transport, traffic demand management, multi-modal passenger hubs and traffic demand management
98 It defined these as (i) strengthening outcomes in infrastructure sectors by improving sector engagement, leveraging private sector investment and emphasizing operations and maintenance; (ii) pursuing the vision of a region free of poverty by expanding support for achieving rapid and inclusive economic growth, supporting infrastructure projects that connect the poor to markets, emphasizing financial inclusion and social protection, strengthening governance systems and institutional capacities; (iii) promoting natural resource management, scaling up support for climate change adaptation, maintaining support for climate change mitigation, strengthening integrated disaster risk management, and facilitating countries to access global and regional funds for environment and climate change; and (iv) supporting cross-border infrastructure investments, expanding regional connectivity, facilitating trade, strengthening financial and monetary cooperation, and supporting regional public goods.
99 The lower middle-income countries will continue to face issues similar to those in low-income countries. ADB has extensive experience in addressing many such development challenges.
challenges of UMICs such as the PRC. The approach will help ADB enhance private sector development and private sector operations. EARD pioneered the “One ADB” approach in 2013 (see Linked Document 3 for further details).

79. **Increasing scale of operations.** It is anticipated that borrower countries will not appreciate ADB’s knowledge work without sufficient financing support, and ADB will find it difficult to remain relevant without a certain scale of operations. ADB will need to adopt the “finance++” approach and leverage other resources effectively, which will be difficult without sufficient financial resources of its own. This requirement provided the rationale for the merger of the Asian Development Fund and ordinary capital resources (OCR) to increase resources available to ADB for lending.

80. **Upper middle-income countries.** ADB’s role in supporting, collaborating, and partnering with UMICs is explained in a February 2015 paper. This paper includes the following six broad priorities (i) mitigating inequalities and promoting inclusive growth, (ii) addressing the challenge of demographic change, (iii) managing climate change and the environment, (iv) boosting productivity and competitiveness by developing the private sector, (v) strengthening RCI, and (vi) promoting South–South knowledge collaboration. These priorities resonate with the PRC’s development challenges and objectives.

81. **Other measures to improve ADB’s effectiveness.** To harness the benefits of the “One ADB” and “finance++” approaches, the MTR calls for ADB to enhance its effectiveness in the new business environment by, among other things: (i) launching new products and services that are more in tune with changing requirements; (ii) adjusting internal procedures and systems to reduce response times; and (iii) enhancing staff capacity to engage in policy dialogue, create new knowledge and find innovative solutions that can potentially transform borrower countries.

**C. On-the-Ground Presence**

82. With a view to being responsive to the PRC requirements, the need to closely engage with the government on a large number of issues, and manage a large portfolio, the resident mission has been strengthened over the past 5 years. Specialists on public–private partnerships (PPPs), transport, procurement, legal matters, and knowledge sharing have been out-posted from ADB headquarters. Two international staff and several national staff have been recruited locally. Among other activities, the resident mission has been reviewing policy developments in areas of ADB engagement, and disseminating its findings across ADB.  

83. The resident mission’s total staff strength (including out-posted staff) now exceeds 60, about half the total number of staff located in EARD at headquarters. It has less than 20% as many international staff as EARD, although administration of more than 50% of projects is currently delegated to the resident mission. The large size of the portfolio in the PRC, compared to Mongolia, the only other country covered by EARD, suggests that most EARD staff spend a large proportion of their time on the PRC.

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101 For the purpose of this CAPE, policy is used as a generic term and includes regulation, guidelines, opinions, circulars, decrees and decisions. Standards for improving quality, reliability or other aspects of performance are also included under policy.
sovereign country program. A small number of PSOD staff manage the nonsovereign portfolio.102

D. **Country Strategy Links with Recommendations from Country Assistance Program Evaluation 2007**

84. The PRC CAPE published in 2007 reviewed ADB’s country engagement during the period 1998–2005. It focused on strategic and institutional aspects of ADB’s operations, and key operational thrusts in its lending and nonlending support to the PRC. The CAPE recognized the government had begun changing its development priorities in the mid-2000s and made several forward-looking recommendations. These recommendations were largely reflected in the CPSs that followed CAPE 2007.

85. In view of the government policies directed at economic rebalancing and building a harmonious society, CAPE 2007 recognized the need for innovative approaches to achieve policy objectives. It recommended strengthening the quality of nonlending operations (technical assistance support, knowledge products and services, and policy dialogue).

86. While noting that ADB’s lending program has tended to be concentrated on transport,103 it recognized the PRC objective of creating a harmonious society encompasses (among other things) social inclusivity and environmental sustainability. Therefore, the CAPE recommended a diversification of the lending program with a proviso that ADB will need to have or will develop a sufficient skill base to support innovation in the selected areas. The CAPE recommendations included (i) strengthening rural development operations in water and natural resources management; (ii) addressing social sector and environmental issues in growing urban areas; and (iii) expanding renewable energy, energy efficiency, other clean development operations, and climate change management.

87. As the private sector and other nonstate enterprises can contribute to the government’s objectives of promoting a harmonious society, even when there is a systemic policy bias in favor of SOEs,104 the CAPE recommended that private sector operations be increased, and that a private sector road map be developed for the forthcoming CPS (for the period 2008–2010).

88. By the mid-2000s, the PRC had become a large market for imports and a provider of development assistance and investment to many developing countries in Asia and elsewhere. The CAPE recommended a deepening of regional cooperation by (i) expanding transport development and trade facilitation; (ii) facilitating cooperation on cross-border issues, with ADB acting as an honest broker to mitigate natural disasters, address environmental concerns and combat the spread of diseases and illegal

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102PSOD has one international member of staff and two national staff in the resident mission (who also develop approvals for financing in Mongolia) and a further four to eight international staff and four to five national staff in ADB headquarters for whom the PRC is a portion of their work. This includes staff in all divisions of PSOD and Office of the General Counsel. By comparison, International Finance Corporation (IFC) has 80 staff in its Beijing office dedicated to the PRC private sector and further supported by IFC staff in Hong Kong, China and Washington, DC. From January 2006 to July 2014, IFC staff produced $5.1 billion of transaction approvals compared with ADB’s $4.4 billion (excluding the Trade Finance Facilitation program) over the same period.

103As per CAPE 2007, the transport sector approvals in certain years exceeded 70% of the total lending approvals.

104Combined, private and joint-stock enterprises accounted for more than 60% of industrial employment and manufactured exports in 2005.
trafficking; (iii) facilitating trade agreements on commodities and energy; and (iv) disseminating the knowledge and lessons learned from ADB operations and country experience across the region.

89. The CAPE recommended a mix of measures to improve ADB’s responsiveness to client concerns that included: (i) strengthening the staff complement in the PRC Resident Mission; (ii) delegating more authority to the resident mission, (iii) deploying technical staff in ADB headquarters efficiently for sharing knowledge and building synergies across regions, and (iv) moving toward a system of pilot testing the use of country systems for environmental safeguards.

90. Recognizing that the government could play a role in improving ADB’s responsiveness, the CAPE recommended the following: (i) facilitating ADB’s selective involvement in project design with interested counterparts; (ii) encouraging the piloting of advisory technical assistance recommendations in investment programs; (iii) encouraging selected provincial or municipal governments to gradually pilot the use of country systems for environmental safeguards; and (iv) encouraging more intensive and longer-term involvement with a few provinces to facilitate joint efforts to develop more challenging options and making greater use of ADB’s new products and initiatives.

E. Other Key Development Partners’ Programs

91. Under the government’s leadership, ADB has coordinated with other development partners through regular direct consultations. ADB maintains contact with development partners and social organizations to exchange information and foster cooperation in areas of mutual interest. In view of the PRC’s increasing economic strength and global presence, and its program to rebalance the economy in the coming years, many development partners are looking to continue to engage with the PRC. Some development partners are adjusting their modalities and manner of engagement.

1. World Bank Group

92. The World Bank Group (WBG)\textsuperscript{105} and ADB have articulated similar priorities in their current CPSs.\textsuperscript{106} Both documents were aligned with the government’s priorities outlined in the 12th plan, to promote inclusive development and greener growth, and recognized the need to respond to rapidly evolving government priorities. Regarding international cooperation, WBG seeks to advance mutually beneficial relations by supporting the PRC’s South–South cooperation efforts and its role as a global stakeholder as the PRC becomes an increasingly important stakeholder in international affairs. ADB supports regional cooperation and integration (RCI), particularly through the CAREC and GMS programs.

93. The size of WBG’s and ADB’s sovereign operations portfolio is broadly similar (about $1.5 billion per year). WBG intends to increase lending by about $1 billion per year through policy-based loans. WBG expects that some lending and nonlending operations in the coming years will be derived from “thought pieces” it has prepared


jointly with the Development Research Center of the PRC State Council.107 The extent to which WBG can influence government policies is not clear, but it does have high visibility in the government. WBG’s current CPS proposed that a multi-year program of analytical and advisory activities be designed to maximize relevance and impact.

94. International Finance Corporation’s (IFC’s) annual investments in the PRC are larger than ADB’s nonsovereign portfolio and range from $0.5 billion to $1.0 billion. This is supplemented by $200 million a year or more of cofinancing. IFC endeavors to hold annual consultations with the government to agree on advisory priorities for the PRC. The IFC portfolio includes investments that supported transactions by SOEs outside of the PRC, in addition to PPP transactions within the country.

2. Other Development Partners

95. The European Union intends to change its relationship with the PRC by moving away from the traditional development aid mindset to one of mutual benefit. While its ongoing development assistance work will last until 2017,108 it will continue to engage with the PRC only in the context of its global programs.109

96. The United Nations Development Programme (UNDP) has supported measures in the PRC to facilitate the achievement of the Millennium Development Goals, lowering inequality and reducing the environmental impacts of rapid development. UNDP plans to continue to respond to the government’s policy advice requirements and to facilitate the achievement of its South–South cooperation objectives.110 The United Nations Environment Programme signed a memorandum of understanding with the PRC in November 2013 that guarantees support for green transition, ecological civilization, environmental policy formulation and South–South cooperation. The United Nations Population Fund’s activities in the PRC focus on (among others) gender and ageing. The Population Fund included the PRC in its 2006 pilot project to explore approaches that facilitate healthy and active aging, and continues to support the implementation of the national plan on aging for the 12th plan period.

97. The International Fund for Agricultural Development’s (IFAD’s) program of $20–$30 million per year is dedicated to reducing poverty, and food and nutritional insecurity in rural PRC. In future, IFAD intends to focus more on the modernization and commercialization of agriculture, promotion of agricultural services, and institutional capacity building.

98. The World Food Program (WFP), which phased out its assistance program in the PRC in 2005,111 is presently planning to reengage by: (i) providing technical assistance on disaster management, agricultural development and poverty reduction; and

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107One thought piece, published in 2013, can be considered to have contributed to the decisions delivered at the Third Plenary Session of the 18th Central Committee of the Communist Party of China in November 2013. Another on urbanization is expected to be published in mid-2014. It focuses on three issues (fiscal reform, land reform and hukou system reform) that are central to the objective of creating an urban, competitive, creative and harmonious society. Another thought piece focused on health is envisaged.

108On environmental regulation and governance, low carbon development, social protection, labor health and safety, and private sector trade.

109Such as those related to trade, global public goods and intellectual property.

110Through its field offices, UNDP has helped channel the PRC funding for South–South cooperation, as well as enabling the PRC to provide expertise to other developing countries.

111Since then, the WFP has received grants from the PRC Government for its global food assistance operations.
(ii) promoting South–South cooperation by developing programs where the PRC provides resources for training of country personnel on food-security-related aspects.

99. France and Japan have the largest bilateral programs in the PRC. Agence Française de Développement has supported the PRC since 2003 and expanded its activities in the PRC to above $100 million per year in 2013 and 2014. It focuses on supporting the transition to a low-carbon growth path, sustainable urban development, and natural resources development. The Japan International Cooperation Agency has reduced its assistance in recent years and no longer approves new loans or grants to the PRC. Its program has therefore declined from $275 million in 2012 to $194 million in 2013, and is to be reduced further.

100. Smaller bilateral programs are provided by Australia, the Netherlands, Norway, United States, and others. For example, the United States Agency for International Development runs a $7 million per year program in central and western provinces to promote job growth, and it provides a $5 million–$10 million per year to support green development and reduce illegal trafficking of wildlife (specially endangered species).
CHAPTER 4
Programming and Portfolio

101. The CPS cycle now coincides with the government’s 5-year planning cycle. The portfolio under the country program comprises (i) sovereign loans, mostly to support infrastructure projects; (ii) NSO, mostly to support infrastructure projects and financing facilities; and (iii) technical assistance (TA) and knowledge products over a broad spectrum of sectors, including public sector management, finance, social, agriculture and natural resources, and infrastructure sectors.

102. In addition to lending and nonlending support with regional implications, ADB supports the PRC within the framework of regional programs. The PRC is both a beneficiary of and a contributor to ADB-supported RCI activities.

A. Country Programming

103. Joint ADB–PRC country programming missions are held annually, and since 2011 they have provided the basis for the COBPs. The entire spectrum of sovereign and nonsovereign lending and nonlending activities under the country program are discussed at the programming meetings. Aspects of the regional programs relevant to the PRC are also discussed. Linked Document 4 provides further details on country programming.112

104. Government officials present to ADB a shortlist of candidate loan and TA projects. ADB agrees to support some or all of the projects, as per the available resource envelope. The scope of candidate loan and TA projects needs to be consistent with the CPS. Over the past few years, the PRC has tended to offer projects to ADB that have innovative and value adding features.

1. Project Pipeline

105. Traditionally, country programming missions have been held toward the end of the calendar year, and the COBP for the next 3 years has been finalized toward the middle of the first year. With the objective of making COBPs cover three full years, the programming missions have been moved earlier in the year. The 2014 meeting was held in August, and the COBP for 2015–2017 was finalized in February 2015. Following a mid-term review in June 2015, the next country programming mission was in August 2015.

106. To date, COBPs have provided a pipeline of firm and standby loan and TA projects. COBPs do not include a KPS pipeline, which provides flexibility on the scope of ADB’s knowledge work, although since 2013 some knowledge units have participated in country programming missions. The NSO pipeline is not listed, although COBPs emphasize that NSO will complement sovereign operations and explore synergies with sovereign operations to support CPS goals. The TA pipeline under the CAREC and GMS

112 Programming and Modalities (accessible from the list of linked documents in the Appendix).
programs, where the PRC is a beneficiary and/or contributor, is not covered in the COBPs. The rationale for this omission is not clear, as the central government supports the provinces that participate in these programs, and some regional TA projects under the CAREC program are managed by EARD.

2. Programming Process

107. The country programming process has become more participatory in recent years. Although country programming missions are organized once a year, policy and sector dialogues are held throughout the year. Sector directors and senior staff meet staff from central and provincial departments and agencies to discuss programming, new technologies, and innovations. The EARD director-general and the resident mission country director carry the dialogue forward with the central and provincial governments.

108. ADB holds meetings with MOF, NDRC and the line ministries of the central government to discuss the loan pipeline. Since 2012, ADB, MOF, NDRC, central government line ministries, and concerned executing and implementing agencies have held workshops to discuss newly introduced loan pipeline projects. Project concepts are discussed at these workshops, and ADB gets the opportunity to suggest innovative project design features. Prior to 2012, no such workshops were held and ADB had limited interaction with provincial and local agencies during project feasibility study phase although they are the clients of most loan projects.

109. A TA programming workshop with central and local government officials, executing and implementing agencies, academics and think-tanks now precedes the country programming mission. The envelope of candidate TA projects is discussed at the workshop, in the context of overall economic reforms and sector priorities. At the TA workshop in May 2014, ADB presented key information requirements for TA proposals. At the TA workshop in 2015, it was agreed that third party vetting of TA proposals would be required before consultation with ADB. This would serve to screen TA projects to ensure they are closely aligned with the government’s reform objectives. In identifying the gaps that a proposed TA is required to address, the proposing agency is required to articulate the expected value addition. As knowledge creation and sharing activities have become more prominent during the study period, knowledge programming meetings are now also being held to identify the type and scope of KPS.

B. Portfolio under the Country Program

110. ADB offers financial and technical assistance and a wide range of KPS. The country program comprises loans, grants and TA projects processed and administered by EARD, plus investments financed by PSOD. From January 2006 to December 2013, the total value of ADB’s portfolio of sovereign loans, grants and TA projects was $13.3 billion, and NSO was $4.1 billion. The country program is complemented by the RCI portfolio under the CAREC and GMS programs.

Where necessary, ADB staff may also participate in a special joint mission to confirm the inclusion of a project in the pipeline. Such a joint mission was organized for the Ningxia Liupanshan Poverty Reduction Rural Road Development project in 2013; project preparatory TA was approved in 2014 and the loan is expected to be approved in 2016.
1. **Sovereign Operations**

111. **Portfolio size.** The sovereign operations portfolio comprised 89 sovereign loans, 19 grants, and 267 TA projects (including 84 project preparatory TA projects). This list excludes the regional TA projects involving the PRC that are administered under the CAREC and GMS programs. To date, the focus has been on project loans, and there have been no program loans. Linked Document 5 lists the interventions approved from 2006–2013. ADB support to the PRC is a small fraction of the total investment in fixed assets in the PRC, and its share continued to fall during the study period. The ratio of ADB sovereign loans to total investment in the PRC has dropped from 1:9,000 in 2006 to 1:40,000 in 2012. Individual ADB loans approved during 2013 and 2014 had a maximum size of $200 million, compared with $400 million in 2009 and $600 million in 2005.

112. **Broad trends.** COBPs show a gradually declining trend of resources programmed for loan and TA support to the PRC during the 12th five-year plan period. They show that resources programmed annually decreased from an average of $1.543 billion for 2011–2012, to $1.486 billion for 2012–2014, $1.417 billion for 2013–2015 and $1.393 billion for 2014–2016. By comparison, loan and TA approvals for sovereign operations increased from $1.343 billion in 2010 to $1.564 billion in 2013.

113. **Sovereign portfolio.** ADB’s support for sovereign guaranteed loans, grants and TA projects averaged about $1.48 billion per year during the study period, ranging from $1.2 billion in 2007 to $1.8 billion in 2009. During the first 3 years of the current CPS period (2011–2015) the annual loan approval amounts increased from $1.34 billion in 2011 to $1.54 billion in 2013 (Figure 5). ANR, energy, transport, water and municipal infrastructure and services (WMIS) and multisector projects accounted for more than 98% of the sovereign portfolio.

**Figure 5: Approved Sovereign Loans, Grants, and Technical Assistance, 2006–2013**

![Graph showing approved sovereign loans, grants, and technical assistance from 2006 to 2013.](image)

ANR = agriculture and natural resources, EDU = education, EGY = energy, OTH = includes finance, health and social services, industry and trade, public sector management, MUL = multisector, TCT = transport and information and communication technology, WMIS = water and other municipal infrastructure and services.


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114 Loans, Grants, and Technical Assistance under the ADB Country Program for the People’s Republic of China (accessible from the list of linked documents in the Appendix).

115 Based on data for loans and TA projects provided in COBPs for 2011–2013 through 2014–2016. COBPs do not provide similar resource allocation data for KPS and private sector operations. COBPs were not prepared for previous 3-year periods.

The main sector priorities during 2006–2013 were: transport (36%); energy (17%); WMIS (16%); multisector (16%); and ANR (14%). No WMIS sovereign loans were approved after 2008, but ADB continued to support urban development through multisector loans. These consisted largely of subprojects for meeting urban needs of water supply, transport, and other municipal services. Two education sector sovereign loans were approved for the first time in 2013, although ADB had supported several policy advisory and capacity development TA projects in the sector during the study period.

Geographic mix. Executing agencies for most sovereign guaranteed loans are entities in provincial or other local governments. The predominance of the central and western regions is evident; these two regions account for 80% of the total loan portfolio. The remaining 20% is split evenly between nine more affluent municipalities and provinces in the eastern region and three provinces in the old industrial belt in the northeast. Such a geographic mix is in line with the government’s priorities and those of ADB’s CPSs. At a sector level, transport loans are concentrated in the central and western regions (90%), followed by multi-sector loans (84%) and ANR loans (80%). The portfolio for the WMIS sector has a 60% loan concentration in the two lagging regions and it was relatively more scattered. In the energy sector, 50% of loan approvals were in the two lagging regions. It is also notable that more than 70% of transport and multi-sector loans were approved for projects in the western region (Figure 6).

Sovereign loans were spread over 26 provinces. The loans covered all of the central and northeastern provinces. ADB had no operations in one western province, and during the CAPE period, it had no operations in four eastern provinces.

2. Nonsovereign Operations

PSOD nonsovereign operations show a generally rising trend from 2006 to 2013 (Figure 7). This increase reflects the collaboration between PSOD and EARD, which ensures that PSOD can capitalize on EARD’s work, and that EARD is aware of and able to promote PSOD’s work. PSOD processed and monitored a total of $4.1 billion of

\[\text{\footnotesize ANR} = \text{agriculture and natural resources, WMIS} = \text{water and other municipal infrastructure and services. Source: Asian Development Bank.}\]

For loan projects that span several provinces in more than one region, the ADB loan amount is assumed to be spread according to the ratio of the number of provinces covered in each region.
equity, loan, B loan, and TA approvals during this period. Approval commitments were allocated to clean energy (56%), clean water (22%) and transport (17%). Another $920 million of equity, loans and B loans were approved for NSO projects in the PRC in 2014. Many private sector operations projects were located in the central and western regions.

3. Technical Assistance and Knowledge Products

Technical assistance. During 2006–2013, project preparatory technical assistance projects (PPTA) accounted for 38% of the total TA approvals of $171 million. PPTA projects were allocated to the infrastructure, ANR, and education sectors. ANR and infrastructure—the main sectors—accounted for 72% of all TA support for policy, advisory and capacity development. The ANR and energy sectors dominated, receiving 25% and 23% respectively of all policy, advisory and capacity development support. Other noninfrastructure sectors supported by TA projects included education, finance, HSP and PSM. These sectors accounted for more than 18% of all TA approvals and 28% of policy advisory and capacity development TA approvals. Although finance and education have been among the core areas of operation since Strategy 2020 came into effect in 2009, TA support for PSM has been significantly higher (Figure 8).

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118 This figure excludes the $1 billion of trade finance program transactions available to ADB member countries including the PRC. Over the period 2005–2014, the trade finance program supported $782.6 million of trade finance through 976 transactions that provided counter-guarantees to confirming banks in the PRC. These confirming banks were part of the world-wide trade network involved in the trade finance program. The beneficiaries of the ADB’s trade finance program were issuing banks in other countries.
119. Executing agencies for most sovereign TA projects are central government entities based in the Beijing area, although the findings and value addition from these TA projects potentially benefit the entire country.

120. **Knowledge publications.** During the study period, EARD produced more than 240 knowledge products for the PRC. Since 2007, every year EARD publishes a list of its knowledge management initiatives by knowledge dissemination type. Dissemination methods include policy notes and series, special publications, sector and thematic paper series, good practice series, and terminal notes series (further details are provided in Linked Document 6). These documents include knowledge publications derived from TA projects.

121. The policy notes (which include “observations and suggestions”) are prepared at short notice and respond to government requests for insights on a specific topic. In some cases, knowledge briefs complemented policy notes.

122. Since 2006, a large number of knowledge products and services have also been delivered to the PRC from other parts of ADB, including ADBI, the Economic Research and Regional Cooperation Department, the Office of the General Counsel, and the Sustainable Development and Climate Change Department. Many of these publications were not specific to the PRC, although they could be of interest to the government. A case in point is the *Asian Development Outlook* and its update, which are ADB flagship publications that focus on fiscal policy, governance, energy, public services, rising inequality and other relevant themes.

123. Other than EARD, only ADBI tracks its products and services by country, knowledge dissemination type, and subject matter theme. Over the study period, ADBI prepared more than 300 knowledge products and services for the PRC, covering 19 sectors and themes.\(^{120}\)

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\(^{119}\) Knowledge Products and Services (accessible from the list of linked documents in the Appendix).

\(^{120}\) The number of documents categorized as conference and seminar materials does not mirror the number of actual conferences and seminars in any given year. All information distributed at ADBI events in support of speaker presentations is categorized as ADBI conference and seminar materials. Generally, such information takes the form of PowerPoint presentations or background papers.
124. **Knowledge sharing services.** In 2009, a knowledge-sharing platform strategy was established by ADB and MOF to: (i) promote South–South cooperation as a vehicle for sharing solutions to key emerging development issues and challenges faced by developing countries in the Asia and Pacific region, (ii) contribute to sound development management and policy making, and (iii) promote regionally inclusive development.

125. In 2012, ADB and the PRC exchanged views on developing a regional knowledge sharing initiative (RKSI). Its broad mandate and objective is to share development knowledge and experiences among countries. In August 2013, the RKSI initiative received its first funds under an ADB regional technical assistance instrument. ADB intends to consult with the PRC government and to agree on a mechanism for realizing the RKSI mandate. While the RKSI’s operating mechanisms are yet to be decided, it is noted that ADB has previously supported the development of various knowledge hubs in different areas.

126. EARD has spearheaded the creation of hubs that focus on urban and environmental issues. The PRC Urban Knowledge Hub was established in 2010 to share good practices in urban planning (including water supply and other municipal infrastructure services). In July 2014, a memorandum of understanding establishing a Knowledge Hub on Green Development and Eco-Compensation was signed by ADB, NDRC and China Agricultural University. This aims to enable policy makers, researchers, and parties working on green development, payments for ecosystem services, and eco-compensation to share good practices and disseminate them to development partners and other countries in developing Asia.

127. The PRC has also benefited from regional knowledge hubs supported by ADB, where a knowledge department has taken the lead. These include the International Poverty Reduction Center in China, the Asia-Pacific Center for Water Security (including the centers for Hydroinformatics in River Basins, and Erosion and Sedimentation), the regional platform for Carbon Capture and Storage Technology, and the Asia-Pacific Finance and Development Center. Some of these hubs have provided advisory or consulting services to policy makers, the research community and other clients in specific disciplines.

### 3. Regional Cooperation Programs

128. **Support for Regional Cooperation.** Some interventions in the PRC country program have regional implications. In line with the CAREC and GMS programs, the country program during 2006–2013 included 11 loans and 14 TA projects with regional implications. Total loan approvals for RCI were $1.755 billion and TA approvals totaled $8.2 million. Seven loan projects were related to transport and four to urban development. In addition, the country program includes three loan and six TA projects where both Mongolia and the PRC were beneficiaries. None of these loans and four of the six TA projects were classified as regional projects.  

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122 A partnership between ADB and Tongji University in Shanghai.
123 In parallel, the PRC Center for Hydroinformation in River Basins was set up as a knowledge hub under the Asia-Pacific Water Forum.
124 TA 6370, TA7618, TA7380, and TA7534 are classified as regional projects. Loan 2896, Loan 3042, and Loan 2759 do not have a regional classification even though they have regional objectives (L2759) or some project components explicitly deal with physical infrastructure for border-crossings and trade facilitation (L3042).
4. Status and Performance

129. The country programming process has impeded ADB’s selectivity in terms of sectors and geographical coverage. However, ADB has endeavored to support the PRC’s changing development priorities in the 11th and 12th plan periods and to introduce value-adding and innovative features in its engagements. The success ratings of ADB’s sovereign loans approved during the CAPE study period is noteworthy (Table 2). Self-evaluation project completion reports (PCRs) have been prepared for 14 of the 89 loan projects approved and completed during the evaluation period and they rated all projects successful or highly successful. IED validated six PCRs and downgraded the ratings of two of them, although all project validation reports (PVRs) continued to rate the projects as successful or highly successful.

Table 2: Performance of Loan Projects Approved and Completed, 2006–2013

<table>
<thead>
<tr>
<th>Sector</th>
<th>Approvals</th>
<th>Amount ($)</th>
<th>Closed</th>
<th>Amount ($)</th>
<th>PCR Rating</th>
<th>PVR Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>($ million)</td>
<td>No.</td>
<td>($ million)</td>
<td>HS</td>
<td>S</td>
</tr>
<tr>
<td>ANR</td>
<td>20</td>
<td>2,021</td>
<td></td>
<td></td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Education</td>
<td>2</td>
<td>100</td>
<td></td>
<td></td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Energy</td>
<td>13</td>
<td>1,155</td>
<td>5</td>
<td>150</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Multisector</td>
<td>19</td>
<td>2,496</td>
<td>1</td>
<td>400</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Transport</td>
<td>24</td>
<td>4,660</td>
<td>6</td>
<td>1,350</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>WMIS</td>
<td>11</td>
<td>1,195</td>
<td>8</td>
<td>795</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>89</td>
<td>11,627</td>
<td>20</td>
<td>2,695</td>
<td>5</td>
<td>9</td>
</tr>
</tbody>
</table>

ANR = agriculture and natural resources, HS = highly successful, No = number, S = successful, WMIS = water and other municipal infrastructure and services.

130. Of the 267 TA projects approved during the CAPE period, 183 were for policy, advisory and capacity development. More than half of these 183 TA projects approved during the CAPE study period have been completed, and 92 TA completion reports (TCRs) were available in January 2015. Overall TA ratings mirror loan project ratings; 70 of 92 self-evaluated TCRs were rated successful and 19 were rated highly successful.125

131. Ratings of loan projects in the CAPE study period were broadly consistent with projects approved prior to 2006 (Table 3). Of the 46 sovereign loan projects approved during 1998–2005, only one self-evaluated PCR was rated less than successful. The PVRs for 29 of these 46 PCRs showed IED concurred with the ratings for most projects, and downgraded one to less than successful.

125One TCR was rated unsuccessful and two TCRs were rated partly successful. TA7147, a transport sector TA project was rated unsuccessful, as work did not progress beyond the inception report stage. TA7052, a finance sector TA project was rated partly successful as the planned issuance of asset-backed securities was abandoned when the regulator disallowed the issuance of asset-backed securities and other derivative products, although the TA project did increase awareness of project sponsors, investors, and regulators on the need to improve the legal and regulatory framework for using asset-backed securities for infrastructure financing. TA 4604, a PSM TA project, was rated partly successful as its outputs were partially achieved.
Table 3: Performance of Loan Projects Approved, 1998–2005

<table>
<thead>
<tr>
<th>Sector</th>
<th>Approvals</th>
<th>PCR Ratings</th>
<th>PVR Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>Amount ($ million)</td>
<td>HS</td>
</tr>
<tr>
<td>ANR</td>
<td>5</td>
<td>380</td>
<td>5</td>
</tr>
<tr>
<td>Energy</td>
<td>6</td>
<td>520</td>
<td>2</td>
</tr>
<tr>
<td>Multisector</td>
<td>5</td>
<td>646</td>
<td>1</td>
</tr>
<tr>
<td>Transport</td>
<td>22</td>
<td>5,287</td>
<td>5</td>
</tr>
<tr>
<td>WMIS</td>
<td>8</td>
<td>947</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>46</td>
<td>7,780</td>
<td>10</td>
</tr>
</tbody>
</table>

ANR = agriculture and natural resources, HS = highly successful, LS = less than successful, No = number, S = successful, TRA = transport, WMIS = water and other municipal infrastructure and services.

* All closed.

b Includes one downgrade.

c Refers to Loan 2089 (Hunan Roads Development II Project).


132. With regard to NSO approvals in the CAPE period, there have been few cases of loans closing or of ADB exiting after making equity investments. Table 4 shows NSO ratings in completion documents and IED validations. In addition, some approvals have been cancelled, and more than half of the approvals are in progress. The extent to which in-progress approvals are running smoothly or facing hurdles is considered in the evaluation.

Table 4: Performance of Nonsovereign Operations Approvals, 2006–2013

<table>
<thead>
<tr>
<th>Sector</th>
<th>Approvals</th>
<th>Amount ($ million)</th>
<th>XARR Ratings</th>
<th>XVR Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td></td>
<td>HS</td>
<td>S</td>
</tr>
<tr>
<td>Clean energy</td>
<td>16</td>
<td>2,287</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Clean water</td>
<td>6</td>
<td>885</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ANR</td>
<td>1</td>
<td>24</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport</td>
<td>2</td>
<td>685</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FI/SMEs</td>
<td>6</td>
<td>131</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Health care</td>
<td>2</td>
<td>80</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>33</td>
<td>4,092</td>
<td>1</td>
<td>3</td>
</tr>
</tbody>
</table>

ANR = agriculture and natural resources, FI = financial institution, HS = highly successful, LS = less than successful, NSO = nonsovereign operations, S = successful, SMEs = small and medium enterprises, US = unsuccessful, XARR = extended annual review report, XVR = extended annual review report validation report.


133. The NSO portfolio size in the 8 years preceding the CAPE period was an order of magnitude lower (Table 5). It included equity investments through funds that were rated less than successful or unsuccessful.
Table 5: Performance of Nonsovereign Operations Approvals, 1998–2005

<table>
<thead>
<tr>
<th>Sector</th>
<th>Approvals No.</th>
<th>Amount ($ million)</th>
<th>XARR Rating</th>
<th>XVR Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clean energy</td>
<td>3</td>
<td>37</td>
<td>1&lt;sup&gt;a&lt;/sup&gt;</td>
<td>1</td>
</tr>
<tr>
<td>Clean water</td>
<td>2</td>
<td>68</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>ANR</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport</td>
<td>9</td>
<td>296</td>
<td>3</td>
<td>1 1 3&lt;sup&gt;c&lt;/sup&gt; 2</td>
</tr>
<tr>
<td>FI/SMEs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health care</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>14</td>
<td>401</td>
<td>3 2 1 1 5 2</td>
<td></td>
</tr>
</tbody>
</table>

ANR = agriculture and natural resources, FI = financial institutions, HS = highly successful, LS = less than successful, S = successful, SMEs = small and medium-sized enterprises, US = unsuccessful, XARR = extended annual review report, XVR = extended annual review report validation report.

<sup>a</sup> Includes one approval for which IED waived the requirement of an XARR (Inv 7159).

<sup>b</sup> China Environment Fund 2002 and 2004 were rated together and count as one.

<sup>c</sup> Includes one rating based on a project performance evaluation report (Inv 7219).


C. Subregional Cooperation Program

134. Given the PRC’s larger interests in South–South cooperation, the experiences gained from the rest of the Asia and Pacific region can potentially yield benefits for the PRC. Many TA projects administered under the CAREC and GMS programs are relevant to the PRC (see Linked Document 7).<sup>126</sup> The PRC is also a contributor to some ADB-supported RCI loans and TA projects. During the CAPE study period, $107.1 million of grant assistance was provided by ADB for RCI where the PRC was a beneficiary; about 75% was focused on the GMS area and less than 2% on the CAREC area. During the CAPE study period, the PRC benefited from 21 regional TA projects under the CAREC program. These focused on knowledge and capacity development related to transport, trade, energy, sanitary and phytosanitary measures. The coverage of the 28 regional TA projects under the GMS program was more comprehensive. In addition to knowledge and capacity development for transport connectivity and trade facilitation measures, TA projects addressed energy, agriculture and food security, tourism and regional public goods related issues. Under the CAREC program, regional TA projects were processed and administered by EARD in the trade facilitation sector; the Central West Department (CWRD) was responsible for the transport coordination committee, the World Bank for energy and IMF for trade policy. Under the GMS program, the South East Asia Department (SERD) administered all of the TA even though the GMS includes two PRC provinces.

135. The PRC funded the Regional Cooperation and Poverty Reduction Fund (the PRCF), which contributed $13.1 million to the CAREC and GMS programs from 2006 to 2013. This amount was about a third of the total PRCF commitments and about 10% of technical assistance under the CAREC and GMS programs during the same period. The government also cofinanced two infrastructure projects with ADB, and contributed to various cross border infrastructure projects.<sup>127</sup>

<sup>126</sup>Regional Cooperation and Integration (accessible from the list of linked documents in the Appendix).

<sup>127</sup>These include: (i) financing sections of a road in Lao People’s Democratic Republic as part of the Northern Economic Corridor project (L1989); and (ii) financing a section of the north–south road transport corridor between Choyr and the border with the PRC in Zamyn–Uud as part of the Regional Road Development Project (L2087).
CHAPTER 5

ADB’S Value Addition in Economic Transformation

136. An important reason why the PRC borrows from ADB is because this engagement enables it to learn from international experience. Many of ADB’s lending and nonlending interventions have sought to provide value-adding inputs to support the PRC’s reform program by introducing innovations. Their design, outputs, and outcomes have been consistent with ADB’s strategic objectives.

137. ADB’s value-adding interventions can help bring about change in the way things are normally done. For example, assistance can be provided to make farming practices more efficient, increase labor mobility, promote inclusive urbanization, improve the environment for competition, manage the fiscal health of local governments, and limit and possibly reverse the adverse environmental implications of development. ADB can add value to the government’s policies, strategies, plans and programs by recommending innovative policy measures, good practices for processes and systems, new financing modalities, or new or highly sophisticated technical solutions that have not yet been applied in a particular context or location in the PRC. In addition to innovation, the realization of transformative changes requires replication of ADB-supported demonstration projects, scaling-up of ADB’s capacity development support, and wide implementation of policy initiatives that stem from ADB’s advice. As part of the process of developing these initiatives, effective risk management arrangements need to be established to realize their full potential.

A. Factors Influencing ADB’s Value Addition

138. Loan projects. With the introduction of a workshop to discuss new projects in the pipeline for ADB loan support, it is increasingly likely that ADB will be able to influence project design before the concerned agencies complete their feasibility studies. Before 2012, there were already examples of infrastructure projects where ADB had made significant value-adding contributions. These included projects where the concerned agency had prepared the feasibility study and safeguards documents (as per the country system) before any significant interface with ADB; in other cases, the concerned provincial and local agencies had engaged with ADB while preparing these documents (Table 6). When documents were prepared before significant consultation with ADB, the concerned agency often found it difficult to incorporate any fundamental changes in project design that ADB suggested. As a result, ADB’s due diligence (project preparation) process for proposed infrastructure projects resulted mostly in add-on project components to increase social inclusiveness, safety, or environmental friendliness to make the loan more attractive from a development finance perspective. In future, as ADB aims to increase the value addition and
innovative content of its projects, it intends to configure more projects on the basis of findings from advisory TA projects.128

**Table 6: Value Addition in Loan Project Design**

<table>
<thead>
<tr>
<th>Approval Year</th>
<th>Loan Project</th>
<th>Value Addition</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>Loan 2244: Hunan Flood Management Sector Project</td>
<td>Introduced non-structural measures to strengthen river basin and provincial flood management, flood warning, and flood response systems, plus structural works to raise flood protection standards in priority areas prone to high flash-flooding risks</td>
</tr>
<tr>
<td>2009</td>
<td>Loan 2601: Lanzhou Sustainable Urban Transport Project</td>
<td>Added bus rapid transit systems</td>
</tr>
<tr>
<td>2011</td>
<td>Loan 2744: Forestry and Ecological Restoration Project in three northwest provinces</td>
<td>Supported investment components for tree crop plantations and pilot development of agro-industries (including a cold chain for apples, among other industries) in Gansu province</td>
</tr>
<tr>
<td>2011</td>
<td>Loan 2835: Hebei Energy Efficiency and Emission Reduction Project</td>
<td>The PPTA studied how to channel ADB financing to industrial energy efficiency subprojects prepared by financial intermediaries</td>
</tr>
<tr>
<td>2012</td>
<td>Loan 2915: Jiangxi Fuzhou Urban Integrated Infrastructure Project</td>
<td>Added bus rapid transit systems</td>
</tr>
<tr>
<td>2013</td>
<td>Loan 3014: Hebei-Yichang Sustainable Urban Transport Project</td>
<td>Added bus rapid transit and nonmotorized transport systems</td>
</tr>
<tr>
<td>2013</td>
<td>Loan 3074: Yunnan Sustainable Road Maintenance Project</td>
<td>Included a road asset management system for the entire main road network</td>
</tr>
<tr>
<td>2014</td>
<td>Loan 3202: Gansu Baiyin Integrated Urban Development Project</td>
<td>Is establishing an enhanced environmental management system for an industrial park</td>
</tr>
<tr>
<td>2014</td>
<td>Loan 3218: Low-Carbon District Heating in Hohhot in Inner Mongolia Project</td>
<td>The PPTA helped analyze the potential for clean and renewable-energy-based heating</td>
</tr>
</tbody>
</table>

ADB = Asian Development Bank, PPTA = project preparatory technical assistance.

* In many cases, feasibility studies of infrastructure projects prepared by the PRC agencies focused on infrastructure engineering aspects. For example, urban transport projects that proposed construction or rehabilitation of urban roads without an integrated urban transport planning approach to reducing air pollution and congestion.

Source: ADB Independent Evaluation Department.

139. In the case of ANR projects, ADB has accessed grant resources from the Global Environment Facility and/or climate funds and/or other trust funds,129 and it has been able to contribute significantly to project design (Table 6). This is because of a combination of (i) global innovations in natural environment management since the

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128 For example, Developing Multimodal Passenger Hubs (TA 7925) in which ADB supports several multimodal passenger hubs in a particular province. This TA could lead to a loan.

129 About $23.00 million of grant resources, mostly from the Global Environment Facility ($18.9 million) complemented about $2.00 billion of ADB loans approved from 2006 to 2013. The most significant contributions from grant resources included (i) a $5.10 million grant with Loan 2744 to finance reforestation, restoration of degraded land and capacity development for carbon market readiness in state forest farms; (ii) a $4.50 million grant with Loan 2436 that supported a multifocal approach to conserving biodiversity, and encouraged an integrated ecosystem management approach to restore productive and protective functions of ecosystem resources; and (iii) a $4.27 million grant with Loan 2572, to improve biodiversity conservation and management by restoring forest habitat, improving endangered species management, and providing sustainable livelihoods for the local population.
Global Environment Facility was set up in 1991;\textsuperscript{130} and (ii) a general acknowledgement of the size of the environmental challenge facing the PRC today, which reflects the disconnect between rapid economic growth of the past three decades and slow progress on strengthening institutional mechanisms for environmental protection. ADB has introduced significant innovative design features to address agricultural modernization, water resource management, ecosystem restoration and other environmental protection objectives.

140. In all infrastructure and ANR loan projects, ADB has contributed by comprehensively addressing environmental and social safeguards.\textsuperscript{131}

141. **Technical assistance and knowledge work.** TA and KPS activities serve several levels of interest, from agency capacity development (e.g., improved sector regulation) to higher order changes and outcomes (e.g., policy and strategy support). Some activities have a capacity development and learning focus. Many facility TA subprojects that address specific knowledge needs are not characterized as transformative or high-impact although they can be effective in meeting their narrower goals.

142. Central government ministries and executing agencies appreciated ADB support through TA and most of the outputs were taken as food for thought for policy making. Likewise, the knowledge content of KPS, particularly those produced at the government’s request were considered in policy making processes. Government agencies take a holistic and comprehensive view of the PRC context and internal government perspectives, along with inputs from ADB, other development partners, local research institutes, academics and other sources when developing policy. The actual contribution of a TA project to a particular policy can be small or it can be significant. It is difficult to attribute policy pronouncements to ADB TA outputs and knowledge products with any certitude. Likewise, the actual contribution of policy and sector dialogue throughout the year is difficult to gauge. Quality TA and knowledge output and policy advice provided at the right time, coupled with strong demand, is likely to directly inform and influence policy.

**B. Value Addition in Meeting Strategic Objectives**

143. ADB’s value-adding interventions were consistent with stated CPS objectives and government reform priorities. Many interventions addressed several CPS objectives or government priorities. Most value-adding interventions primarily addressed environmentally sustainable growth, inclusive growth and good governance objectives presented in the CPSs.

\textsuperscript{130}Activities include: improving river basins and marine ecosystem management, slowing down desertification and land degradation, improving agricultural practices, and addressing climate change.

\textsuperscript{131}ADB’s value addition in the field of environmental and social safeguards is evident from the following: (i) ADB builds on environmental impact assessments prepared according to the country system. It includes aspects that are not covered at all in the country assessments (such as community health, worker safety and HIV/AIDS) and strengthens the assessment of aspects that are not sufficiently well covered (such as biodiversity, climate change and grievance redress). (ii) ADB helps fill gaps on involuntary resettlement (as the country systems are not required to prepare a resettlement plan before project approval) and engages a third party for six-monthly monitoring and reporting of resettlement and compensation. (iii) Issues related to ethnic minority development are not normally considered at the project level in the PRC. ADB helps prepare ethnic minority development plans to fill this gap.
1. Value Addition from Sovereign Operations

144. **Value-adding loan projects.** Environmental and social sustainability aspects of ADB-supported projects go beyond the safeguards’ “do no harm” principle. For example, two completed demand-side energy projects in Guangdong province (L2426, and L2611) that were the first two loans of a three-tranche multitranche financing facility generated significant value addition. These loans led to two industrial energy efficiency loan projects supported by a financial intermediation modality and a revolving fund in two other provinces (L2771 in Shandong and L2835 in Hebei).

145. Many ongoing loans are designed to demonstrate innovative features, such as (i) cutting-edge green energy generation technologies (L2616 and L3075); (ii) new practices to modernize agriculture (L2607); (iii) sustainable transport from a maintenance perspective (L3074) and for a clean environment (L2962); and (iv) urban wastewater reclamation and reuse (L2237) and geohazard control measures for urban development (L2941). Most completed and ongoing loan projects meet ADB’s environmental sustainability goals and the PRC’s environment protection priorities.

146. In some cases, where the ADB loan was a minor share of project capital cost, its value addition related largely to safeguard implementation. For instance, ADB loan amounts accounted for less than 5% of the project cost for two loans approved in 2008. These loans provided value-adding support for safety equipment and related capacity development, and assisted counterpart agencies to learn ADB processes for procurement and safeguards when implementing an entire rail construction project.

147. **Value addition from technical assistance.** Many TA projects completed during the CAPE study period led to policy recommendations. Others contributed to innovation in such areas as a new investment program (through strategy, design, or capacity development) or introduced good international practices; yet others supported pilot experiments or the establishment of knowledge hubs.

148. Linked Document 8 lists the value-adding contributions of TA projects approved during the CAPE study period. Value-adding policy recommendations relate to many reform objectives of the government, in particular (i) urban and rural development, and (ii) labor and welfare systems. Together these reform programs sought to create a new socialist countryside and to accelerate the urbanization program. Value addition supported the achievement of the government’s environmental protection objectives by (i) introducing financial mechanisms (to reduce energy intensity of SMEs, and develop carbon markets); (ii) making technical design recommendations (an intelligent railway station building, and user-friendly multi-modal hubs); and (iii) advising on other operational measures (non-structural measures for water conservation).

149. Other value-adding TA support included (i) pilot testing a new two-tiered rural pension system; (ii) developing capacity to administer the new rural pension system, integrated ecosystem management, and planning and implementing a leading edge clean coal power project; and (iii) supporting the government’s financial sector reform objectives by improving financial inclusion and strengthening the legal framework for anti-money laundering activities. In a few cases, the government confirmed that TA outputs were incorporated in policy (Table 7) or provided inputs to five-year plans.

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132 (i) Loan 2471: ADB loan of $300 million is 3.5% of the estimated project capital cost (ongoing); and (ii) Loan 2481: ADB loan of $150 million is 4.9% of the estimated project capital cost (ongoing).

133 Value Addition from ADB Support (accessible from the list of linked documents in the Appendix).

134 For instance, (i) TA 7170 (PSM): the findings and strategic inputs (regarding rural finance, agricultural modernization, rural infrastructure, SME development, public-private partnership) were incorporated in the
### Table 7: Examples of Technical Assistance Inputs into Policy-Making

<table>
<thead>
<tr>
<th>TA Number (Sector)</th>
<th>Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>7933 (ANR)</td>
<td>Guangdong Provincial Government submitted major policy recommendations on environmental improvement in rural areas and small cities to the PRC government, and received positive feedback</td>
</tr>
<tr>
<td>7212 (EGY)</td>
<td>Ministry of Finance issued a regulation on concessional loans for clean development projects</td>
</tr>
<tr>
<td>7592 (HSP)</td>
<td>National Development and Reform Commission issued a policy note on improving equity, efficiency and effectiveness of rural health services</td>
</tr>
<tr>
<td>7702 (HSP)</td>
<td>State Council issued Temporary Regulations on Social Assistance in February 2014 on social assistance support for unemployed able-bodied persons (for interest free bank loans, and subsidies on social insurance)</td>
</tr>
<tr>
<td>7391 (PSM)</td>
<td>The provincial government confirmed it will adopt the recommendations for strengthening public employment services</td>
</tr>
<tr>
<td>7083 (WMIS)</td>
<td>Ministry of Housing and Urban–Rural Development confirmed that it issued guidelines on urban wastewater reuse in 2013</td>
</tr>
</tbody>
</table>

ANR = agriculture and natural resources, EGY = energy, HSP = health and social protection, PSM = public sector management, TA = technical assistance, WMIS = water and other municipal infrastructure and services.


150. Facility TA projects that enable ADB to respond quickly to emerging PRC requirements were an important means of supporting and disseminating innovation serving different CPS objectives and the PRC reform priorities. For example, TA 4933 made important contributions to meeting (i) the CPS objectives of inclusive growth, environmentally sustainable growth and governance; and (ii) the PRC reform priorities related to urban and rural development, environmental protection, and labor and welfare.

151. **Value addition from mutually reinforcing interventions.** Toward achieving certain specific objectives, ADB has supported several loans and TA projects (see Linked Document 8 for examples). Most notable is ADB’s TA support since the early 2000s to develop a long-term water pollution control plan for the Songhua River Basin. Three loan projects demonstrated wastewater treatment and other new technology measures for pollution control and clean-up. Additional TA was provided for tariff reform and corporate governance, which contributed to the development of an enabling environment for private sector participation, culminating in two private sector projects.

152. **Value addition from knowledge products and services.** Policy notes were the most prominent input to the PRC decision makers. MOF valued policy notes that responded to its stated requirements. Linked Document 8 provides an overview of selected policy recommendations prepared by ADB that resulted in government actions. In many cases, it appears the government had been contemplating some action for many years before it requested advice from ADB. Similarly, the government might take many years after receiving ADB’s recommendation before deciding to act. Normally government action occurred in incremental steps. Piloting appears to be the government’s preferred approach to ascertaining the direction or decisiveness of taking action. Over time, the government’s stance appears to be converging with developed-economy norms, for instance using dividend payouts from state-owned capital to finance social spending or other public goods. Most recommendations provided through policy notes related to the CPS objective of good governance and the government objective of fiscal reform. Although policy notes are normally prepared at the request of the government, ADB has proactively initiated policy dialogue in certain provincial-level 12th Five-Year plans of the two provinces; and (ii) TA 7361 (PSM): the respective provincial level governments adopted the TA recommendations for promoting socioeconomic development.
cases. These include advice on making value added tax more broad based, and policy advice on areas that are anticipated to become important during the 13th plan period (2016–2020). Memoranda of understanding on environmental protection and climate change provide a basis for ADB to focus on these areas and provide further value addition.

153. It is difficult to ascertain the extent to which other knowledge products prepared by various ADB departments and by ADBI added value to the state of knowledge in the PRC, although positive feedback has been received from the government on *Asian Development Outlook* and its updates, and the Asia Bond Monitor series.

### 2. Value Addition from Nonsovereign Operations

154. In line with CAPE 2007 recommendations, PSOD has provided several significant innovations that have greatly increased its visibility in the PRC. PSOD's value addition to the private sector has primarily occurred through the development of financial structures to finance many small PPP projects, enhancing corporate governance and safeguard practices, promoting environmental sustainability, local currency financing, direct value-added cofinancing through B loans and other financial instruments, and contributing to banking sector reform (see Linked Document 8). Small PPP projects were recognized in the PRC when MOF showcased the China Gas Holdings Limited Municipal Natural Gas Development project at a high-level Asia-Pacific Economic Conference in 2014.

155. As development benefits increase when foreign currency risks can be mitigated, ADB has approved loans to the PRC borrowers in local currency or dual currencies (dollars and yuan). ADB's ability to offer such loans depends on its ability to issue local currency bonds, which depends on government approvals and capital market conditions. ADB has played a pioneering role in developing these capital markets.

156. PSOD’s B loan program provided borrowers with additional foreign currency funding from international financial institutions through syndicated loans where ADB was the lender of record. The B loan is an instrument that enables international lenders to gain familiarity with projects, local borrowers, and the PRC context. It is an important tool that leverages ADB’s resources, and it is an important contributor to private sector development in the PRC when borrowers are able to manage the foreign currency risks of dollar-denominated loans. As internationalization of the PRC currency progresses, it will be possible for ADB to offer local currency complementary loans.

157. ADB’s strategic direct equity investments into companies and financial institutions have contributed to their growth, and to their ability to attract additional investors and lenders. Through these equity investments ADB can potentially have greater influence on corporate governance and institutional incorporation of ADB safeguard policies. Equity investments carry greater risks than loans and require significant staff commitments to manage risks, especially when ADB takes a board seat.

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136 Over the period 2006–2014, ADB exited seven of its nine equity investments in the PRC, with proceeds of $709 million on investments purchased for $216.94 million. Six of the seven exited investments were exited profitably, contributing profits of $491.36 million to ADB’s corporate results.
C. Tracking Value Addition from ADB Support

158. The extent to which TA and knowledge products contribute to policy making, or to which loan projects provide benefits or are replicated is not systematically tracked. Despite this, informal feedback from the government is provided by ADB staff communications with specific executing agencies or from news publications. Many government entities acknowledged to the CAPE team the transformative contributions made by some of ADB’s TA projects and its knowledge work. EARD and MOF have instituted two events that give awards for loans and TA projects that have resulted in policy impact. ADB organizes press tours for journalists from large PRC-based media enterprises to visit sites of three to five ADB-supported projects each year. The journalists interview the executing and implementing agencies and project beneficiaries. In addition to preparing news reports for wide dissemination, the media enterprises prepare briefing notes on some projects for presentation to the State Council.

159. ADB plans to systematize the tracking of value addition from ADB interventions. A triangular arrangement that involves MOF and third-party think tanks is envisaged. To assist progress toward this, ADB’s Sustainable Development and Climate Change Department prepared a KPS results framework in 2014. Although this is work-in-progress, it will support efforts to measure knowledge using quantitative and qualitative indicators for major knowledge products and knowledge events. The Sustainable Development and Climate Change Department is designing instruments to monitor outcomes and outputs. ADB plans to begin testing the system later in 2015.

D. Risk Mitigation

160. An important corollary to pursuing innovation and value addition is the need for ADB and the government to accept a higher level of risk when designing projects and programs. The government normally seeks ADB support for investment projects that it believes will be successful. Given that institutional capacities are stronger in the eastern provinces, relatively high-risk innovations can be supported there. To date, few loans have supported investments in leading edge technologies, although ADB has provided value-added inputs and introduced innovative aspects in project design for several loans.

161. The government considers ADB-supported TA and knowledge products to be one of many inputs to development policy, and its internal processes enable informed policy-making to minimize risk and the unintended consequences of new policy. ADB appreciates that it needs to have a good understanding of the critical success factors for the policy advice it offers, and that it needs to take into account contextual factors such as institutional capacities and organizational cultures.

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138 The framework is intended to focus on major knowledge products, knowledge events and other knowledge services. The determination of what is major will be left to the discretion of the concerned operations and knowledge departments.
CHAPTER 6

Evaluation of Sovereign Operations

162. The country strategies and sovereign operations during the study period were evaluated using the following criteria: (i) relevance, (ii) effectiveness, (iii) efficiency, (iv) sustainability, and (v) development impacts. The evaluation recognized that ADB has tended to focus on areas that could potentially have a multiplier effect and leverage impacts. Lending operations demonstrated new and emerging technologies and innovative project designs. Nonlending operations used various TA and KPS modalities to contribute to policy designs that addressed a wide range of sector-specific and cross-cutting issues, and helped develop the capacity of central and local institutions to design, implement and monitor programs in line with development priorities (see Chapter 5).

163. In addition to reviewing loans and TA, the evaluation covered ADB’s knowledge products and services. IED reviewed all of the sectors where ADB was engaged in the PRC during the evaluation period. The large portfolio of loans and TA projects was classified by sector and subsectors. In most cases, the classification formed a good basis for sector assessments. Linked Document 9 presents assessments of sovereign operations for ANR and infrastructure sectors. Assessments of sovereign operations for finance, PSM, and social sectors are provided in supplementary appendixes.

164. The CAPE evaluated loan and TA projects approved during the study period (paras. 130 and 131). IED reviewed available project approval and implementation documentation for all completed and ongoing projects; and reviewed self-assessed PCRs or TCRs and/or independently assessed PVRs where available. Additionally, it consulted with ADB staff and stakeholders for selected projects. The evaluation acknowledges the success of ADB sovereign operations prior to 2006, and notes that many of these operations were initiated under previous CSPs. Prior ADB CSPs reflected the government’s emphasis on creating infrastructure. Linked Document 10 shows the overall ratings presented in self-assessed completion reports and IED’s validation reports, and explains the differences in ratings for each criterion.

139 Loans and TA projects that were regrouped for the purpose of conducting sector assessments are listed in a supplementary appendix. For example, TA projects classified under energy, finance and PSM sectors provided support related to climate finance; for the purposes of this assessment, these TA projects were included in the energy sector as the TA portfolio in this sector includes a large number of initiatives that support climate change mitigation.

140 Sector Assessments (accessible from the list of linked documents in the Appendix).

141 Ratings of Loan Projects Approved during 1998–2005 but Completed After 2006 (accessible from the list of linked documents in the Appendix).
A. Relevance

165. ADB’s engagement with the PRC is rated relevant. The CPS objectives (along with thematic priorities and/or drivers of change) were appropriate; ADB was strategically well positioned to deliver the CPS, and the program design reflected CPS objectives.

1. Appropriateness of Country Partnership Strategy Objectives

166. Poverty reduction was an overarching goal of ADB corporate strategies during the CAPE period, and this objective reflected the government’s strategies to promote social fairness. ADB’s three PRC country strategies consistently sought to pursue the following objectives: (i) inclusive growth, (ii) environmentally sustainable growth, and (iii) regional cooperation. In doing so, they were consistent with ADB’s corporate strategies, sector operational plans and the government’s strategies. Within this framework, the country strategies evolved over time to reflect accumulated experience in undertaking difficult reforms and the need to bring about changes at scale. The PRC’s growing economic strength has influenced this evolution.

167. The government tried to liberalize market forces through its 11th and 12th plans. In response, the ADB country strategies up to 2010 included market development as an explicit objective. ADB’s intention was to support the creation of an enabling environment for the private sector. Although market development was not an explicit objective in CPS 2011–2015, private sector development was recognized as a driver of change where ADB could play a significant role.142

168. Good governance and knowledge sharing were thematic priorities in CSP 2004–2006 and CPS 2008–2010. CPS 2011–2015 included good governance, capacity development and knowledge sharing as drivers of change. Along with the three objectives, the drivers of change can contribute toward the achievement of the PRC reform objectives outlined in the Third Plenum resolution (paras. 49–57).

2. Strategic Positioning

169. The four major areas of ADB support (ANR, energy, transport, and urban development) accounted for nearly 99% of the total amount of loans and TA projects approved during 2006–2013. Overall TA support was less than 1.5% of the total portfolio. Over 30% of TA support was for the education, finance, HSP, and PSM sectors. ADB’s interventions in these core and non-core sectors were important for achieving the government’s objectives and priorities during the CAPE study period. ADB support in all sectors is expected to remain important during the coming decade as the government strives to implement the Third Plenum resolution.

170. By providing ADB with a short-list of project candidates (para 104), MOF has helped in the determination of the overall relevance rating. ADB has traditionally responded to the short-list of candidate projects by agreeing to support them within its available resource envelope. ADB’s responsiveness has made it less selective in terms of sector and geographic coverage. Within this framework, ADB endeavored to introduce

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142 In improving the policy and regulatory environment, improving access to finance, supporting infrastructure development through PPP, improving financial and logistics services, and introducing innovative financial solutions.
innovation in project design and to provide value-adding inputs for policy making. Increasingly MOF has been short-listing projects that have innovative content.

171. **Responsiveness and selectivity.** How and by when the government would achieve its goals has not always been clear. The core reasons for this uncertainty have included the following: (i) multiple and complex links among key reform areas, and (ii) the varying extent to which provincial and local governments were receptive to and had the capacity to implement reforms led by the central government. ADB’s country strategies recognized this uncertainty. In particular, CPS 2011–2015 stated (i) that ADB and the government should regularly consult and revisit strategic priorities to ensure the country programs remained responsive to the PRC’s evolving social and economic context; and (ii) that ADB should offer knowledge solutions on specific issues at the request of the government, and in this way, help spread the reform message across the PRC.

172. **Sector coverage.** ADB’s responsive approach meant it was engaged with the PRC in a large number of sectors and subsectors, and provinces. The need for flexibility made it difficult for ADB to focus on a smaller number of sectors, while the relatively small scale of ADB’s operations made it difficult to maintain continuity across all areas of engagement. This being the case, CPS 2011–2015 sought to make ADB more selective within each sector, with a view to focusing on value addition and innovation, and in so doing, contributing to the PRC’s economic transition across many dimensions. The emphasis on value addition and innovation during the CAPE period is evident from the following: (i) a greater share for ANR sector projects where ADB interventions include significant innovation for protecting the environment; (ii) a phasing out of support for expressway projects and greater emphasis on sustainable transport, logistics and safety; and (iii) support for cutting-edge energy generation technologies. In addition, ADB mainstreamed knowledge support through loans, TA, and KPS, across all sectors of engagement.

173. **Public sector management and governance support.** ADB’s focus on PSM and governance has evolved to reflect the fast changing the PRC policy and development landscape and its requirements. ADB’s country strategies also reflected its own institutional evolution, and the growing focus on mainstreaming governance, knowledge work, and capacity development. The CSP for 2004–2006 and CPS for 2008–2010 were informed by stand-alone governance thematic assessments, in addition to governance risk assessments, as prescribed under ADB’s Second Governance and Anti-Corruption Action Plan. In future, ADB can improve its diagnostics and programming through a stand-alone PSM assessment and road map with a results framework. This will help sharpen ADB’s focus and strengthen results-orientation in this critical area.

174. **Geographic coverage.** ADB’s three country strategies responded to the government’s objective to develop lagging provinces in central and western PRC. Many infrastructure projects (particularly in transport and urban development) in the PRC provinces bordering countries in Central and Southeast Asia had regional implications. These regional dimensions helped ADB achieve synergies between the country program and the CAREC and GMS programs.

175. **Development partners.** The government has established a clear division of labor among its development partners. Whether or not the government clearly demarcated ADB’s role in a particular sector or subsector, there was no evidence of duplication or redundancy in the provision of support among development partners, and constructive
synergies emerged across their activities. ADB operated independently of other development partners, which enabled it to analyze critical issues and offer impartial policy advice.

3. Program Relevance and Design Quality

176. With a view to increasing leverage and visibility, and in keeping with the available OCR lending envelope, ADB has restricted individual loan sizes in recent years to less than $200 million. The average TA size was also reduced from nearly $600,000 for TA projects approved from 2006–2009, to under $550,000 thereafter. TA and knowledge support contributed to policy dialogue.

177. Loans. All ADB loans in the CAPE period were project based; there were no program loans. ADB’s infrastructure loans supported investments that were an integral part of the development plans of the concerned provinces and municipalities or other local jurisdictions. Loan projects incorporated increasingly complex designs over time. In the ANR sector, loans normally had components that spanned two or more themes (irrigation efficiency, dryland and forest management, flood and drought management, water pollution control, or ecosystem restoration). Transport sector loans did not support any standalone highway or expressway projects. Typically, the transport projects included rural interconnectors attached to highway or expressway projects, and increasingly projects moved into energy-efficient modes and multi-modal transport systems. Urban development projects typically packaged several subprojects based on a masterplan, and these subprojects often changed during implementation as the masterplan was updated. Evidence of a holistic design and analysis approach in the selection of subprojects was not readily available. In the energy sector, many loans supported one major or sole investment project. Difficulties sometimes arose because the loans were intended to finance cutting edge technologies, or to incorporate innovative financial intermediation arrangements.

178. ADB loans supported about 25% of the project capital costs estimated at approval. They accounted for more than 40% of the project capital cost in ANR, education and urban development projects; about 33% for energy projects; and less than 15% for all transport projects (Table 8). If two loans in the rail transport subsector are excluded, where ADB’s share of project cost is less than 5%, the share of ADB loans in financing transport project capital costs was 21%. This indicates that ADB contributed significantly to enabling capital expenditures in most cases. By comparison, ADB’s value addition to the design aspects of loan projects varied considerably across sectors and projects (paras. 138–139).

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143 In the financial sector, the division of labor among ADB, IMF, and WBG is clear. The PRC looks to ADB to focus on financial inclusion, the IMF to focus on monetary and currency convertibility, and the WBG on banking. However, this does not preclude ADB from offering knowledge solutions or other support in areas that the PRC earmarks for the IMF or the WBG. For example, ADB has advised on the stress testing of commercial banks, while the WBG has provided support in the development of the rural pension system. In urban development, the government seeks policy advice on management of landfills, wastewater, solid waste and storm water only from ADB. Even when broad sectors or subsectors are not demarcated for support by ADB or another development partner (such as in having renewable energy and energy efficiency), there is no overlap or redundancy.

144 Individual loan sizes were as high as $400 million in 2009 and $600 million in 2005.

145 Loan 2471: ADB loan of $300 million is 3.5% of the estimated project capital cost (ongoing); and (iii) Loan 2481: ADB loan of $150 million is 4.9% of the estimated project capital cost (ongoing).

146 By comparison, for investment loan projects approved between 2002 and 2011 for support to Pakistan, ADB’s average loan size exceeded 70% of project cost in energy, transport and WMIS sectors; and exceeded 80% of project cost in the ANR sector.
Table 8: Share of ADB Loans to Project Capital Cost for Approved Projects, 2006–2013

<table>
<thead>
<tr>
<th>Sector</th>
<th>Loan Size ($ million)</th>
<th>Project Capital Cost ($ million)</th>
<th>Share of Loan to Project Capital Cost (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANR</td>
<td>2,021</td>
<td>4,487</td>
<td>45.0</td>
</tr>
<tr>
<td>Energy</td>
<td>1,155</td>
<td>3,454</td>
<td>33.4</td>
</tr>
<tr>
<td>Transport</td>
<td>4,760</td>
<td>31,947</td>
<td>14.9</td>
</tr>
<tr>
<td>- 2 projects</td>
<td>450</td>
<td>11,680</td>
<td>3.9</td>
</tr>
<tr>
<td>- all other projects</td>
<td>4,310</td>
<td>20,267</td>
<td>21.3</td>
</tr>
<tr>
<td>WMIS</td>
<td>1,195</td>
<td>2,918</td>
<td>40.9</td>
</tr>
<tr>
<td>Multisector</td>
<td>2,396</td>
<td>5,073</td>
<td>47.2</td>
</tr>
<tr>
<td>Education</td>
<td>100</td>
<td>209</td>
<td>48.0</td>
</tr>
<tr>
<td>Total</td>
<td>11,627</td>
<td>48,088</td>
<td>24.2</td>
</tr>
</tbody>
</table>

ADB = Asian Development Bank, ANR = agriculture and natural resources, WMIS = water and other municipal infrastructure and services.


179. **Project preparatory technical assistance.** All loans approved during the CAPE period were preceded by a PPTA that performed due diligence on technical, institutional capacity, financial and economic aspects, in addition to preparing environmental and social safeguards. ADB’s value addition in project design was determined by the stage in the project life cycle at which it became engaged in the project. PPTA made significant contributions to the design of complex projects in the ANR sector, and in selected projects in other infrastructure sectors (paras. 138–139). In all cases, PPTA made a comprehensive contribution to addressing environmental and social safeguards issues (para. 140).

180. **Policy advisory and capacity development technical assistance.** Policy advisory and capacity development TA projects were in line with the PRC’s priorities and ADB’s CPS objectives. The quality of TA project designs was generally of a high standard, with a few exceptions. TA impacts, outcomes and outputs were clearly identified and justified. Consultants were mobilized in most cases to execute the TA assignments (and to prepare knowledge products, if included in the scope of work). TA projects were properly sequenced, and in some cases they were clustered around or attached to loan projects.

181. TA projects had tight timelines to achieve their outputs and the timelines were extended as a matter of routine. In a few cases, the proposed scope of work was excessively broad. Some finance sector TA projects had to be scaled back during implementation. PSM sector TA projects covering public financial management

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147 No loan was approved without a PPTA. There were only three PPTA projects (all in the transport sector and approved in 2007 and 2008) that did not result in any loans. Other PPTA projects that have not led to loans so far were approved in 2013 or 2014 and these are expected to lead to loan approvals in the coming years.

148 For instance, Energy Efficiency Improvements in Inner Mongolia Autonomous Region (TA 7443), was approved in 2009 after a loan, Inner Mongolia Autonomous Region Environment Improvement (L2260, approved in 2006), had shown the need to enhance the skills base of municipal level district heating entities in the design of energy-efficient district heating systems; this CDTA provided useful inputs for a subsequent ADB loan, Inner Mongolia Autonomous Region Environment Improvement, Phase II (L2658, approved in 2010). In the case of Shaanxi Weinan Luyang Integrated Saline Land Management Project (L2980) the executing agency showed limited interest during PPTA phase in implementing the urban-rural environment master plan. ADB responded with a $300,000 attached capacity development TA, Management and protection of Wetlands in Weinan City in Shaanxi Province (TA 8293, approved December 2012) for the required mitigation measures.

149 Developing a Legal System for the Credit Market (TA 7835, approved in 2011), which provided assistance to develop a legislative structure for a multi-tiered credit market, had a broad project scope that had to be refocused and scaled-back during implementation.
included disparate components which made them difficult to administer.\footnote{For instance, Supporting Fiscal Reforms in High Priority Sectors (TA 7095, approved in 2008) aimed to support fiscal reforms in three areas: health care financing, local government debt management, and local treasury cash management.} PSM TA projects that supported planning at the provincial level have developed a better focus in recent years as they have covered one province and a particular sector.

182. The traditional one-off TA modality tended to be project-based. The facility TA allowed ADB to provide support across a broad range of reform areas in the PRC, and it was normally used as a quick response instrument. The facility TA modality is more amenable to a programmatic approach, and increasingly, it has been used to help ADB respond rapidly to the PRC’s requirements as and when they arise.

183. **Knowledge products and services.** Some knowledge products were based on TA project outputs; others were provided in response to specific requests from the government; and yet others were provided at the initiative of EARD and ADB’s various knowledge units. The Policy Notes series included “Observations” and “Suggestions” that provided information from one or more countries across the globe. The knowledge hubs were designed with a view to their eventually becoming centers of excellence for specific areas (e.g., environment and urban development); and the regional knowledge-sharing platform was pursued with a view to promoting South–South cooperation.

### B. Effectiveness

184. The ADB portfolio is rated *effective* in achieving targeted outputs and outcomes. The rating reflects the value addition provided through ADB support.

185. **Loan projects.** Of the 89 loans approved during the CAPE period, 20 had closed as of February 2015. PCRs were available for 14 of these 20 loans, of which IED had validated six. The validated PCRs rated the projects effective or highly effective. In four completed energy projects, the outcomes were achieved and generally exceeded expected results. These loan projects were effective in developing significant environmental benefits, and in reducing pollution and greenhouse gas emissions. The completed transport and urban development projects met or exceeded expectations.

186. Regarding ongoing loan projects, ADB’s project performance management system and eOperations are supposed to track progress in achieving results indicated in the DMFs. Although the database is supposed to be updated regularly (usually annually), much depends on the user unit’s diligence in updating the information. There is therefore no comprehensive database that tracks progress in meeting performance targets and intended outcomes and outputs for ongoing projects.\footnote{The DMFs in approval documents for ongoing loan projects specify outcomes mostly at a macro-level while outputs are relatively specific. Both outcome and outputs are accompanied by area-specific performance targets and indicators against respective baselines. Extensive research is needed to verify whether or not the area-specific targets in the DMFs have been achieved or are likely to be achieved by the specified target dates.} In the absence of such a database for ongoing projects, it suffices to note the CAPE team investigations did not find any evidence that a significant number of ongoing projects would turn out to be less than effective. Corrective actions were initiated for one project where the technical design of a component required improvements.\footnote{Xinjiang Altay Urban Infrastructure and Environment Improvement Project (L2759), approved in 2011, was one of the projects MOF evaluated as part of its efforts to evaluate selected completed and ongoing projects supported by ADB and other international financial institutions. One of its seven components includes the construction of six new wastewater treatment plants along with collector and trunk sewers. In}
performance tracking system revealed that all loans approved during the CAPE period were generally effective, or likely to be effective, in achieving the target outputs.\textsuperscript{153}

187. ADB projects were generally effective in complying with safeguard and procurement standards during implementation. Although the government has instituted environmental and social safeguards, many implementing agencies have capacity limitations and find it difficult to comply with them. Executing agencies and implementing agencies generally appreciated the opportunity to learn how ADB addresses procurement and safeguard issues when implementing its projects.

188. The effectiveness of achieving outputs and outcomes for ongoing loan projects is discussed by sector in Linked Document 9. In the ANR sector, where none of the projects approved during the CAPE period has been completed, lessons from problems encountered in earlier loans appear to have been incorporated in some subsequent loan projects approved during the study period.\textsuperscript{154} In the energy sector, the supply-side energy efficiency projects are expected to demonstrate that a significant expansion of energy-efficient district heating systems can occur without increasing net emissions, thus leading to better air quality. Renewable energy and clean coal technology projects are expected to create capacity for construction, operation and management of two leading edge technologies. Transport projects are expected to strengthen road asset management systems, improve freight services through efficient logistics terminals, and enhance railway emergency responses to accidents. Water supply projects are expected to improve water supply quality and reliability, and to enhance the urban environment through improved management of waste water and solid wastes.

189. For the two ongoing railway project loans where ADB’s share of the project capital cost is less than 5%, ADB is providing safety equipment, capacity development support, and helping counterpart agencies to learn ADB processes for procurement and safeguards. These processes have been applied to the entire rail construction projects in both cases. So, in addition to acting as a traditional development finance institution, ADB has served as a supervision consultant on both these projects. China Railway Corporation, the executing agency for both, has subsequently sought to internalize the procurement system and has created a procurement portal covering procurement for all rail projects. This is along the lines of the ADB procurement portal, and has increased the transparency for procurement for all rail projects in the PRC. More

\textsuperscript{153} As recorded in eOperations, all closed loans were on track. Of the 69 ongoing loans approved during the CAPE period, 51 projects are considered to be on track, 15 to have potential problems, and 3 to have an actual problem (or to be at risk). However, these 18 projects with potential or actual problems had no problems with technical aspects, financial management, and compliance with ADB’s safeguard policy. The problem areas related to the fact that actual contract awards and actual disbursements were significantly below the originally projected levels as of February 2015. The reasons for these delays relate to one or more of the following: (i) unfamiliarity of the concerned implementing agency with ADB processes and procedures; (ii) time taken to carry out a minor change in project scope; and (iii) in some cases, the need to conduct a feasibility study and safeguard assessment for a new subproject.

\textsuperscript{154} For instance, agro-processing enterprises are involved as agents of change (L2436). However, a number of problems were identified for similar projects. L1386 (approved in 1995 and completed in 2003) identified a number of problems common to such projects including (i) changing market trends; (ii) location problems in relation to raw material supply; (iii) the weak financial position of subproject proponents; and (iv) inappropriate financing terms. As CAPE 2007 pointed out the financial intermediation modality was not sufficiently well developed at the time.
generally, the MOF has issued standard bidding documents which have significantly improved the quality and efficiency of national competitive bidding procurement.

190. **Technical assistance projects.** The executing agencies for most policy and advisory TA projects are central government ministries or other Beijing-based government agencies. These agencies routinely accepted the outputs of policy and advisory TA projects, and took them into consideration in their policy-making processes (para. 142). However, the actual policy formulation can be a long drawn out process, making it difficult to assess outcomes. ADB is not in a position to track the PRC’s policy-making process. Nevertheless, there was clear evidence that TA was considered for policy-making purposes (paras. 147–149).

191. Some TA projects were intended to feed into other TA projects that contributed to policy-making. Others assisted executing and implementing agencies meet capacity development needs and enhance knowledge in well-defined domains or created knowledge platforms and facilitated knowledge sharing. Most TA projects generally met their specific intended purposes. A few did not deliver all the planned outputs and/or meet the intended outcomes because of design problems. For example, some PSM TA projects included disparate components in the scope of work and this led to implementation challenges. Others specified a scope of work that proved overly optimistic during implementation owing to problems that could not have been foreseen either by ADB, MOF, or the concerned executing agency.

192. **Project synergies and geographic spread.** To the extent possible, ADB avoided one-off projects in certain sectors or subsectors. This approach helped to enhance the effectiveness of the portfolio (para. 151). However, continuity was hindered by the need to support investment projects across a large number of provinces. Even in the same province, the beneficiary agencies were often different parties for projects in the same sector. This issue was most prominent in urban development projects where different municipal governments were beneficiaries of loans where the same provincial government was involved. As a result, there were only a few instances where a series of loan and TA projects was implemented by the same executing and implementing agencies. There were a few provinces in the central and western regions where ADB supported investments by providing only one loan during the CAPE period.

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155 However, the concerned government agency may informally communicate to ADB specific inputs to a new or forthcoming policy, or ADB’s role may be reported in the press.

156 For instance, the findings from subproject 1.4 of the Facility for Policy Reform and Poverty Reduction (TA4933) regarding operational mechanisms for rural *dibao* (PRC’s rural minimum living standard guarantee program) and medical financial assistance programs fed into Strengthening the Antipoverty Effects of Social Assistance (TA 7438), approved in 2009 and completed in 2012, which focused on the design and functioning of a social assistance system. TA7438, in turn, fed into Building Equitable Opportunities into Social Assistance (TA 7702), approved in 2010 and completed in 2012, which provided policy recommendations on reforming social assistance.

157 There are 46 capacity development TA projects that have supported executive and implementing agencies in managing increasingly complex projects (covering such areas as energy conservation, low-carbon development, industrial waste management, drought management, combating land degradation, rural pension administration, rural road maintenance, and improving corporate governance).


159 Supporting Reforms in Taxation and Budget Management (TA 7568), approved in 2010. The outcome targets for components 2 (framework and implementing regulations for Sustainable Development Reserve and Fund policy adopted by 2012) and 3 (framework for nationwide implementation of the Treasury Single Account and real-time monitoring system of budget execution adopted by 2012) proved overly optimistic, “given the technical complexity of the issues and the extent of institutional changes needed,” as indicated in the TCR.

160 Guizhou province in the western region, Henan and Jianxi in the central region, and Sichuan in the western region are sole beneficiaries of just one ADB loan each, although each one participates in a multi-province ADB loan with other provinces.
193. Knowledge products and services. As with TA projects, ADB is not in a position to track the policy-making process that follows the submission of policy notes (including “observations and suggestions”). There is no system in place to track or monitor the extent to which other knowledge publications were useful to the PRC agencies. Therefore, it is difficult to ascertain how the nearly 600 knowledge publications that were produced provided visibility to ADB and achieved their objectives. However, some executing agencies and implementing agencies appreciated TA-based knowledge products that had brought to their attention the possibility of replicating some successful practices. It is too early to ascertain the effectiveness of knowledge hubs and the knowledge sharing initiative.

194. Role of consultants. Executing agencies at all levels of government acknowledged that ADB’s value-added contributions through TA and loans were largely derived from international consultants. The benefit of engaging international consultants generally increased substantially when they were (i) familiar with the context and circumstances where their specific expertise was sought, (ii) able to devote a large share of their consulting time (person-days) to planning, strategizing and developing innovative solutions based on perspectives provided by good international practices, and (iii) funded by TA projects that provided sufficient budgets for translating reports. This feedback from executing agencies was particularly relevant for policy and advisory TA.

195. In recognizing the value-added benefits from international consultants, the executing agencies effectively acknowledged the need to enhance the level of expertise of local consultants. This result is consistent with the fact that the PRC consulting firms (or institutes) do not normally compete globally—unlike equipment suppliers and construction contractors who are globally competitive. In this situation, it would be expected that local consultants would learn on the job by working closely with international consultants. Yet some executing agencies noted that such cooperation is often not observed.

C. Efficiency

196. The ADB portfolio in the PRC is rated efficient.

1. Economic Rates of Return

197. The economic internal rate of return (EIRR) at approval for all approved loan projects exceeded the threshold value of 12%, and most projects were resilient to reasonable assumptions of cost increases and reduced benefits. EIRR calculations in loan approval documents considered benefits relevant to a particular sector or subsector. In some cases the benefits were not treated uniformly across all projects in

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161 A concerned executing agency in one province mentioned that the same international consulting firm had been appointed by ADB for four successive loan projects despite the fact that the executing agency had pointed out to ADB that the firm’s performance has progressively deteriorated.

162 For instance, the Ministry of Civil Affairs (MOCA) notes that survey questionnaires were modified on the basis of comments from an international consultant who did not appreciate the PRC context or circumstances. This created some difficulties in cooperating with the international consultant during the course of project implementation.

163 In reality, a significant share of international consulting time is spent on conducting training workshops and seminars, and on meeting reporting requirements. Consultants are normally required to prepare an inception report, a mid-term report, a draft final report, and a final report.
Similarly, willingness-to-pay for certain types of public services was not valued in the same way across all projects that expanded or improved the same public service. Some project documents presented the overall EIRR only for each type of subproject, and not for the overall project. Some approval documents overlooked some project benefits, and their inclusion would have increased the stated EIRRs. The EIRR for each project component was more than 12% in nearly all cases. In certain cases, although the overall project EIRR exceeded 12%, individual components had EIRRs below 12%. Projects that focused on improving end-use energy efficiency, or upgrading the environment, or managing floods had very high EIRRs.

Other notable observations on EIRR calculations in loan approval documents across various sectors include the following: (i) energy project documents presented EIRRs with and without environmental benefits in all but one project (L3075), where the EIRR crossed the 12% threshold level only if environmental benefits were included; (ii) ANR project documents presented EIRRs either with or without environmental benefits, but when water pollutant emissions were reduced, the resulting benefits were not quantified, and GHG emission reduction benefits were not considered in many cases, apparently due to difficulty in making credible estimates (L2694 which involved carbon sequestration); (iii) transport project documents included environmental and other benefits such as travel time and operating cost savings in the EIRR estimates; and (iv) urban development project documents included social and environmental benefits in their EIRR estimates.

Completed loan projects continued to be economically efficient and project completion and validation reports confirmed that in almost all cases the EIRRs were above the 12% threshold. Although EIRRs of completed projects were above the 12% threshold, they were often reduced at completion, largely because of factors such as project cost and time overruns and lower traffic volumes in the initial few years than originally anticipated.

Generally all ongoing projects are expected to remain economically viable under reasonable assumptions of cost increases and reduced benefits. One exception where an updated EIRR is forecast to fall below 12%, other things being equal, was a transport sector project (L2471).

2. Project Costs

Initial project cost estimates were revised upwards for many loan projects. The average cost overrun for the 14 completed loan projects for which PCRs are available

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164 Social price assumptions vary significantly across energy projects. The social price of GHG emission reduction was presented in only one case (L2658). A simple calculation shows that environmental benefits can vary significantly across projects if the social prices for L2658 are used. For instance, they increase by 19% for L2898 and by 36% for L2885, but reduce by 32% for L2616 and 63% for L3075.

165 In L2436, approved in 2008, one component, the Yinxu alternative livelihoods, has an EIRR of 11.3%. This component has the greatest potential direct impact on poverty reduction as it involves nearly 10,000 households, a high proportion of which fall below the poverty line defined by the Yinchuan municipal government. The project component is expected to raise the incomes of all these households above the poverty line.

166 In L2471, the EIRR estimated at appraisal was 17.1%. This falls to 12% if the project cost escalates by 23%, while benefits remain unchanged. For this project, the revised project cost data show a 35% increase in cost, because of (i) difficult topography that necessitated design variations; and (ii) higher land acquisition costs; and (iii) higher resettlement costs because of increases in the compensation rates as per government regulations.
was 43%.\textsuperscript{167} Cost overruns for loan projects were funded by a mix of central and local government resources, and loans from banks or other sources. The approved ADB loan was normally used to cover costs of items that were planned upfront. To the extent that the cost of those items exceeded appraisal estimates, the cost overruns were funded from non-ADB sources. If the actual cost fell below appraisal estimates, the unused portion of the loan was cancelled at closing. Available data show that loan cancellations averaged less than 2% of approved amounts.\textsuperscript{168}

202. Project cost overruns occurred for a variety of reasons. Appreciation of the yuan and project design changes contributed significantly to cost overruns across all sectors. Higher land acquisition and resettlement costs were another principal cause of cost overruns, particularly in transport and urban development projects. In an urban development project, in addition to increased land acquisition and resettlement costs, the difficult geological terrain for two water tunnels contributed to cost overruns of 44\% (L2388). Cost overruns in completed energy projects were usually below 15\% of appraisal estimates. For ongoing energy loan projects that supported leading edge technologies, cost overruns were higher, given the need to address new technical design challenges as they emerge.

203. Cost overruns for TA normally reflected additional time-inputs from local consultants, and these costs were borne by the concerned executing or implementing agency. ADB’s share of TA costs normally covered the time costs and other expenditures of international consultants. If additional ADB resources were required to meet the additional costs of engaging international consultants, ADB approved a supplementary TA. Less than 15\% of TA projects under the country program required supplementary TA support.

3. Project Timelines

204. Loan project timelines. Loan processing timelines, from loan concept clearance to approval, increased from an average of 14 months for loans approved during 2006–2009 to 17.9 months for loans approved during 2010–2013.\textsuperscript{169} This increase occurred despite ADB streamlining its business processes in the latter period, and reflected the increasing complexity of projects and the involvement of many executing and implementing agencies for the first time.

205. Twenty loans approved during the CAPE period have closed to date. Of these, two energy project loans were completed ahead of schedule. The closing date was delayed more than 2 years for two urban development loans; between 1 and 2 years for another two urban development loans; and by less than 1 year for the remaining energy, transport and urban development loans.

\textsuperscript{167}The maximum cost overrun was 88\%. Four projects were completed at less than the originally estimated capital cost. The major reasons for savings in capital costs related to (i) lower than anticipated finance charges during construction; (ii) contingency savings; and (iii) cancellation of a particular project component.

\textsuperscript{168}According to data from the ADB Loan and Grant Financial Information System, a total of $19.55 million was cancelled for nine projects approved and closed during the CAPE period, 1.8\% of the total loan approvals of $1.1 billion.

\textsuperscript{169}Reflects average time elapsed from loan concept clearance to loan approval date for 38 loans approved during 2006–2009 and 42 approvals during 2010–2013. The averages exclude loan processing timelines for multitranche financing facilities and their tranches. Based on data from ADB Operations Services and Financial Management Department.
206. No ANR project had closed as of February 2015, but of the 15 loans approved within this sector from 2006 to 2011, at least six have experienced delays of 1 year or more, and it is highly likely that three loans will suffer delays of 2 years or more. In one ANR loan, the emphasis on a comprehensive and viable environmental strategy made it difficult to keep to the implementation schedule (L2428). This loan included multiple infrastructure components in addition to awareness building and local community involvement. In an exceptional case, ADB had to interface with the concerned executing and implementing agencies and NDRC for more than 1 year after approval to firm up institutional arrangements and counterpart funding (L2572).

207. Delays were caused largely by (i) land acquisition issues, as more time was required to reach agreement with affected persons on acquiring their land and/or homes; (ii) project components which were linked to activities undertaken by other development agencies; and (iii) extended closure of an entire loan because of the technical complexity of one component that affected the timeline for completion of civil works, equipment installation and testing of the other components. Cost overruns were often associated with time overruns, and in recent years, lack of timely availability of additional counterpart funds has contributed to delays, or to the cancellation of some components. This is consistent with the fiscal deficits experienced by some local governments.

208. Of the 69 ongoing projects, 51 are on track, 15 have a potential problem and three are at risk. The potential problem or actual problem (at risk) rating reflects the relatively slow pace of contracting and disbursements vis-à-vis contracting and procurement schedules according to revised timelines to closing. A few ongoing projects are expected to be delayed by more than 24 months from originally approved timelines. These projects include (i) two district heating loan projects in Inner Mongolia (L2260 and L2658), which have been delayed because of the lack of capacity of district heating company personnel to prepare feasibility studies of subprojects; (ii) an integrated gasification and combined cycle (IGCC) plant (L2616), which contains a large number of unknown elements in design, construction, testing and commissioning; (iii) the Guangxi Wuzhou urban development project (L2491), which integrated geohazard management in the urban development program and needed to acquire large tracts of land to resettle several thousand people away from a geohazard-prone valley; and (iv) the Wuhan urban environment improvement project (L2647), which was designed to restore the ecological capacity of rivers and lakes and promote surface water management to reduce the risk of flooding, among other activities.

209. **Technical assistance project timelines.** Most policy and advisory TA and capacity development TA projects experienced significant completion delays. The expected benefits materialized, but later than originally expected. Fewer than half the completed TA projects closed within 1 year of the originally planned closing date. Eight completed ANR sector TA projects and six completed energy sector TA projects were extended for 2 years or more. Delays occurred for a variety of reasons that are attributable to either one or all of the stakeholders involved in implementing the TA: ADB, the counterpart agencies, and the consultants.

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170Delays in counterpart funding were experienced mostly for urban development projects (including L2574, L2550, L6706, L2647 and L2821). Difficulty was encountered in raising counterpart funding in projects in the ANR (L2428) and transport (L2600) sectors. Although it is difficult to determine implementation delays caused by delays in availability of counterpart funding, it is estimated that delays have ranged from 3 months (L2574) to about 2 years (L2647). In some cases, project components were cancelled (L2901) or the scope was reduced (L3022) as counterpart funding was not available in a timely manner.

171The performance assessment reflects the revised (most recent) closing dates, and not the completion dates projected at approval.
210. Consultant contracting and/or mobilization has often taken more time than expected at approval. In some cases, the executing agency was not familiar with ADB processes, or the first round of bids did not yield the expected responses from the consulting community. In a few cases, poor consultant performance required changes in the consulting team, which was a time consuming process. In some cases, the scope of work was modified following initial investigations. Scope changes included additions to or modifications of the following: (i) objectives and outputs of analytical work; and (ii) training, workshop, study tour, and knowledge product requirements. The time required to implement these scope changes, no matter how quickly it was done, contributed to TA completion delays.

211. In some cases, delays can be partly attributed to the more than anticipated time taken by the concerned government agencies to (i) review, discuss, and accept consultant outputs; and/or (ii) finalize the contents of knowledge products that were made on the basis of TA projects. In other cases where surveys had to be conducted, the pilot testing took longer than envisaged, and the survey schedule came into conflict with the holiday season or other events on the national calendar. For delegated TA projects, the duplication of effort for approvals during implementation also led to delays.

212. **Knowledge products and services timelines.** ADB was responsive to the PRC requests for policy notes (particularly “observations and suggestions”) and normally delivered them within 1 month. For TA-based knowledge products, the process of finalizing the reports consumed a considerable amount of time. The timelines for other knowledge products were determined by ADB’s internal processes. The knowledge-sharing platform strategy discussed in 2009 has made slow progress. ADB and the government have been exchanging views on developing a RKSI since 2012, but there is no clear agreed forward path.

**D. Sustainability**

213. ADB’s portfolio in the PRC is rated likely sustainable. The rating reflects government commitment to reform areas that are expected to enhance the sustainability of ADB-supported projects, environment and social sustainability aspects of ADB-supported projects, the degree of policy and institutional sustainability, and financial and debt sustainability.

1. **Institutional Sustainability**

214. The government’s development priorities have impacted upon all areas of ADB engagement with the PRC. ADB-supported loan projects were part of the investment plans of the central or local governments. These projects exposed the executive and implementing agencies to ADB’s international business processes for procurement and contracting. Some investment projects were accompanied by capacity development TA to address weaknesses in areas such as project management. While these measures were appreciated, lack of continuity with executing agencies and implementing agencies may have reduced the potential for sustained institutional capacity development.

215. Many TA projects in various sectors contributed to policy formulation processes in the PRC (paras. 147–149) and they are likely to have durable impacts. The importance of improving public financial management was recognized in the Third Plenum resolution, increasing the likelihood that achievements of ADB-supported PSM
TA projects will be built upon. The same applies for many other reforms—including in social, environmental, and financial areas—that ADB has supported during the CAPE period.

216. The government has been committed to addressing the issues raised in policy notes (including “observations and suggestions”) and through policy and advisory TA projects. However, the extent to which the government has relied on other knowledge publications is a matter of conjecture.

2. Financial Sustainability

217. For revenue-generating projects, where affordability considerations have influenced tariff levels, it was assumed the government would provide a subsidy to meet any shortfall in cost recovery. The financial sustainability of revenue-generating projects is likely to improve given government moves to encourage private participation in public utility projects. Similarly, the financial viability of non-revenue-generating projects was based on an assumption the government would continue to subsidize public goods (such as ecological restoration). All ADB-supported investment projects were shown to be financially viable at appraisal and their financial rates of return (FIRRs) were higher than their weighted average cost of capital (WACC). Where PCRs were available for completed projects, the FIRRs continued to be higher than their WACCs. FIRRs at completion were less than at appraisal for most urban development projects, mixed for transport projects, and higher than at appraisal for most completed energy projects. No ANR loans had closed as of February 2015 and no PCRs were available. However, the prospects for the long-term sustainability of some ANR projects have been enhanced because these projects support a national priority such as forest protection (L2744). Some ANR loan projects introduced innovative approaches to improve sustainability; for example, by supporting the development of biodiversity-based attractions that can generate revenue from eco-tourism and contribute to sustainable management and enhancement of a nature reserve (L2572).

218. In the transport sector, two ongoing rail projects have suffered significant cost overruns compared with appraisal estimates and it is not known whether or not the FIRRs at closing will be higher than their WACCs. In a completed rail project (L2274), the FIRR exceeds the WACC, as the revised traffic forecasts were higher than originally expected. For non-revenue-generating projects such as roads, there is little evidence that detailed asset management plans or alternative sources of funding were considered during project design, and this may create problems in the future. Despite these concerns, PCRs and PVRs indicate that almost all completed projects are sustainable. Yet some local executing agencies and implementing agencies in lagging provinces note that they will need to rely on central government transfers to maintain the transport infrastructure, whether or not it is revenue-generating. Where the ADB-supported transport project was designed to generate revenue, it is very likely that affordability and willingness to pay considerations will come in the way of setting cost recovery tariffs, and government support will be required.

219. All energy projects were designed to either reduce consumers’ energy bills or generate revenue. The financial viability of all the energy loan projects was generally satisfactory; the possible exceptions being two leading edge technology projects (L2616 and L3075). Given the government commitment to mitigating climate change,

172 According to revised project cost estimates, Lanzhou-Chongqing Railway Development project (L2471) has a cost overrun of 35%. Similarly, Chongqing-Lichuan Railway Development project (L2481) has a cost overrun of 37%.
it is highly likely it will set sufficiently high feed-in tariffs to enable the projects to recover all operating and maintenance costs. The completed projects in the energy sector remain financially viable. FIRRs of completed demand-side energy efficiency projects have exceeded those at appraisal by a wide margin (L2426 and L2611). All ongoing energy projects appear to have FIRRs that are comfortably higher than their WACCs.

220. Knowledge hubs will need to develop financial mechanisms that will enable them to continue functioning beyond TA closing and to be financially independent from ADB. The sustainability of RKSI will be influenced by the agreement on how it can realize its mandate (para. 125). Human resources, funding, and other resources required for sustained RKSI operations will be covered in discussions with the PRC authorities. A cost-sharing partnership approach will be among the options considered.

3. Debt Sustainability

221. The government’s commitment to public financial management reforms and regulating shadow banking activities provides a measure of comfort about debt sustainability. MOF intends to begin screening all projects for debt sustainability as part of the country programming process, before proposing them to ADB for loan support. Nevertheless, the poor fiscal situation of provincial and municipal governments remains a concern. Debt sustainability is an ongoing issue for all ANR and urban development projects in the ADB portfolio; many transport sector projects; and at least two leading edge technology energy projects. Innovative financial structures such as PPPs or credit enhancement products could enhance the financial sustainability of these projects.

222. ADB has tried to address these concerns through specific covenants in loan and project agreements. Provincial and municipal governments are required to provide funding for all operation and maintenance costs in most ANR projects, although this may be implicitly inferred in some cases (L2572, L2694 and L2700). Periodic and timely tariff adjustments are sought in most urban development projects to enable full cost recovery (L3022). However, the requirement to meet debt service obligations with a targeted debt-service-coverage ratio has been discontinued for ANR and urban development loans approved in recent years. Most energy loans approved in the CAPE period set this requirement explicitly, as did many transport projects approved until 2011. This practice was discontinued in 2012 and 2013, but reappeared in one approval in 2014 (L3112).

E. Development Impacts

223. Development impacts from ADB’s engagement in the PRC were rated satisfactory. This rating reflects government policy initiatives and available information that points to ADB’s contribution to achieving CPS objectives. ADB support for infrastructure sectors emphasized development in the lagging central and western provinces. Energy projects contributed to reducing the energy intensity of GDP, improving energy efficiency in industry and district heating systems, reducing GHG emissions and improving urban air quality, among others. Transport projects helped to improve energy efficiency in passenger and freight transport, road safety, logistics and asset management. Along with PSM and social sector interventions, urban

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173 The covenants call for timely availability of counterpart funding to meet any project shortfall or cost overruns.

174 The most recently approved ANR and urban development loans with this requirement were approved in 2008. These are Loans 2428 and 2420.
development projects helped to improve water supply, wastewater treatment and recycling, solid waste management, public financial management and social services. ANR projects played a role in improving water resources management, modernizing agriculture, and ecological restoration.

224. This assessment of development impacts focuses on beneficiary entities, is subject to data availability, and recognizes the following: (i) it is too early to assess the development impacts of most completed loan and TA projects; and (ii) there is little clarity on the extent policy announcements of the central government were adopted by local governments, or how much local governments benefited from TA-based knowledge products, or replicated innovative project designs. It is also not clear the extent to which executing agencies and implementing agencies institutionalized capacity development benefits, or internalized good international practices for environmental and social safeguards.

225. Development impacts of lending and nonlending interventions are difficult to gauge. The central government has no mechanism to monitor progress in implementing policy or internalizing new knowledge. ADB has not tracked the extent the infrastructure projects it supported have contributed to extensive urbanization (urban sprawl) and relied on easily procured land. The ownership of concerned government agencies, the consistency among CPS objectives, government reform priorities, and the design of interventions are positives, but unintended and undesirable impacts must be weighed as well.

226. Development impacts can be discerned in a few cases. For example, some commercial banks have begun lending to agro-industry enterprises. ADB’s contribution to this result is evident from its continued support to various aspects of contract farming since the mid-1990s.

227. **Inclusive growth.** ANR, transport and urban development loan projects were socially inclusive, albeit in different ways. ANR projects had a strong focus on raising rural incomes and they specifically targeted relatively poor households in designated poverty counties. Local and rural roads improved the access of rural dwellers to urban centers and markets. Ten loan projects with trunk road components supported construction of local and rural roads that were twice the length of major trunk roads, but had a capital cost of less than 10% of trunk roads. The share of the poor population directly benefiting from nine completed urban development projects ranged from 4.6% to 12.2% of the total beneficiaries. These projects mainly helped reduce the risk of waterborne disease and associated expenditures for medical treatment.

228. Education sector TA contributed to the establishment of a labor market information system, and improved the links between the labor market and the technical and vocational education and training system. Health-care-related support contributed to improving rural health services, and suggested ways to improve quality and contain costs of rural health care. Support for social assistance led to policy

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175 For example, the recommendations of an ANR TA (TA7386) included the following: (i) a shift in enforcement of environmental laws and regulations from a preventive to a more proactive approach; and (ii) a strengthened role for social organizations in the enforcement process (information disclosure, media exposure, mediation, counselling and education of victims of environmental incidents, and provision of legal assistance). Although the TA was completed in 2012 and the executing agency was a central government ministry (Ministry of Environment Protection), there is no firm information on the present status of implementation of the recommendations.

176 One of the earliest loans to support agro-industry enterprises was L1386 (approved in 1995 and closed in 2003). During the CAPE period, ADB has extended three loans (L2395, L2436 and L2474).
recommendations in a key policy document to improve the coverage and targeting of the poor. ADB contributed to the steady progress toward establishing a more inclusive financial system. It supported actions to increase access to financial services in rural areas and to poor households, SMEs, and micro-enterprises. In terms of improving social security, ADB supported the piloting of a two-tiered rural pension system and improving the administration of the urban pension system.

229. **Environmental protection.** Loan and TA projects in the ANR, energy, transport and urban development areas contributed to environmental protection, although it is too early to estimate the benefits that will accrue by preventing desertification, addressing water security issues, cutting air or water pollution, reducing soil erosion, restoring forests and wetlands, and lowering net carbon emissions.

230. All ANR loan projects and most ANR TA projects were designed to contribute explicitly to environmentally sustainable growth. All energy loan and TA projects had direct local air quality improvement and/or climate change mitigation benefits. Compared with projects before the beginning of the CAPE period, many transport loan projects supporting rail, water and intermodal traffic movement included climate change mitigation benefits. Urban development loans and TA contributed to environmentally sustainable growth by supporting the protection of watersheds, reductions to the threat to the quality of water resources, use of treated municipal wastewater in areas with limited water resources, and implementation of solid waste management systems. Some TA projects classified under the ANR, energy, financial and PSM sectors contributed to the development of the carbon market, explored the possibility of carbon financing for carbon sequestration, developed climate finance mechanisms for other types of mitigation projects, and the establishment of an emissions trading system.

231. **Regional cooperation.** The PRC country program complemented the CAREC and GMS regional programs. Through the PRC country program, ADB supported investments in highways and the development of towns and cities in the PRC provinces that are part of the CAREC and GMS programs. These interventions contributed to additional economic activity in border provinces and improved connectivity to neighboring countries to support trade. Of the 42 ADB-supported loan projects in the western region, 19 are in four border provinces (Inner Mongolia and Xinjiang, Guangxi and Yunnan) and these accounted for 45% of the approved loan amount in the western provinces.\(^{177}\)

232. **Private sector development.** ADB’s sovereign operations supported private sector development before and during the CAPE study period in finance, energy and environmental infrastructure. ADB’s contribution to private sector development in other sectors was marginal. ADB contributed to the establishment of prudent financial systems by providing support for micro-credit companies, small and medium-sized enterprises, and through its policy dialogue and knowledge product support on a wide range of financial sector reform and modernization topics. After the Renewable Energy Law became effective in 2006, ADB supported renewable energy resource assessments that were of interest to private sector players in the energy area. ADB supported full cost recovery of water tariffs, and the development of (i) a national policy framework for wastewater and solid waste tariffs; (ii) quality standards for reuse of wastewater; and (iii) tariff guidelines for promoting wastewater reuse and sustainable sludge

\(^{177}\)In comparison, seven other western region provinces (Chongqing, Gansu, Guizhou, Ningxia, Qinghai, Shaanxi, and Sichuan) accounted for 23 loan approvals and 55% of the approved loan amount.
management. In the transport sector, ADB support was limited, although in one case it helped develop a predictable road maintenance works pipeline by supporting the development of a computerized road asset management system, which provided private sector firms with a greater level of comfort when negotiating maintenance contracts with the concerned local government agency.

F. Overview of Assessment Ratings

233. Table 9 summarizes the assessment ratings by sector for sovereign operations. The sector weights reflect the volume of ADB support provided during 2006–2013 through loans, grants, and TA resources (including trust funds).

<table>
<thead>
<tr>
<th>Item</th>
<th>Relevance</th>
<th>Effectiveness</th>
<th>Efficiency</th>
<th>Sustainability</th>
<th>Development Impacts</th>
<th>Overall Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANR (17.6%)</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2.2</td>
</tr>
<tr>
<td>Education and HSP (0.9%)</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2.0</td>
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<tr>
<td>Energy (10.1%)</td>
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<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2.2</td>
</tr>
<tr>
<td>Finance (0.1%)</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2.0</td>
</tr>
<tr>
<td>PSM (0.2%)</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2.0</td>
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<tr>
<td>Transport (40.4%)</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
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<td>2.0</td>
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<td>Urban/Water (30.8%)</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2.0</td>
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</tbody>
</table>

**Cross-cutting CPS Objectives**

<table>
<thead>
<tr>
<th>Item</th>
<th>Relevance</th>
<th>Effectiveness</th>
<th>Efficiency</th>
<th>Sustainability</th>
<th>Development Impacts</th>
<th>Overall Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inclusive growth (25%)</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Environmentally sustainable growth (25%)</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regional cooperation (25%)</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Private sector development (25%)</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Weighted Score | 2.28 | 2.0 | 2.0 | 2.0 | 2.0 | 2.06

**ANR = agriculture and natural resources, CPS = country partnership strategy, HSP = health and social protection, PSM = public sector management.**

234. The approach to assigning weights to various sectors for rating the overall portfolio is transparent and is prescribed in the CAPE guidelines. Nevertheless, this system underestimates the importance of TA and KPS to the PRC. It does not take into account the fact that an important reason why the PRC borrows from ADB is because this engagement enables it to learn from international experience. However, this shortcoming does not impact on the overall rating in this evaluation.

235. The country program is rated *successful.* The ratings by individual evaluation criteria are as follows: (i) *relevant,* which reflects the government’s high level of ownership of the country program; (ii) *effective,* given that many interventions met targeted outcomes and outputs, and provided value addition through demonstration effects and policy support; (iii) *efficient,* as with a few exceptions, loans had attractive economic rates of returns; (iv) *likely sustainable,* given the strong central government commitment to improve debt sustainability and the expectation it will continue to offer
subsidies to support public goods and meet shortfalls in cost recovery for public services; and (v) *satisfactory* in terms of development impacts, given that across all sectors of engagement, the CPS objectives and priorities were, or are being, achieved, although the precise project-specific development impacts are difficult to determine.
CHAPTER 7

Evaluation of Nonsovereign Operations

236. This assessment follows the revised CAPE guidelines that became effective on 31 March 2015. As the NSO (including private sector) portfolio in the PRC is large, it was assessed separately from the sovereign portfolio. This evaluation reviews the overall portfolio using the private sector ratings methodology, which evaluates projects using four criteria that are weighted and aggregated to produce an overall rating. The rating criteria are (i) development results, (ii) ADB investment profitability, (iii) ADB additionality, and (iv) ADB work quality. Further information on specific NSO approvals and recommendations is provided in Linked Document.

237. The CAPE evaluated NSO approvals made during the study period (para. 117). IED reviewed available documentation for all completed and ongoing projects, and the available self-assessed XARRs and/or independently assessed XVRs. Additionally, IED held consultations with PSOD staff and discussions with stakeholders for selected projects (para. 9). The evaluation noted the relatively small portfolio of PSOD approvals initiated in the pre-CAPE period, and their performance ratings (para. 133). Linked Document 12 shows the overall ratings presented in self-assessed XARRs and XVRs validated by IED, and explains the differences in ratings for each criterion.

A. Evaluation

238. Based on the contribution of each of the approvals to the overall portfolio in accordance with the weighted criteria, the overall rating for the 2006–2013 portfolio of approvals is successful. The rating for each of the four evaluation criteria is satisfactory.

1. Development Results

239. The overall rating for development results for PSOD’s program during the CAPE period is satisfactory. Development results are rated by combining ratings for the following four subcriteria: (i) contribution to private sector development; (ii) business success; (iii) contribution to economic development; and (iv) environmental, social, health, and safety performance.

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179 Nonsovereign Portfolio and Assessment (accessible from the list of linked documents in the Appendix).

180 Ratings of Projects Completed after 2006 in Extended Annual Review Reports and Validation Reports (accessible from the list of linked documents in the Appendix).
a. Contribution to Private Sector Development

240. The range of results for the 2006–2013 approvals is considerable. Many results were pending as of March 2015, and many other formal ratings have not yet been documented. Therefore, to develop an overall rating for the portfolio, the current contributions of each approval were grouped into the following categories for the purpose of this evaluation: (i) successful, (ii) not successful, (iii) in progress and progressing, (iv) in progress but stalled, (v) cancelled, and (vi) approved 2013. The list of approved investment commitments by name of the intended investee and/or project is given in Linked Document 11, and supporting explanation is provided. Figure 9 shows that more than 18% of investment commitments were successful and more than 35% were progressing toward making tangible contributions to private sector development; fewer than 2% were not successful and about 11% were cancelled. Most PSOD projects that built on EARD’s work have performed well, although policy changes affected some projects in the PSOD portfolio.

![Figure 9: Status of Nonsovereign Projects, 2006–2013](Image)

241. The seven investment commitments categorized as successful each made tangible contributions to private sector development. These projects responded to specific needs in the PRC by developing financial structures that enabled the private sector to participate more fully in the supply of clean energy, clean water, and SME financing, which were the key target areas of PSOD’s PRC program. These projects provided demonstration effects and have the potential to be replicable in future projects so long as the enabling environment for the private sector is maintained.

242. The five commitments categorized as not successful included four equity investments through funds which were either impaired or completed with investors realizing low returns and/or losses. The fifth approval was intended to provide support for SME financing through an equity stake in an SME credit guarantee company where allegations of fraud could not be resolved. As with the approvals categorized as successful, these not successful approvals were in the clean energy, clean water, and SME financing sectors. Although these approvals were less than 2% of the $4.1 billion of capital commitments approved over the review period, each of these assets required

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181 Percent shares of $4.1 billion committed during 2006–2013, which excludes the commitment to support the trade facilitation finance program.

182 Includes one commitment to the trade facilitation finance program and six others.
the same staff resources to achieve approval as other approvals. Furthermore, these investments required a further significant commitment of ADB staff because of increased transaction monitoring and management by ADB to enable the development of an exit solution. Transactions in this category pose high risks to ADB’s overall reputation.

243. The 12 commitments categorized as in-progress and progressing are generally moving toward making tangible contributions to private sector development; although it is too early to be certain that they will deliver these contributions, particularly with regard to the equity investments through funds.

244. The three approvals categorized as in-progress but stalled include one project which was not able to achieve the required government approvals needed to make further progress and was not able to deliver the complete program envisaged at approval because of apparent policy reversals in the PRC. The other two have not been able to meet the conditions precedent to loan disbursements.

245. The seven cancelled approvals were stopped for a variety of reasons fairly specific to each case. Five of these experienced difficulties among the project sponsors that resulted in their inability to meet conditions precedent for disbursement of funds. The sixth was cancelled because of an issue that developed with subsequent legal due diligence related to the financing structure; and the seventh was cancelled due to the inability of ADB and the sponsor to agree to the final terms and conditions for investment. In total, five of the seven cancellations were for equity investments through funds. These cancellations can be viewed positively, in the sense that transaction structuring prevents funds from being disbursed into projects that do not meet ADB’s requirements. Cancellations can also be viewed negatively, as they represent missed opportunities to contribute to private sector results, and produce any return on the considerable resource commitment required by ADB to achieve an approval.

246. The three commitments approved in 2013 are still in the early stages of implementation. It is too early to comment on their contributions to private sector development, apart from noting they have all been designed to support ADB’s strategies and policies.

247. Reflecting these results, the overall rating of the portfolio’s contribution to private sector development is satisfactory.

b. Business Success

248. The overall portfolio rating for business success is satisfactory based on the information available at March 2015, and this reflects the approved size of each ratable investment. The primary indicator for business success is the investee’s FIRR. For nonsovereign investments, this information is confidential and the specific details are not included in this NSO assessment. For the seven approvals categorized as successful, four were or are likely be rated satisfactory, one excellent, and two less than satisfactory. There were five approvals that were, categorized as not successful, or are likely to be, rated either less than satisfactory or unsuccessful. The rest of the approvals were not sufficiently progressed to enable a useful rating to be made of the FIRR of the investee entities. Therefore, of the 12 approvals rated for business success, five are excellent or satisfactory, and seven are less than satisfactory or unsatisfactory. Larger investments had more successful business outcomes.
c. Contribution to Economic Development

249. The overall portfolio rating for contribution to economic development is *satisfactory* on the basis of information available at March 2015, and this reflects the approved size of each ratable investment. The primary indicator for contribution to economic development is the investee's EIRR. For nonsovereign investments, this information is confidential and the specific details are not included in this NSO assessment. For the seven approvals categorized as successful, five are or would be likely be rated satisfactory, one excellent, and one less than satisfactory. Five approvals that were categorized as not successful are, or are likely to be, rated either less than satisfactory or unsuccessful. The remaining approvals were not sufficiently progressed to enable a useful rating on the EIRR of the investee entities to be made. Therefore, of the 12 approvals rated for contribution to economic development, six are excellent or satisfactory, and six are less than satisfactory or unsatisfactory for the purpose of this evaluation. The larger investment made a greater contribution to economic development.

d. Environment, Social, Health, and Safety Performance

250. The portfolio rating for environment, social, health and safety performance, and for compliance with ADB's safeguards policies is *satisfactory*. Of the 33 approvals, 183 23 were specifically intended to contribute directly to environmental improvements in the PRC by delivering clean energy, clean water, sustainable transport, and sustainable agriculture. This was reflected in the project designs, which included specific on-going monitoring requirements to comply with ADB's policies. A number of these projects were particularly notable for their contribution to the environment and for the long-term commitment of ADB to the sector. In addition, the work done by ADB to develop specific criteria to suit particular projects was recognized, and these project entities reported that they had applied these criteria throughout their organizations, including particularly notable programs at China Water Affairs Group and China Everbright International Limited. With regard to social safeguards, only one project was category A, and the investee company was working to resolve outstanding matters. Given the expected compliance with ADB's safeguards policies and on-going monitoring by ADB, its overall contribution to projects that were categorized as successful or in-progress and progressing is notable.

2. ADB Investment Profitability

251. ADB's investment profitability is rated *satisfactory*. The disbursed loans all complied with ADB's pricing requirements for approvals by the Investment Committee. One loan is being repaid at an accelerated rate due to ongoing financial covenant breaches; for another some of the debt was being repaid with support from sponsor guarantees. The rest of the disbursed loans portfolio appears to be meeting scheduled repayments and the overall loans portfolio profitability is rated satisfactory.

252. Six of the seven direct equity investments that have been exited have returned profits, and on a portfolio basis the profitability of the direct equity investments is rated excellent. The 12 equity investments through funds that were approved have produced seven active funds (three were cancelled; two recent approvals are in very early stages of development and have either made only a few or no investments to date). Of the seven active funds, four were not successful, one does not appear likely to

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183 Approvals number 34 if the trade facilitation finance program is included.
achieve ADB’s required hurdle rate, and two may achieve ADB’s required hurdle rate. On a portfolio basis, the seven active funds are rated less than satisfactory (although ADB’s financial commitment for these investments is small).

3. ADB Work Quality

253. The overall rating for ADB work quality for the NSO portfolio is satisfactory. This category considers the screening, appraisal, and structuring of the investments approved and ongoing monitoring and supervision. PSOD’s projects were generally well structured to reflect all of ADB’s policy requirements using appropriate financial and information covenants. Many of these structures were innovatively designed to satisfy the requirements of newly opened areas for private sector finance. The ongoing monitoring of the portfolio was extensive, with detailed monitoring reports on file for all transactions. Transactions that encountered implementation issues or otherwise have not performed are monitored more frequently, with requirements for additional information being documented and provided.

254. Given these results, it appears the area in need of further consideration is the screening and appraisal of equity investments through funds. Five approvals for equity investments through funds resulted in four of the five transactions being categorized as unsuccessful and all seven transactions that have been cancelled. The other funds which are active are not expected to produce outstanding results. These results suggest the screening and appraisal process for equity investments through funds is not effective.

4. ADB Additionality

255. The overall rating for ADB’s additionality from the NSO portfolio is rated satisfactory. This category considers (i) the extent to which ADB finance was a necessary condition for the timely realization of the project, through direct mobilization of funds and/or indirectly by improving the risk perception of other financiers; and (ii) ADB’s contribution to the design of the project to improve the allocation of risk and responsibilities and to enhance development impact.

256. Documents for all approvals across all informal categories included a discussion on the importance of ADB’s involvement for the success of the intended project. All approvals categorized as successes demonstrated the importance of ADB’s involvement for the target project to proceed. ADB played a lead and important role in the design of these successful projects, reinforcing its contribution to the overall outcome. It also attracted additional lenders (including B lenders and complementary financiers) and/or additional equity investors to a number of these approved projects. ADB’s involvement increased the visibility of these projects, and when they were successful they could be successfully replicated. Many of the projects categorized as in progress in this sector assessment share these characteristics, with ADB contributions intended to produce unique demonstration effects that contribute to the PRC’s and ADB’s strategies and program objectives.

257. However, it also needs to be noted that ADB’s involvement attracted other investors who made commitments to projects categorized as not successful. Four of the five projects in the not successful group were equity investments through funds, which have been unsuccessful for reasons to do with the fund manager investment selections, their ability to find investments in the agreed target profile, and their ability to exit these investments. The fifth investment in this group was a direct equity investment in
a company where allegations of fraud surfaced after the investment had been made. In terms of structuring and risk mitigation, these transactions all appear to have been appropriately structured. The reasons for their lack of success were generally not due to matters that fall within the ADB additionality category. However, with ADB actively seeking to develop successful projects and to attract additional investors to them, it needs to acknowledge that its involvement is perceived as a positive signal that the project must be taken seriously. The concentration of equity investments through funds in the unsuccessful projects category and those likely to be unsuccessful, can be expected to detract from the overall perception of ADB’s contribution.

B. Conclusion

258. Nonsovereign operations increased significantly during the CAPE study period and demonstrated value enhancements by increasing private sector participation in development programs. Most PSOD projects that built on EARD’s enabling environment assistance have performed well, although policy changes affected some projects in the PSOD portfolio. PSOD’s value addition to private sector operations has included: developing financial structures to finance multiple small PPP projects; enhancing corporate governance and safeguard practices; promoting environmental sustainability, local currency financing, direct value added cofinancing through B loans and other financing mechanisms; and contributing to banking sector reforms.

259. Private equity funds performed less well than expected. ADB invests in private equity funds to facilitate private sector development. The funds must meet ADB profitability requirements and development objectives through their contribution to either increased equity investment in the fund’s chosen sector, or by demonstrating that investee companies benefit from the investment and contribute to the sector’s development. In practice, the requirements of fund managers to produce profits have not always allowed development objectives to take priority. Few of the equity investments through funds have delivered the expected returns or development results. Although the capital commitments for these approvals over the review period was just $405 million out of the total PSOD approvals of $4.1 billion (10%), they represent 9 of the 33 approvals over the review period (for 12 funds, in addition to 9 funds approved prior to the review period and still active during the review period). The work required to achieve these approvals and to monitor the portfolio is equal to that required for other types of PSOD approvals. It is recognized that PSOD is developing a new strategy for private equity funds; this strategy should carefully consider the ability of investments made through private equity funds to contribute to ADB’s development objectives in the PRC.

260. A small number of PSOD staff have delivered and are managing the PRC transactions. While operational risks have been managed successfully to date, spreading few staff resources thinly over a continuously growing portfolio is not sustainable. Limited staff resources can result in foregone opportunities to pursue projects in new sectors.
CHAPTER 8

Other Evaluations

261. ADB’s sovereign and nonsovereign operations in the PRC are rated successful (paras. 235 and 238). Other aspects of ADB engagement with the PRC are discussed below.

A. ADB Performance

262. ADB’s performance is rated satisfactory. ADB support was responsive to client needs. The loan and TA projects were generally well designed and focused on the country’s strategic objectives. A sufficient number of review missions were carried out: one per year for most loan projects and two if necessary (such as for some urban development loan projects that involved many subprojects with multiple implementing agencies). These reviews provided timely inputs to executing and implementing agencies. ADB responded by providing appropriate capacity building activities in many cases when implementing agency capacity was weak in areas such as procurement and monitoring and reporting on safeguards implementation.

263. Although the PRC counterpart agencies acknowledged ADB’s contributions to policy and regulation, they would like shorter TA approval times. They acknowledged the benefits of relatively quick subproject approvals under the facility TA modality, and the inefficiencies of delegated TA. They generally appreciated ADB’s efforts to hold consultations to streamline TA scope and activities. Feedback from the government showed that ADB has established a strong relationship with many PRC agencies.

264. Some executing agencies expressed concern about ADB procedures. Project preparatory TA for transport projects where project feasibility studies had been prepared beforehand resulted in delays in project completion by up to 2 years. These delays were considered unnecessary, particularly because ADB’s due diligence resulted in marginal value addition in project design. Some implementing agencies for ANR projects acknowledged that disbursements were being made more quickly than in the past, while other sector agencies (notably in transport) mentioned that ADB took a long time to respond to queries. Some agencies pointed to the need for ADB to improve internal quality control procedures, by citing examples where cost estimates in the loan documents did not match, or where there were ambiguities and errors in project documents on budget and funding allocations.

B. Performance of the Borrower, Executing Agencies, and Implementing Agencies

265. The performance of the borrower, executing and implementing agencies was rated satisfactory. The government provided clear directions on development priorities. The government and executing and implementing agencies displayed strong commitment and ownership of ADB-supported projects. The executing and implementing agencies provided full support that contributed to the success of loan
projects. Counterpart funding was provided in a timely manner in most cases. Adequate facilities and staff were provided to closely monitor schedules, and the quality and compliance with safeguards. Loan covenants and conditionalities were complied with. Where necessary, executing agencies provided adequate guidance to implementing agencies and, through their project management offices, helped strengthen implementation capacities of implementing agencies in construction management, procurement, disbursement, financial management and safeguards compliance. Where executing or implementing agencies needed to coordinate with other government agencies, they performed this function responsibly. The government actively participated in ADB-supported knowledge events on financial sector issues, and in training on procurement, safeguards and ADB’s anti-corruption policy.

266. However, there were a few exceptions. In one ANR project with more than 30 subprojects, ADB observed several instances of noncompliance with the environment management plan on measures to control erosion, dust, and noise during construction, and environmental monitoring. For many TA projects, slow decision-making by the responsible government authorities contributed to delays in TA completion.

C. Regional Programs

267. A full-fledged evaluation of the ADB-supported regional cooperation programs is the subject of another forthcoming evaluation from IED. This evaluation examines the implications of regional cooperation programs supported by ADB for the PRC.

268. Relevance. RCI is an important strategic objective for both ADB and the government. As part of its regional cooperation mandate, ADB has encouraged monetary and financial cooperation and integration to further economic and financial stability by establishing regional financial mechanisms.184

269. The government appreciates the services ADB provides as a facilitator and honest broker, and considers the CAREC and GMS programs to be important for developing good relations with neighboring countries. The government supported regional cooperation programs through the PRCF, the mandate of which was in line with the ADB’s RCI strategy, as well as with the CAREC and GMS programs. The PRC has been both a beneficiary of and a contributor to these programs, which can be viewed in the context of the government’s South–South cooperation agenda.

270. The CAREC and GMS programs complemented the RCI aspects of the country program. No loan or grant supported investment projects under the CAREC and GMS programs were located in the PRC. Nevertheless, the PRC is a beneficiary of many regional TA projects under the two regional cooperation programs. The PRC and ADB have cofinanced two road projects in the GMS area. Along with ADB, the PRCF set up by the government and administered by ADB has funded several TA projects where the PRC was one of the beneficiaries. These TA projects mostly contributed to (i) trade

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184 These include support for regional financial market integration under the ASEAN+3 Finance Ministers Process, the Asia-Europe Finance Ministers’ Meeting, the Asia-Pacific Economic Cooperation Initiative on regional bond market development, the Association of Credit Rating Agencies in Asia, and East Asia Pacific Central Banks Asian Bond Fund. ADB has supported the ASEAN+3 Finance Ministers Process by, among others, hosting the AsianBondsOnline website (a one-stop information clearinghouse on bond market development within the region), conducting studies for the Asian Bonds Market Initiative working groups on credit guarantee mechanisms and regional clearing and settlement mechanisms, developing a regional early warning system, and capacity building to strengthen the surveillance capacity of participating member countries.
facilitation and regional energy cooperation in the CAREC area;\(^\text{185}\) and (ii) trade facilitation, energy cooperation, and regional or global public goods such as climate change mitigation, communicable and animal disease control, biodiversity preservation, and regional financial stability in the GMS area.

271. **Effectiveness.** Regional TA projects under the country program and under the CAREC and GMS programs made a positive contribution to RCI through capacity building and sharing knowledge among CAREC and GMS countries. The PRCF established by the PRC government supports many of these regional TA projects.

272. The GMS Phnom Penh Plan for development management and the CAREC capacity building programs were among the most successful projects to train CAREC and GMS officials to manage regional cooperation issues. One regional TA under the GMS program (TA6324) generated new knowledge products on biofuels, contract farming, and cross-border supply chain of eco-products. These have helped improve the competitiveness of GMS agriculture. The full potential for regional cooperation in the CAREC area has not yet been realized. There is relatively slow progress in terms of reducing the costs of customs clearance and cross-border transport agreements.\(^\text{186}\) It is expected the CAREC Institute will be in a position to conduct further analytical work in the coming years, and to help formulate strategies for regional cooperation. ADB has supported the CAREC Institute to strengthen its knowledge program since 2008. Better coordination among ADB regional departments can help increase the benefits of regional cooperation.\(^\text{187}\)

273. **Efficiency.** More than 30% of regional TA projects under the CAREC and GMS program required supplementary TA support,\(^\text{188}\) compared with fewer than 15% in the PRC country program. These additional resource requirements reflect the fact that many issues addressed through RCI TA projects are complex and require consensus building across member countries.

274. **Sustainability.** The regional TA and investment projects implemented under the CAREC and GMS programs were approved through a consultative and consensus building process. In general, if a proposal for an investment or TA project was included for discussion at an official meeting of CAREC or GMS member countries, it was included in the respective program. Once included in the program, the concerned governments continued to meet their commitments (in terms of institution building, decision-making and providing resources).

275. **Development impacts.** The collective ownership of the CAREC and GMS programs by the respective member countries and the generally effective interventions to date indicate that development impacts were satisfactory. ADB has played a pivotal role in this process by acting as an honest broker. However, the CAPE team did not assess the development impacts of the regional TA projects that were completed during the study period.

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\(^{185}\) ADB. 2012. *CAREC 2020: A Strategic Framework for the Central Asia Regional Cooperation Program 2011–2020.* Manila. There is limited progress to date on other areas (knowledge, capacity development and regional public goods).

\(^{186}\) Slow progress in modernizing customs clearance at one border post is reported. ADB. 2014. *Kyrgyz Republic: CAREC Transport Corridor 1 (Bishkek-Torugart Road) Project. Validation Report.* Manila: IED.

\(^{187}\) Just as EARD coordinates the trade facilitation activities under the CAREC program, it could coordinate the work one or more of 10 sectors covered under the GMS program.

\(^{188}\) Based on the list of approvals from 2006 to 2013: 9 of 29 approvals were for supplementary TA in the CAREC program, and 19 of 48 approvals were for supplementary TA in the GMS program.
CHAPTER 9
Outlook

276. The PRC has transformed itself into an upper middle-income country and it is approaching ADB’s graduation threshold. ADB and the PRC have had a mutually beneficial relationship to date, and it is worth considering how this relationship can be adjusted in future.

A. Key Influences for the Future

277. The PRC’s rising financial strength has become increasingly evident in recent years. The PRC is a donor to the Asian Development Fund, has set up the PRDF, and has announced a $40 billion Silk Road Fund, a $3 billion aid package to GMS member countries, and a $46 billion package of assistance to Pakistan. Additionally, it has spearheaded the establishment of two multilateral development banks. The PRC has the world’s largest foreign exchange reserves although they have been declining since the peak level of nearly $4 trillion since mid-2014.

278. The PRC’s annual investments in fixed assets have exceeded $4 trillion per year since 2011, which is several thousand times larger than ADB’s support. Yet the PRC can derive benefit from ADB’s support in the coming years, and so can ADB.

279. The PRC’s interest in continuing a partnership with ADB reflects the value-added support ADB has provided to date. The PRC’s requirements have been evolving over time; most notably, the physical infrastructure focus of the 1990s and early 2000s morphed into an increased emphasis on the agriculture, natural resources, and social sectors in the mid-2000s. Financing has been a part of this relationship, but increasingly policy interactions and knowledge exchange will likely be decisive. The PRC

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189 GDP per capita at current prices is projected at $8,154 for 2015 and $8,659 for 2016. See International Monetary Fund. 2015. World Economic Outlook: Uneven Path, Short- and Long-Term Factors. Washington DC, April. As per ADB’s graduation policy, graduation is triggered when per-capita gross national income reaches $7,185 in 2013 prices (see ADB. 2008. Review of the 1998 Graduation Policy of the Asian Development Bank. Manila, April). The graduation policy requires that the PRC’s graduation from regular ADB assistance needs to be an outcome of a consultation process. Additionally, as noted by the 2014 midterm review of Strategy 2020, ADB will continue to assess its graduation policy, as appropriate, taking into account graduation policies of other multilateral development banks and changing circumstances in the Asia and Pacific region.

190 Announced at the APEC Heads of State Meeting in Beijing in November 2014; http://www.reuters.com/article/2014/11/08/us-china-diplomacy-idUSKBN0IS0BQ20141108

191 Announced at the 5th GMS Summit meeting in Bangkok in December 2014. The offer included $1 billion for infrastructure, $490 million for poverty alleviation and $1.6 billion in special loans for exporting production of electricity, telecommunication, steel and cement on regional transportation routes in neighboring countries. http://www.vietnambreakingnews.com/2014/12/china-offers-3-billion-in-aid-and-loans-to-neighbors-xinhua/is


is likely to seek continued collaboration, but its content and intensity will probably depend on the leveraging any financing would bring, and perhaps more importantly, on the value addition from lessons of experience and innovations. Just as a strengthened knowledge role by ADB will be useful to the PRC, the experience that ADB gathers in the PRC in the coming years will be useful to other countries in the Asia and Pacific region.

**B. Key Enablers for ADB**

280. ADB appreciates that knowledge and innovation will be key elements of its support to the PRC as it implements reforms across multiple dimensions, raises factor productivity, and pursues its South–South cooperation agenda. ADB recognizes that it needs to provide a certain level of financial support to wield influence on project outcomes and the PRC’s development.

281. In order to sharpen its focus on brokering and creating knowledge and making innovative lending and nonlending interventions, ADB will need to manage associated risks, broaden the scope of a high-level policy dialogue with the government, accelerate the implementation of the “One ADB” approach, and deploy adequate staff resources.

282. **Risk management.** To the extent ADB supports knowledge-intensive and value-adding innovative interventions, it will need to weigh the risk of being less successful more often and make a greater effort upfront to understand the specific context of each intervention. For loan projects, ADB will need to consider and manage the risks associated with the innovative project designs it proposes. For TA projects, it will need to have a good understanding of the critical success factors of the good international best practices it promotes.

283. **Policy dialogue.** ADB must broaden the scope of its high-level policy dialogue with the government so it is in a position to deploy a range of instruments and modalities for different purposes. In addition to traditional lending and the TA modalities that it has used so far in the PRC, ADB can introduce a suite of new loan and TA modalities to meet the various requirements of the government. For example, results-based lending can help set up or build on existing monitoring systems. Policy-based lending can provide policy and regulatory support to address issues that are sufficiently well-defined. TA loans and reimbursable TA projects can use OCR for TA support and to augment limited TA resources. Traditional loan instruments can support bankable SOEs and creditworthy municipal governments without sovereign guarantees. Box 2 provides an overview of opportunities to deploy these instruments in the PRC along with the instruments currently in use.
Box 2: Opportunities to Deploy Instruments

**Results-based lending.** This modality is suited to financing large government programs that consist of certain types of investment projects with minor or no safeguard implications (such as education). The results-based lending focuses on results rather than inputs. While loan performance is monitored in the same way as traditional project-based loans, loan drawdown is determined by the extent to which pre-defined performance indicator targets are met. The performance indicators identified for the Asian Development Bank (ADB) portion of the financing package would be applicable for the entire program.

**Policy-based lending.** ADB has offered this modality in many countries. Policy-based lending (PBL) can be used to drive policy changes designed to improve growth prospects and economic efficiency. To date, the People's Republic of China (PRC) Government has not accepted PBL. However, the PBL modality can be used to drive reforms initiated by the central government down to provincial and local levels, particularly when the policy and regulatory requirements to address the reform issue are clear upfront.

**Technical assistance loan.** ADB has used technical assistance (TA) loans to support the preparation of detailed feasibility studies. It may be possible to apply the TA loan modality (perhaps by modifying the relevant policy and procedures in ADB’s Operations Manual) to allow such loans to be offered in addition to one-off and facility TA. The World Bank Group has offered TA loans to the PRC to pursue programmatic approaches, the government is familiar with this modality, and likes technical assistance outputs to be of top quality. TA loans using ordinary capital resources funds can be used to expand the resource base for TA support.

**Reimbursable technical assistance.** ADB has offered reimbursable TA to other graduated countries. With a view to expanding the resource base for TA support, ADB can consider discussing with the PRC and other upper middle-income governments whether to use ordinary capital resources funds for reimbursable TA.

**Traditional technical assistance modalities.** Traditional one-off TA projects and facility TA projects can continue to the extent that traditional TA resources are available and allocated to the PRC. Both these modalities have contributed to informing policy and developing institutional capacity. They have helped to create and disseminate knowledge. PRC counterparts appreciated the added flexibility provided by the facility TA modality. Its effectiveness can be improved if consultant procurement time-frames are shortened and if ADB can assign adequate staff to work simultaneously on the many subprojects that are at various stages of the subproject cycle.

**Traditional loan modalities.** These instruments include project loans, financial intermediation loans, and multitranche financing facilities. Their long tenors can provide a financial buffer for non-revenue generating public goods projects and public utility service projects when there is a revenue shortfall below full cost recovery. They can support investments that entail high technology risk where commercial bank financing is not normally available. They can complement proceeds from bond issuances as the municipal bond market develops.

*Where municipal governments are in a position to issue bonds, ADB can consider subsovereign loan support. This is most likely to be in the eastern region initially, where the municipal bond market is expected to develop first. ADB can also consider subsovereign loan financing to support investment programs of creditworthy state-owned enterprises.

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*a* The municipal bond market can only develop after a clear agreement is reached between MOF and the People's Bank of China on who pays for the debt swap for existing municipal government debt. These agreements are on the horizon, but no target date is available.


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284. **“One ADB” approach.** Given the need to deliver high-quality knowledge products and services in a timely manner, ADB will need to continue to explore approaches to optimally utilize its staff knowledge, and to improve coordination and communication among EARD, other knowledge departments, and ADBI. The “One ADB” approach is designed to achieve these objectives, and the PRC offers a good
opportunity to accelerate the piloting of the “One ADB” approach. A CPS knowledge management plan for 2016–2020 could provide the broad contours for the application of a “One ADB” pilot program.

285. Staffing. The need to manage a portfolio that is knowledge-intensive and has high innovation content will require EARD (including the PRC resident mission in particular) and PSOD to be resourced commensurately. Sufficient staff with sector and/or thematic expertise will need to be allocated for this work.

C. Suggestions for Development Cooperation

286. The key aspects of the ADB–PRC partnership in the coming years are likely to be two-fold: (i) making improvements based on past experience; and (ii) shifting the focus, even if past interventions have been successful, in response to changing needs. The ADB–PRC cooperation program in future may look very different from that of the past. Below are some suggestions for ADB and the PRC to consider as the country comprehensively deepens reforms towards a truly inclusive, environmentally sustainable and efficient growth model and as both ADB and the PRC bolster international cooperation, including South–South cooperation. The suggested areas are in line with the 2014 MTR and the 2015 approach to UMICs. They would provide ADB with an opportunity to broker knowledge and push the frontiers of knowledge as it supports innovative reforms.

287. Strengthen ADB’s role as an honest broker to foster cooperation within CAREC and the GMS and in the PRC’s relations with other countries. ADB’s role as an honest broker is likely to become more important as the Silk Road Fund and other PRC-aid packages bring in more connectivity infrastructure. ADB will have the opportunity to leverage its own resources by partnering with the PRC to cofinance connectivity infrastructure and other cross-border investments. This will make ADB’s honest broker role more challenging, although disparities of size mean that other members of CAREC and the GMS and other countries in the Asia and Pacific region would probably welcome ADB playing a facilitating role as they deal with an unequal partner such as the PRC. ADB would need to continue to be selective in facilitating projects and programs that clearly show poverty reduction benefits, pollution control, climate change, and other regional public goods benefits in the concerned CAREC, GMS, and other ADB borrower countries.

288. Vastly increase support to address climate change and protect the environment. ADB’s memoranda of understanding with the government on environmental protection and addressing climate change provide a good basis for continued cooperation in these areas. In consultation with the government, ADB can identify certain well-defined areas where it can make visible contributions to the government’s programs. This will require a mix of activities that, when combined, can demonstrate ways of achieving an inherently clean, resource efficient and/or climate-friendly growth path. For example, ADB can work toward demonstrating the following: (i) air and water quality improvement in a selected city, and/or (ii) reducing negative regional spillovers from the discharge of industrial effluents into a river that ultimately flows into an open sea, and/or (iii) supporting the establishment of a national carbon emission trading regime.

289. Focus on reducing social inequalities and poverty. The government aims to reduce income and non-income disparities between rural and urban areas, and to
reduce the number of people living below the poverty line. ADB can support these objectives at three levels.

(i) In line with the government’s approach to reducing inequalities faced by the population in the countryside, ADB can support infrastructure investment along with measures to increase access to finance, and to affordable utility and social services.

(ii) In designated poverty counties, (mostly in central and western provinces), ADB can design and support pilots to integrate development-oriented poverty reduction programs with subsistence support, and to help establish systems to enable government programs to improve targeting of poor households.

(iii) In urban areas, ADB can support the government in addressing issues that have arisen because of the residency registration system, such as providing migrants with equitable access to affordable and reliable public utility services, and equitable access to social services, including education and healthcare.

290. **Support tracking the implementation of the reform program.** The government acknowledges it lacks a system to gauge the extent to which the central government’s reform initiatives are followed and implemented at provincial and local levels. Through a mix of TA and loan support (including results-based lending), ADB can help establish and/or build upon existing monitoring systems.

291. **Intensify support for public sector management.** Given the importance of fiscal management and capacity building at provincial and local levels in the ongoing reform program, ADB needs to remain focused on these two PSM areas. It can articulate this requirement formally in a PSM sector assessment, strategy and road map to provide clarity on the extent, modality and provincial coverage of PSM support, and the likely results.

292. **Continue PSOD’s private sector finance and EARD’s policy dialogue.** Total factor productivity for non-state enterprises has grown faster than that for SOEs, which provides a good rationale for ADB to continue NSO and private sector operations in the PRC. During the CAPE period, ADB supported (i) upstream policy advisory support through EARD, (ii) projects in sectors where the participation of private and other non-state enterprises was permitted, and (iii) equity investments through funds. For the continued growth and success of ADB’s operations it should consider (i) strategically engaging with the government on high-level policy matters through EARD to strengthen the enabling environment required to sustain private sector development; (ii) continuing to monitor market conditions for the issuance of local currency bonds, with ADB acting as either an onshore or an offshore borrower; (iii) continuing to monitor the yuan internationalization program with the objective of launching local currency complementary loans; (iv) targeting strategic equity investments in companies and financial institutions, subject to the availability of qualified ADB staff dedicated to managing them; and (v) targeting equity investments through funds in order to contribute to the achievement of ADB’s development objectives in the PRC.
Appendix
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<th>APPENDIX: LIST OF LINKED DOCUMENTS</th>
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| 1. | Framework for the Country Assistance Program Evaluation  
| 3. | ADB Country Strategies  
| 4. | Programming and Modalities  
| 5. | Loans, Grants, and Technical Assistance under the ADB Country Program for the People's Republic of China  
| 6. | Knowledge Products and Services  
| 7. | Regional Cooperation and Integration  
| 8. | Value Addition from ADB Support  
| 9. | Sector Assessments  
| a. | Agriculture and Natural Resources  
| b. | Energy  
| c. | Transport  
| d. | Urban Development  
| 11. | Nonsovereign Portfolio and Assessment  
| 12. | Ratings of Projects Completed after 2006 in Extended Annual Review Reports and Validation Reports  