The Role of World Bank Lending in Chinese Economic Development, Poverty Reduction, and Social Adjustment

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Abstract

Chinese economic growth continues around 10% annually and while many assume that it will continue indefinitely lessening the need for outside assistance, the World Bank will continue to play a vital role in Chinese development. The challenge for the World Bank is how to craft lending programs and policies that reduce poverty and aid the transition to a fully industrialized country across regions. The paper focuses on describing the challenges of working with a relatively well managed rapidly growing economy and the future role of the World Bank in Chinese economic development. First, the World Bank should focus on poverty reduction and income inequality projects. Second, as China continues broad based economic restructuring, the World Bank is well placed to lend to reduce the impact dislocated industries and populations. Third, the World Bank is well placed to encourage regional integration of the Chinese market. Fourth, the World Bank can play a major role in energy infrastructure. The rapidly growing Chinese economy allows the World Bank to focus on meeting specific needs of reducing absolute poverty and assisting on an as needed basis rather than assume responsibility for the development of an entire economy.

Introduction

Chinese economic growth continues around 10% annually and while many assume that it will continue indefinitely lessening the need for outside assistance, the World Bank will continue to play a vital role in Chinese development. Home to 150 million people who live on less than $1 per day, or nearly 20% of the world total, uneven economic growth increases inequality within and across the regions of China. The challenge for the World Bank of remaining relevant in a rapidly growing economy with excess capital is to craft lending programs and policies that reduce poverty and aid the transition to a fully industrialized country. Chinese economic development suffers from numerous cleavages that the World Bank can assist in ameliorating. Rural and urban, interior and coastal, agricultural and industrial, and regional versus national divergence are some of the cleavages dividing the Chinese economy. As China undertakes continued economic reforms, the risk exists that institutional and popular support for further restructuring will erode if movement towards a liberalized environment fails to account for dislocated persons. China can sustain economic growth, reduce inequality, and poverty by reducing existing cleavages through public investment in infrastructure and human capital.

In this paper, I study the role of the World Bank in a rapidly expanding economy and how its lending policies can mitigate the potential risks of rural urban cleavages, state owned enterprises (SOE), and social adjustment and inequality policies as China continues its economic transition. This paper focuses on describing these challenges and how the World Bank responds to them. First, the World Bank is working with a relatively well managed economy that is growing rapidly. The World Bank must adapt

its lending by assisting Chinese development to target under served populations which did not benefit from increased investment and international trade levels. Second, the World Bank can focus on poverty and income inequality reduction by drawing on its extensive infrastructure and governance expertise. By targeting poverty reduction measures such as rural and regional disparities in the Chinese economy through increased integration, infrastructure, and adjustment programs, the World Bank can make large reductions in global and domestic levels of absolute poverty. Third, as China continues broad based economic restructuring, the World Bank is well placed to reduce the impact of economic restructuring. Focusing lending projects on mitigating the negative consequences of economic restructuring, layoffs, and shutdowns of SOE's will encourage further reforms as the World Bank cooperates with local and regional authorities to prevent significant dislocation through household and small and medium enterprise growth. Fourth, the World Bank is well placed to encourage regional integration of the Chinese market. As one recent World Bank report notes, "…city level investment climate varies widely. Business law and regulation are basically the same throughout China. Hence, differences mainly reflect local government efforts (or lack of efforts) to operate efficiently," (World Bank 2006a). Stimulating improved management of existing regulation helps facilitate many of the ongoing transformations taking place within the Chinese economy. Fifth, the World Bank can play a major role in transportation and energy infrastructure. The World Bank with financial capital and sectoral expertise provides strategic capabilities of meeting increased infrastructure requirements and improving environmental sensitivity.

This paper is divided into four sections. First, I focus on the state of the Chinese economy and its continued development. Second, I turn to the cleavages within the Chinese economy and the future risks of further development in the Chinese economy. Third, I frame the role of the World Bank in China accompanying high growth rates and ongoing reform efforts. Fourth, I study the future role of the World Bank in moderating future risks to the Chinese economy and reduce existing inequality and poverty measures. I argue that the rapidly growing Chinese economy allows the World Bank to focus on meeting specific needs of reducing absolute poverty and assisting on an as needed basis rather than assuming responsibility for a wide range of issues. I find that the World Bank has responded well to the rapid industrialization of the Chinese economy but there remains significant room to both expand operations and meet the needs of a rapidly expanding and evolving economy.

The State of the Chinese Economy

Since first instituting small scale agricultural reforms in the late 1970's, the Chinese economy has grown rapidly expanding at 10% annually in recent history. While more concentrated in southern, coastal, and urban areas, real income has risen dramatically around the country leading to an unprecedented reduction in absolute poverty. Though dynamic and rapidly expanding across a variety of industries, Chinese economic growth depends on low value added products and increasing investment levels. Potential risks and limits to the current driving factors of the Chinese economy exist (Nolan 2005a). To sustain high levels of growth, the Chinese economy must address institutional weaknesses in the legal and governance framework, human capital,

infrastructure, industrial restructuring, and movement towards greater economic productivity. Research into the returns on public investment, indicate that public investment in road, agricultural research and development, and education produce the highest returns and reduces inequality (Fan 2003). Large needs exist in infrastructure, human capital, and agricultural R&D to sustain broad based economic development moving into higher value added products and away from an agrarian based society.

Three factors underpin the rapid economic growth experienced by the Chinese economy. First, moderate and ongoing market oriented economic reforms. Beginning with small scale agricultural reforms in specific regions aimed at increasing production which allowed farmers to sell excess production at local markets, Chinese law now permits owning private property and the Communist party permits capitalists to join the Party (Economist 2007a). Research indicates that "rural reform, the nonstate sector, ..capital accumulation along with fiscal reform are the key driving forces of China's impressive growth over the past 20 years," (Lin and Liu 2000). Gradual but ongoing incremental reform of the Chinese economy, continue its move towards a more market oriented system including liberalized international trade and the dismantling of two tier pricing systems for agricultural staples increasing competition which increase poverty and inequality (Martin 2001a and Huang, Li, and Rozelle 2003).

Second, high levels of investment drive Chinese economic growth. China received in 2005 foreign direct investment (FDI) totaling nearly $60 billion from outside investors (National Bureau of Statistics 2007). Portfolio investment levels through initial public offerings (IPO) and merger and acquisition (M&A) activity grew rapidly as China opens up its financial sector and large state owned banks. Domestically China

maintains high savings rates prompting investment in recent years to grow at 25% annually. Concern exists that current growth levels of fixed asset investment cannot continue indefinitely and may lead to excess capacity especially in light of an appreciating currency. Third, an export led focus to economic growth borrowing from the Asian model of growth. Focusing on labor intensive low skilled labor industries, China expanded exports from $150 billion in 1995 to $750 billion in 2005 a five fold increase in ten years. Trade represents a large and growing portion of Chinese GDP and increases integration into the international economy (Martin and Ianchovichina 2001b). Though domestic consumption continues to lag, financial market reforms encourage increased consumption specifically for durable goods and housing. Measured and ongoing economic reform coupled with high investment levels and an export led growth drives the Chinese economy.

The Risks and the Limits of the Chinese Economy

While Chinese economic growth remains impressive, potential risks and limits to continued development require attention. First, investment growth as the driver of Chinese economic expansion is unsustainable (Nolan 2005a). Fixed asset investment for the past 20 years increased rapidly. However, to sustain the rapid growth levels of recent history, investment as a percentage of GDP would need to increase past its current level of 40% of GDP to unsustainable levels. With GDP growth averaging 10% annually and investment growth averaging 25%, fixed asset investment cannot continue to drive GDP growth. The Chinese economy still requires significant investment in infrastructure, human capital, and small and medium enterprises (SME) rather than state owned

enterprises (SOE). To maintain growth levels, China must begin to allocate credit and investment resources more effectively. Currently, SOE's and collective enterprises absorb nearly 50% of all investment. For instance, banks funnel financing to SOE's and well connected firms that increase output supply levels but at lower levels of productivity rather than more dynamic SME's (Brandt and Zhu 2000). Research also indicates that SOE's and collective enterprises receive higher financing than privately owned corporations but are less profitable and overstaffed (World Bank 2006a).

Second, human capital and total factor productivity pose a potential obstacle to sustained growth. Research indicates that skilled workers do not receive a wage premium for increased levels of human capital due to a variety of restrictions reducing the material incentives for investment in education (Fleisher and Wang 2004). Despite the image of a vast army of low wage and productive labor, research indicates that total factor and human capital productivity gains contributed little to previous Chinese economic growth. To sustain high growth rates over the medium and long term, human capital and total factor productivity must play a larger role in continued economic expansion. Fixed asset investment, if not at the sustainable limit will reach it shortly. Businesses in China already complain of a lack of qualified workers in rapidly expanding and higher skilled industries (Economist 2007b). The Chinese economy cannot continue to depend on fixed asset investment to drive growth but must increase total factor productivity and human capital to sustain future economic expansion.

Third, continued evolution towards a market based economy will sustain growth by more effectively allocating existing resources. Currently, significant distortions prevent economic restructuring of failing companies, credit allocation activities do not

rely on market pricing, lack of adherence to intellectual property regulation decreases greater value added activity, and regulations inhibiting labor market movement prevent greater productivity gains (Nolan 2005b and McKibbin and Tang 2000). Previous economic reforms occurred in a controlled environment and continued economic growth depends on ongoing and moderate openings of the Chinese economy. Significant gains remain from continued economic reforms (Nolan 2005b).

Fourth, environmental degradation due to increased natural resource input and higher pollution levels threaten to harm economic growth in the long run. Some research indicates that if accounting for increased environmental resource input use, economic growth collapses to zero (Pan 2005). While the methodology remains debatable, the Chinese government and communist party emphasize the importance of increased environmental responsibility though the many layers of government fail to adequately enforce existing regulation (Varley 2005a, Rozelle, Huang, and Zhang 1997). China passed the United States in 2007 for total emissions of greenhouse gases but conversely requires increased energy infrastructure investment to meet soaring industrial and newly affluent middle class consumption. China finds itself in the unprecedented position of needing to rapidly reduce pollution levels and environmental degradation from economic activity and consumption while industrializing. These limits and risks do not threaten to end growth but act as restraints to sustained long term growth if not properly addressed. The continued evolution towards a fully industrialized high productivity knowledge economy requires improved human capital, infrastructure, and credit allocation markets to sustain growth over the long term.

Cleavages in the Chinese Economy

Despite rapid economic expansion and large drop in poverty levels, the Chinese economy suffers from serious cleavages which prevent broader access to the benefits of globalization and growth. Though China benefits from increasing international trade, research indicates that "the gains of economic growth have not been evenly distributed across regions…(and) foreign trade and inward FDI seem to play a certain role" (Zhang and Zhang 2003). These cleavages within the Chinese economy create clear divisions of haves versus have-nots. Ignoring equity arguments, these divisions prevent sustained economic growth if large portions of the population cannot participate in a rapidly expanding economy. In other words, if selected groups cannot move into higher growth and productive sectors, this will drag down overall economic expansion. A number of cleavages in particular are worth mentioning.

First, rural versus urban populations. In addition to the large and growing disparities between urban and rural incomes, numerous Chinese policies prevent the narrowing of the income gap (Yang 1999). Research indicates a regressive tax policy with transfers from lower income rural populations to higher income urban populations are one factor that prevent reducing the income differential. Additionally, official statistics may underestimate the true extent of urban unemployment and poverty (Xue and Zhong 2003). Urban biased policies come through in other areas such as health care quality (Ooi 2005). As World Bank research notes, the evolution away from a primarily agrarian and rural society has "been made more challenging by a number of conditions special to China and by China's policy choices," (Findlay 2005). Other policies such as

the prohibition on migration from rural to urban centers prevent effective reallocation of labor resources into higher productivity work ensuring a significant differential between rural and urban incomes though debates remain about how much these regulations impact poverty specifically in rural areas (Cai, Wang, and Du 2002 and Du, Park, and Wang 2005, Park and Wang 2001, Riskin 1994, Gibson, Huang, and Rozelle 2003, Fang, Zhang, and Fan 2002, Jalan and Ravallion 1998, Jalan and Ravallion 2002). As one researcher notes "returns to investment in poverty reduction were highest in the west…while returns in agricultural production growth were highest in the central region…investment in the western region led to the greatest reductions in regional inequality for all types of government spending…" (Fan 2003).

Second, agricultural versus industrial sectors. Agricultural productivity and income rose since the first small scale reforms but continues to grow at a slower rate than industrial and service sector incomes (Kuijs and Wang 2005). Again ignoring equity arguments, to sustain high growth levels the Chinese economy must reallocate a high percentage of agricultural labor into the industrial and service sectors and drive agricultural productivity (World Bank 2006b). Integrating Chinese agricultural markets through such mechanisms as the World Trade Organization (WTO) and improved rural infrastructure whereby industrial scale farming overtakes subsistence farming to drive incomes will more efficiently allocate labor and increase agricultural productivity. Third, the widening inequality gap in China. Though debates persist on the nature, level, and solutions to poverty in China, inequality increased to some of the highest levels in the world both within and between regions (Yao 2000,Ravallion and Jalan 1999, and

McCulloch and Calandrino 2003)[1]. In other words, extreme inequality exists within the poor western regions and the wealthy coastal regions and across China as a whole. World Bank research notes that "even after the substantial reduction in poverty brought about by two decades of rapid growth, the overall incidence of poverty at the end of the 1990's was higher in China than in many countries at the same average level of living" implying uneven growth between regions and sectors (Khan 2005). Uneven public investment and divergent growth patterns threaten to limit national economic growth if resources do not migrate from low return regions and sectors into higher productivity activities. Research implies that industrial production, decentralization, and international trade exacerbated inequality between regions and impacted growth patterns (Kanbur and Zhang 2005 and Zhang and Zou 1998). In fact, by targeting under performing populations, China can sustain and drive economic expansion by making growth pro-poor without exacerbating inequality (Ravallion and Chen 2003). Geographically, central and western regions in China lag the gains of southern and coastal regions which benefited the most from FDI, export led growth, and market oriented reforms (Yao, Zhang, and Hanmer 2004). Reforms and market orientation drive poverty and inequality reduction as research indicates that regions with larger gains in international trade witnessed declines in rural urban inequality (Wei and Wu 2001). Sectorally, sustained growth will rely on how well the 60% of the Chinese population engaged in agriculture moves into higher income growing industrial and service sectors. To sustain high growth rates, China must

[1] A significant portion of the debate about poverty in China stems from how to measure poverty. Research indicates that different economic and caloric measures can yield divergent numbers of people in poverty. Additionally, many persons not counted in poverty numbers may be highly vulnerable to changes in their economic status which may help explain why different measures of poverty obtain such different results.

transfer its focus to broader based integration of the population into the rapidly expanding sectors of the economy.

Framing the Role of the World Bank in China

The unique circumstances of both Chinese economic development and the historical role of the World Bank require an analysis of future interactions. First, the World Bank by total lending and investment capital will play a minimal role in overall development, but remains well placed to alleviate poverty and lend area specific expertise. Second, a rapidly growing relatively well managed and gradually liberalizing diversified economy faces different obstacles than many World Bank clients. Third, the World Bank must sustain and increase total lending to China to influence the course of Chinese development rather than rely on persuasive arguments and intellectual prowess. Fourth, the World Bank should narrowly focus its efforts on at risk populations within a country of 1.3 billion by targeting the limits, risks, and cleavages within the Chinese economy identified previously. Due to the overall size of the country and the state of the economy flush with investment capital, the World Bank has the freedom to pursue a narrowly focused program on needy peoples and leave important needs to other parties.

Framing the role of the World Bank in Chinese economic development requires in depth exploration of a number of issues. First, the World Bank by total lending and investment capital will play a minimal role in overall development but remains well placed to alleviate poverty and lend area specific expertise. Investment from the rest of the world floods into China which when coupled with high domestic investment from savings significantly reduces the impact of World Bank financing. Furthermore, FDI will

account for only 5.2% of all investment in China (Chinese National Bureau of Statistics 2007). While much of the investment due to the currency conversion regime comes in the form of FDI rather than portfolio investment, scholars and policy makers increasingly worry more about excess supply due to fixed asset investment rather than sudden rapid outflows of financial capital. Private equity and investment firms build infrastructure where recovery rates provide a reasonable return. Additionally, high Chinese savings rates ensure that domestic investment in both financial and fixed assets will remain steady for the foreseeable future. World Bank lending in 2006 represented only 4% of all FDI and .2% of all investment in China.[2] In short, investment in China will dwarf any lending provided by the World Bank. The investment climate allows the World Bank to focus on specific activities.

Second, a rapidly growing relatively well managed and gradually liberalizing diversified economy faces different obstacles than many World Bank clients. Though the World Bank cites the lack of institutionalization of World Bank advice and expertise in Chinese governance, the long term policy trend indicates higher levels of openness, ongoing market oriented reforms, and improved rule of law. Critics may cite the slow pace of reform, but the fundamental trend of Chinese economic policy remains market oriented. Whereas in most developing countries, the World Bank works to attract investment from abroad, the concern of excess investment permeates the Chinese economy. Conversely, the risk for the World Bank stems not from mission creep but from mission disappearance in a country with high levels of poverty. The state and market driven financing crowd out traditional areas of World Bank expertise, eliminating

[2] This comes from the authors calculations using statistics from the websites of the World Bank and the China National Bureau of Statistics.

bank input on environmental, social, and poverty alleviation measures. Formulating lending practices which adequately complement the market while balancing social and environmental concerns, will determine the influence of the World Bank in Chinese development.

Third, the World Bank must sustain and increase total lending to China to influence the course of Chinese development rather than rely solely on persuasive arguments and intellectual prowess. The World Bank expresses frustration with the level of Chinese adoption of World Bank recommendations and best practice policies as World Bank lending decreases in relative importance to China. Experience around the world suggests that if the World Bank fails to retain a degree of financial relevance to China, their ability to influence policy will decrease accordingly. Consequently, while some reports talk of the importance of creating best practices standards, sector experts, and knowledge relevance through which to influence Chinese development, the relative and absolute declining financial stake of the World Bank in China undercuts their ability to influence policy. For instance, while activists cite the decline of World Bank transportation and energy lending as good for the environment, Chinese ability to self finance or tap market sources may actually lower environmental, health, and human standards in the absence of World Bank presence. A financial stake in the Chinese economy gives the World Bank increased leverage to influence policy. As World Bank research notes, "only two power loans have been made since 1998, resulting in a significant decrease in overall energy lending," (Churchill and Thum 2005a). Therefore, it is not surprising that "after the major policy breakthroughs of the mid 1990's in the power sector, progress on sector reform has slowed and major policy issues in such

critical subsectors as coal, oil, and gas have largely gone unattended," (Churchill and Thum 2005a). The World Bank must increase lending activity to significantly impact Chinese energy policy. New approaches may include adopting similar joint venture models as used Chad whereby the World Bank partners with companies or lower levels of government to enhance legitimacy and standards (Churchill 2005b).

Fourth, the World Bank should narrowly focus its efforts on at risk populations by targeting the limits, risks, and cleavages within the Chinese economy identified previously. Despite a flood of investment and economic growth of 10%, large populations of absolute and relative poverty exist which can effectively utilize World Bank financing and expertise. Instead of broadly focusing on the Chinese economy, rapid growth allows the World Bank to narrow its focus to at risk populations which can effectively absorb and utilize relevant expertise and funds. Targeting rural areas which can benefit substantially from public investment driving agricultural productivity and further the movement towards a fully industrialized economy will allow the World Bank to focus it efforts.

Focusing the World Bank within Chinese Economic Development

Operating under the unique set of circumstances require a reassessment of how to manage World Bank lending practices in China. Based upon previous analysis by evaluation studies and academic research on development lending efficacy in China, refocusing does not require major overhauls of World Bank policy (World Bank 2005). Instead, a rapidly growing economy with a gradually but steadily liberalizing economic reforms, permit a focus on specific project areas leading to poverty alleviation which will

drive income inequality reductions. To that end, focusing on poverty reductions will require lending and expertise in core areas of World Bank infrastructure, specifically transportation, energy, policy reforms, and the environment. Working within this unique economic environment will require continued lending and expertise as well as engaging potential joint venture opportunities which utilize sectoral knowledge and World Bank legitimacy. Critics may debate this role but the World Bank stands to impact Chinese economic development more by influencing policy rather than removing itself.

The World Bank can play its largest role by focusing on poverty and indirectly inequality in China. Though uncontentious as a general point of reference, the means to reduce poverty are contentious. A number of key points require elucidation. First, though many key issues about Chinese poverty remain debated, high numbers of poor remain (Cai, Wang, and Du 2002 and Du, Park, and Wang 2005, Park and Wang 2001, Riskin 1994, Gibson, Huang, and Rozelle 2003, Fang, Zhang, and Fan 2002, Jalan and Ravallion 1998, Jalan and Ravallion 2002, Deaton 2005)[3]. Though the divergence remains between transitory and structural, urban and rural, and income or caloric measures, key points emerge which can frame World Bank lending. First, greater need exists for lending, development assistance, and investment in rural areas. For instance, investment in urban areas account for 85% of total investment (China National Bureau of Statistics 2007). A disproportionate number of the poor live in rural and inland areas, beset by slower growth, creating a two track development system. To sustain Chinese economic growth, it becomes increasingly important to include larger amounts of the

[3] The debate about the true level of poverty reduction in China and more expansively the world stems from disagreement over statistical methodologies. As the aim of this paper is not to engage this debate, I will not cover it in depth and only not that some reasonable disagreement exists about the level of decline in poverty. It is worth noting that no one debates that poverty in China has fallen.

population in rapidly expanding sectors. Furthermore, most investment FDI flows into a limited number of urban and coastal regions, exacerbating the need for rural development funds. The coastal region from Liaoning to Guangdong receives nearly 80% of all FDI and 60% of total investment (Chinese National Bureau of Statistics 2007).

Second, in addition to less favorable tax policies, rural areas generally face greater geographic obstacles to market access the eastern and coastal urban areas do not face. In addition to being located further away, inland rural regions have more infrastructure obstacles than coastal urban areas (World Bank 2006a). Research indicates that Chinese market integration remains incomplete with significant divergence in a range of policies (Xu 2002, World Bank 2006a). Lower human capital, transport costs, and energy costs inhibit rapid growth of the industrial sector outside of coastal regions. Reducing exogenous cost of doing business in inland regions will help integrate inland and rural regions. According to World Bank research, "China's road network ranks among the sparsest in the world relative to geographic area and population" and physical infrastructure has expanded only 7 to 8 per cent per year on average…while infrastructure utilization has soared 13 to 14 per cent per year" (Churchill and Thum 2005). Third, southern and coastal regions score higher on governance measures than inland and rural regions fostering economic development (World Bank 2006a). Regions outside of the main Chinese power centers could benefit substantially from World Bank expertise and bring about significant reductions in absolute numbers of poverty. Lending more to regions with populations the size of most World Bank client countries would provide development funds and human capital transfers which do not currently receive significant investment, potentially impacting massive numbers of poor not experiencing

rapid development. By focusing on issues that will enable poor rural areas to increase their ability to attract both domestic and foreign investment these steps will have the largest impact on long term poverty.

The second focus of the World Bank should assist Chinese economic restructuring. A major impediment to further economic reforms, Communist party leadership and displaced workers fear potential dislocation caused by restructuring or termination of politically motivated bank financing. A recent World Bank survey found that many SOE's retain large numbers of excess staff and absorb more investment capital than their privately owned competitors (World Bank 2006a). The excessive number of agricultural labor will require relocation into more productive industrial and service sector employment. Broad agreement exists that the movement towards a more market oriented system remains a broadly positive development, but fear remains about the intermediate steps to achieve this goal. Conversely, the Chinese approach of continual gradualist reforms need constant encouragement to spur restructuring as production moves from SOE's to privately owned enterprises and from small scale subsistence to large scale industrial farming. Research indicates that "loans to households for agricultural activities positively affect agricultural growth in poor counties while all other uses of poverty funds agricultural infrastructure, rural enterprises, and SOE's did not have a discernible positive effects on growth," (Rozelle, Park, Benziger, and Ren 1998). In other words, targeting the inability of rural areas to integrate their markets and increase small business expansion drives economic growth. In the intermediate term, these measures may include infrastructure projects designed to target areas with higher poverty, rural populations, and restructuring displacement; expertise in writing and enforcing

financial restructuring legislation which can purchase bad loans and restructure loss making industries; land reform programs designed to increase agricultural production and move excess labor into the industrial sector (Nolan 2005b). The World Bank promotes a liberal economic environment but can also work to reduce, in a market oriented fashion, the risks of economic dislocation brought on through restructuring.

Third, the World Bank is well placed to assist integration of the Chinese market. This focus on activities has a lending and policy component. The policy component first. As a recent World Bank study notes, a wide variety in governance, tax, policy, and corruption levels exist around the country (World Bank 2006a). Consequently, many companies with national or international aspirations, not already strategically placed, face great difficulty planning national or international expansion. This may take the form of excessive 'travel and entertainment' expenses, licensing, taxes, property rights, or transportation difficulties but research indicates that the Chinese economy can increase its level of integration and competitiveness (World Bank 2006a). The study on "China Governance, Investment Climate, and Harmonious Society: Competitiveness Enhancements for 120 Cities in China" by the World Bank begins the process of establishing benchmarks and standards against which to judge local government. Local Chinese governments retain wide latitude on how to manage local affairs which can promote or inhibit local development and integration into the broader Chinese market.

The World Bank can also increase lending to assist internal Chinese market integration. Despite its large internal economic market, significant distortions exist in the internal transportation, energy, and labor markets. Transportation is expensive between regions or from inland regions to coastal regions facilitating international trade. Many of

the coal fired power plants are of the small environmentally unfriendly rather than large cleaner plants which can distribute power throughout a larger region.[4] It is reported that 40% of all rail traffic stems from coal transportation to small scale power plants spread throughout the country rather than building large generating capacity at the mine mouth or distributing to a few large power plants (Churchill and Thum 2005c). Labor regulations prevent the movement of people between regions, specifically rural and urban areas. Though economists debate the economic gains and volume of movement from relaxing labor mobility regulation, as business labor demands evolve and specifically require specialized or high skilled workers one can expect relaxation of legal impediments.

Fourth and finally, the World Bank can play a significant role in transportation and energy infrastructure investment. Before analyzing its potential role in depth it is necessary to briefly address criticism that the World Bank would contribute to environmental degradation and pollution by lending to Chinese transportation or energy projects. These criticisms fail to consider the realities of Chinese development. First, China does not need World Bank financing and plans to increase its infrastructure investment. Transportation and energy infrastructure investment will occur with or without World Bank consultation and influence. By remaining an active participant and knowledge source the World Bank can mitigate the negative externalities of infrastructure development. Second, to effectively utilize its depth of expertise and influence in China the World Bank must remain a viable financing source or risk losing its ability to impact energy policy. This may mean an evolution to joint financing

[4] The importance of energy and transportation will be covered in more depth later. Its importance here however rests on the lack of a low cost national liquid market.

projects but in the absence continued project financing the World Bank risks losing influence. Third, assessing World Bank impact moving forward should be measured against expected output in the absence of World Bank influence and not the increase in pollution outputs. Research indicates that World Bank lending for energy projects between 1984-1999 positively impacted the evolution of environmental standards within its energy project portfolio (Martinot 2001). Transportation and energy project should be compared to what pollution from a project would be if the World Bank did not provide expertise and work with officials to include abatement measures.

A World Bank focus on financing transportation and energy infrastructure furthers a number of objectives. First, research indicates that infrastructure investment has the highest rates of return to rural poverty above numerous other types of public investment (Fan, Zhang, and Zhang 2004). To improve agricultural productivity and narrow the regional divides, infrastructure investment should reduce transportation costs, increase Chinese economic integration, and improve market access. Transportation projects can also serve the poor in urban areas through public transportation projects which allow greater mobility and access to work in large cities (World Bank 2006c). In short, poverty reduction and infrastructure investment do not conflict. Second, energy and transportation projects impact World Bank efforts at environmental and pollution mitigation. Large numbers of small coal fired generators are the highest pollution emitters. By building more advanced and larger generators with modern scrubbing and coal washing technology, the World Bank could significantly impact Chinese environmental efforts. Alternatively, building centralized generators near the mine mouth with a national electrical distribution system could reduce the strain on the

transportation system and reduce pollution levels. Additionally, due to the low levels of natural gas use despite access to reserves, the Chinese energy market can significantly increase its use of this more environmentally friendly power source. Sector evaluation reports and academic research indicates that Chinese officials speak highly of World Bank involvement, expertise, and pressure in increasing environmental standards (Varley 2005a). Third, World Bank lending activities allow it to leverage its financial stake into influence on policy and project management. Within a large and expanding economy World Bank lending will never provide a large percentage of the whole, however, lending operations provide the ability, both formally and informally, to influence projects and sectoral policy. Due to both the rapid increase of investment and historical project planning and execution issues, China looked elsewhere to finance infrastructure projects reducing World Bank influence. Though the World Bank retains expertise in a variety of development related areas, the decline of its lending activities in China threatens to undercut its financial role reducing it to an advocacy group. As one World Bank report summed up the situation on transportation and energy lending in China, "the job is far from finished – it has just become more complicated," (Churchill 2005b).

Conclusion

The rapidly growing Chinese economy and the World Bank can continue to partner to drive economic development and reduce poverty and inequality. The Chinese challenge stems from its need to sustain high economic growth rates while engaging in large economic restructuring and integrating dislocated and marginal populations into the rapidly expanding industrial and service sectors. The World Bank challenge arises out of

the reduced need for World Bank financing specifically in core areas of expertise such as energy and transportation. By increasing lending to China, the World Bank will play a greater role in influencing policy and targeting specific areas to maximize the results. Focusing the projects on infrastructure, poverty alleviation, and rural and agricultural issues the World Bank will remain an vital to Chinese economic development.

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