



Technical Assistance Report

Project Number: 48460-001
Policy and Advisory Technical Assistance (PATA)
May 2015

People's Republic of China: Promoting the Decisive Role of the Market in Resource Allocation

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 20 April 2015)

Currency unit	–	yuan (CNY)
CNY1.00	=	\$0.1614
\$1.00	=	CNY6.1953

ABBREVIATIONS

ADB	–	Asian Development Bank
DRC	–	Development Research Center
PRC	–	People's Republic of China
SOE	–	state-owned enterprise
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

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POLICY AND ADVISORY TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 48460-001	
Project Name	Promoting the Decisive Role of the Market in Resource Allocation	Department /Division	EARD/EAPF
Country Borrower	China, People's Republic of People's Republic of China	Executing Agency	Development Research Center of the State Council
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Reforms of state owned enterprises		0.50
		Total	0.50
3. Strategic Agenda		Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change		Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional systems and political economy	No gender elements (NGE)	✓
Knowledge solutions (KNS)	Knowledge sharing activities		
Private sector development (PSD)	Conducive policy and institutional environment		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. TA Category:	B		
7. Safeguard Categorization	Not Applicable		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		0.50	
Policy and advisory technical assistance: Technical Assistance Special Fund		0.50	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		0.50	
9. Effective Development Cooperation			
Use of country procurement systems	No		
Use of country public financial management systems	No		

I. INTRODUCTION

1. The proposed policy and advisory technical assistance (TA) is included in the country operations business plan, 2015–2017 of the Asian Development Bank (ADB) for the People's Republic of China (PRC). Dialogue with the Ministry of Finance and the Development Research Center (DRC) of the State Council clarified the policy and institutional context, and the priorities for ADB support.

2. Agreement was reached with the Government of the PRC on the TA project's impact, outcome, output, implementation arrangements, cost and financing arrangements, and terms of reference. The design and monitoring framework is in Appendix 1. The cost estimates and financing plan are in Appendix 2. The outline terms of reference for consultants are in Appendix 3.¹

II. ISSUES

3. Effective economic policies in the PRC since the introduction of reform and opening up in 1978 have sustained economic growth and social development at an unprecedented pace. However, rapid growth has come at a cost. Excessive reliance on investment, exports, and industrial development has created structural constraints that need to be addressed. Moreover, periods of high growth in emerging economies come to an end, requiring economic restructuring to sustain growth through productivity increases.

4. To meet these challenges, the government has acknowledged the importance of the balance between the government and the market in guiding structural reform. The Decision on Major Issues Concerning Comprehensively Deepening Reforms that followed the Third Plenum of the 18th National Congress of the Communist Party of China emphasized the leadership's commitment to assign a decisive role to the market in the allocation of resources.

5. To promote the role of the market, the government pledged focus on ensuring macroeconomic stability and the adequate provision of public services, limiting the scope of its intervention to areas of market failure. This vision underpins government efforts to foster innovation-driven growth and greater private sector participation in the economy, which are essential to increase productivity growth to help the PRC achieve higher income levels.

6. This important decision is consistent with international evidence suggesting that private sector participation is a fundamental engine of long-term growth. Structural reforms are therefore needed to maximize the use of public resources while allowing the market to play a decisive role as a driver of growth. The current weakness of the global economy adds urgency to implementing these reforms.

7. Against this background, a sound private sector is critical to sustain growth. While the private sector has become the largest source of gross domestic product and employment generation, its economic dynamism is hampered by limited access to production factors, in particular financial resources. Moreover, state monopolies and weak competition policies often limit barriers to entry for private enterprises. Equal access to factor markets and fairer competition policies are required to unleash the full potential of the private sector, which would lead to productivity increases and greater employment opportunities in the PRC.

¹ The TA first appeared in the business opportunities section of ADB's website on 12 March 2015.

8. In contrast, profitability and productivity of state-owned enterprises (SOEs) have declined, despite their privileged access to factor markets. Some SOEs run at a loss, as they are constrained by inefficient managerial practices and financial burdens stemming from regulated prices and costly public service delivery, which the private sector could provide more effectively. Nevertheless, the decision identifies the public and private sectors as important components of the socialist market economy, and it views both as essential to supporting inclusive economic and social development to achieve a harmonious society by 2020, a key government target.

9. Against this background, accelerating reform of SOEs is one of the government's reform priorities. Policy actions should include efforts to diversify ownership of SOEs, improve their governance structure, upgrade managerial standards, and lift their productivity and profitability levels. It would also be necessary to focus their intervention in the economy on selected sectors, including support to emerging strategic industries, environmental protection, innovation, and national security.

10. Both SOEs and private enterprises would benefit from increased competition, so reforms should target lowering barriers to entry and exit, including dismantling monopolies and oligopolies in key industries (i.e., telecommunications, power, and financial services), and increasing oversight and efficiency of natural monopolies.

11. Reform of factor markets (capital, labor, and land) is critical to increased competition. Changes are needed to ensure equal access to production factors for optimal resource allocation to boost productivity and sustain growth. Regarding capital, further finance sector liberalization is vital to develop a financial system that supports the needs of the real economy. Regarding labor, accelerating plans to gradually phase out the *hukou* (household registration) system and advance the portability of pensions and social security benefits is crucial to increasing labor market mobility. Regarding land, as emphasized in the decision, market-driven allocation of resources should also apply to land rights of rural residents to increase rural income and close the rural–urban divide.

12. Successful structural transformation will require institutional changes that redefine the role of the government in the economy and the scope of its intervention. This must ensure equal access to factor markets irrespective of ownership type and business size, and greater competition between public and private enterprises. Allowing the market to play a decisive role in the areas identified under this TA project will result in higher productivity levels and increased economic efficiency to sustain inclusive growth in the PRC in the longer term.

III. THE POLICY AND ADVISORY TECHNICAL ASSISTANCE

A. Impact and Outcome

13. The impact will be the greater role of the market in resource allocation. Allowing the market to play a decisive role in resource allocation, while redefining government functions toward a service-oriented approach, will underpin efforts to rebalance the sources of growth and make growth more inclusive. Greater reliance on private sector participation, a fundamental engine of long-term growth, will facilitate the country's transition to higher income status. The outcome will be the increased competition between public and private enterprises. Actions to ensure a level playing field for private enterprises through fairer competition policies will result in greater private sector participation in the economy. This will lead to increased economic efficiency and higher productivity levels in the PRC's economy, which are essential to sustain

growth in the longer term.

B. Methodology and Key Activities

14. The output will be a report containing specific policy recommendations to support the decisive role of the market in resource allocation in the PRC. A policy brief targeting senior policy decision makers in the PRC will be also prepared, highlighting key policy recommendations to guide the implementation of the identified reform priorities. The report will comprise three subreports.

15. Subreport 1 will focus on policy directions to diversify ownership in SOEs, improve the governance structure, upgrade managerial standards, and increase productivity and efficiency levels. Measures to limit intervention in the economy by SOEs to allow the market a decisive role in resource allocation will be also analyzed.

16. Subreport 2 will examine changes in industrial policy to lower firms' entry and exit barriers, enabling the break-up of administrative monopolies, and increasing the oversight and efficiency of natural monopolies to enhance market competition. In addition, the subreport will look into complementary reforms to increase competition and create a level playing field for the public and private sectors to compete on an equal basis.

17. Subreport 3 will focus on factor market reforms to ensure equal access to production factors regardless of ownership type. Capital market reforms will include measures to liberalize the finance sector (i.e., allowing private capital to set up small- or medium-sized banks). Labor market reforms will ensure labor moves to where it generates the highest returns. Increased labor market flexibility will also allow the workforce to adjust to changing market conditions. Land reform will focus on land tenure, land use, land revenue, and its use as collateral.

18. The report will be prepared under the "One ADB" approach. Expertise and resources from both ADB and the ADB Institute will be tapped throughout the project. In addition to the three subreports, supplementary reports on finance sector liberalization and labor market reform will be prepared by ADB staff. Insights will be also provided by the ADB Institute on urbanization, as land and labor market reforms will have important implications in the pace of urban development.

19. The implementing agency will (i) organize an international study tour focusing on countries in Asia that have been successful in the focus area, and (ii) prepare a short report outlining its contents and findings. The related output of the study tour will be incorporated in the draft final report.

20. The TA will disseminate research findings and policy recommendations through three national workshops (inception, midterm review, and final review) and a final dissemination event to present key findings and policy suggestions to a wider audience.

21. The main assumption is the government remains committed to undertaking reforms that give the market a decisive role in the allocation of resources to sustain economic growth in the longer term. The main risks are limited access to key data, and postponement of structural reforms amid economic growth moderation in the PRC.

C. Cost and Financing

22. The TA is estimated to cost \$600,000, of which \$500,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-other sources). The government will provide counterpart support in the form of office space, accommodation, transport, remuneration, per diem of counterpart staff, and other in-kind contributions.

D. Implementation Arrangements

23. The TA will be implemented over 20 months, from 1 June 2015 to 30 January 2017. The Department of International Cooperation of the DRC of the State Council will be the executing agency for the TA. The Department of Industrial Economy of the DRC of the State Council will be the implementing agency. The executing agency will be responsible for establishing and chairing a TA steering committee composed of experts and representatives of relevant ministries and agencies. The steering committee will be regularly consulted and invited to participate in TA activities.

24. In dialogue with the executing agency, ADB will recruit national and international experts to provide inputs as individual consultants. A total of 32 person-months of individual consulting services (six national consultants for a total of 30 person-months, and one international consultant for 2 person-months) will be selected based on their academic qualifications and relevant work experience. Given the required expertise, national and international consultants will be selected and engaged on an individual basis by ADB in accordance with its Guidelines on the Use of Consultants (2013, as amended from time to time). To reduce administrative burden and improve economy and efficiency, consulting services under the TA will be engaged on output-based lump-sum contracts. The proceeds of the TA will be disbursed in accordance with ADB's *Technical Assistance Disbursement Handbook* (2010, as amended from time to time).

25. The consultant team will be responsible for producing the TA outputs and deliverables in a timely and effective manner, and for organizing and carrying out all TA activities. Consultants will report to the assigned ADB project officer, and all outputs and reports will be prepared in English. The outline terms of reference are in Appendix 3.

26. TA support for workshops may include costs related to venue, equipment rental, translation, printing and copying, food and beverages, transportation, lodging, logistics and administrative support, and other expenditures with prior agreement from ADB. In line with standard ADB procedures, the TA will not support the implementing agency's management fees or related costs such as staff salaries and allowances, and the use of implementing agency resources (such as office accommodation), which will be provided as part of the counterpart contribution.

27. The executing agency will provide a suitably furnished office with computers, utilities, and telecommunications access (including broadband internet connection). It will also supply data, and documents as required under the TA, and it will cover the cost of office utilities for consultants. The executing agency will designate a TA focal point with strong English speaking and writing skills, and will facilitate all TA activities and links to local government representatives and providers to ensure the effective implementation of TA activities.

28. The TA will have project-specific indicators and targets, including timely implementation and quality progress reports. Policy dialogue will be maintained with the government and the

steering committee of experts established by the executing agency. Consultation and dissemination events will be organized at different implementation stages of the TA. Project-specific issues will be addressed during review missions. Milestones related to the implementation of the TA will be monitored by ADB and the team leader. The design and monitoring framework is in Appendix 1.

IV. THE PRESIDENT'S DECISION

29. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$500,000 on a grant basis to the People's Republic of China for Promoting the Decisive Role of the Market in Resource Allocation, and hereby reports this action to the Board.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
Impact Greater role of the market in resource allocation	Partial reform of state-owned enterprises ownership implemented by 2020. Share of state-owned enterprises with mixed ownership and equity structure to increase to 50% by 2020 (2013 baseline: 37%)	Government policy announcements Report to the State Council	Assumption Government commitment to undertake structural reforms to assign a greater role to the market in resource allocation Risk Delays in the implementation of key structural reforms amid economic growth moderation
Outcome Increased competition between public and private enterprises	By 2020, higher ranking of increased availability of financial services under the Global Competitiveness Index (2014 baseline: 63 out of 144) By 2020, higher ranking of effectiveness of anti-monopoly policy under the Global Competitiveness Index (2014 baseline: 38 out of 144)	Government policy announcements Report to the State Council	Assumptions Government commitment to undertake structural reforms to assign a greater role to the market in resource allocation Private sector preparedness to benefit from increased competition
Output A report containing specific policy recommendations to support the decisive role of the market in resource allocation in the People's Republic of China	Draft subreports submitted to ADB by November 2015 Final report submitted to ADB by May 2016 Policy brief submitted to ADB and to the government by May 2016 Final report disseminated by September 2016	Technical assistance progress reports Technical assistance review missions Consultations with executing and implementing agencies	Assumption Highly qualified professionals available for recruitment Risk Limited access to key data
Activities with Milestones 1.1 Inception workshop by 15 June 2015 1.2 Draft subreports by 30 November 2015 1.3 Midterm review workshop by 10 December 2015 1.4 International study tour by 15 February 2016 1.5 Final review workshop by 10 March 2016 1.6 Final report by 15 May 2016 1.7 Policy brief by 15 May 2016 1.8 Dissemination event by 15 September 2016			Inputs Asian Development Bank: Technical Assistance Special Fund (TASF-other sources): \$500,000 Note: The government will provide counterpart support in the form of office space, accommodation, transport, remuneration, per diem of counterpart staff, and other in-kind contributions.

ADB = Asian Development Bank.
 Source: ADB.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Amount
Asian Development Bank^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants (2 person-months)	40.0
ii. National consultants (30 person-months)	290.0
b. International and local travel	20.0
c. Translation, reports, and communications ^b	20.0
2. Workshops, conferences, and study visits	
a. Policy workshops	20.0
b. Study visits	50.0
3. Surveys ^c	5.0
4. Miscellaneous administration and support costs ^d	20.0
5. Contingencies	35.0
Total	500.0

Note: The technical assistance (TA) is estimated to cost \$600,000, of which contributions from the Asian Development Bank are presented in the table above. The government will provide counterpart support in the form of office space, accommodation, transport, remuneration, per diem of counterpart staff, and other in-kind contributions. The value of government contribution is estimated to account for about 17% of the total TA cost.

^a Financed by the Asian Development Bank's Technical Assistance Special Fund (TASF-other sources).

^b Includes all translation activities, necessary policy documents for desk review, production of technical reports for the main TA report, workshop reports, executive summary of the TA findings and policy note, and interpretation of workshops and conferences, as needed.

^c Includes research and survey materials.

^d Includes report editing, printing, and dissemination.

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. National Consultants

1. **Market reforms specialist, subreport 1 leader (state-owned enterprises reform), and team leader** (8 person-months, intermittent). The specialist will have strong expertise and extensive experience in market reforms and management. The specialist must have a master's degree or higher qualification in a related field, and must be fluent in English. The specialist must have at least 15 years of experience in economic reforms supported by relevant publications and affiliation with a reputable university or research institute. The specialist will

- (i) have overall responsibility for the quality and timely delivery of the technical assistance output, including all subreports, and completion of relevant technical assistance activities under the guidance of the implementing agency and the Asian Development Bank project officer;
- (ii) prepare an inception report, including a review of (a) the main issues under the research topics to identify critical areas for reform under the project, and (b) the specific issues to be addressed by each of the subproject leaders;
- (iii) adapt lessons from relevant international experience to the conditions in the People's Republic of China (PRC), with support from the international consultant;
- (iv) lead the preparation of subreport 1, identifying the main milestones to accelerate reform of state-owned enterprises, and drafting relevant policy recommendations for implementation of the proposed reforms;
- (v) supervise and review the draft and final subreports, ensuring that the contents address the identified key issues and necessary reforms;
- (vi) supervise the preparation of the final report by consolidating the subreports and synopsis into a final volume to be presented during the final workshop and at the dissemination event;¹
- (vii) organize the study tour in coordination with the implementing agency; and
- (viii) lead the preparation of workshops and conferences by drafting agendas, proposing participants, and acting as a resource person, as needed.

2. **Market reforms specialist, subreport 2 leader (reform and regulation of monopolies)** (7 person-months, intermittent). The specialist will have a relevant university degree and be an experienced researcher affiliated with a reputable university or research institute with at least 10 years of expertise on reform and regulation of monopolies. The specialist will lead the preparation of subreport 2 and work in coordination with the team of consultants. The specialist must be fluent in English. The specialist will

- (i) take responsibility for the quality and timely preparation of subreport 2 under the analytical guidance of the team leader;
- (ii) review international experiences and best practices in reform and regulation of monopolies together with the international consultant;
- (iii) identify the priorities for reforming monopolies in the PRC, including the preparation of a detailed reform road map;
- (iv) draft relevant policy recommendations for the implementation of the proposed reforms; and

¹ The final report will be submitted by the team leader within 1 month of receipt of the comments on the draft final report from the executing and implementing agencies and the Asian Development Bank, and will respond to the comments received.

- (v) assist the team leader in (a) preparing inception, midterm, and final reports, (b) making arrangements for workshops and conferences, and (c) participating in workshops and seminars as a resource person, as needed.

3. **Market reforms specialist, subreport 3 leader (reform of factor markets)** (6 person-months, intermittent). The specialist will have a relevant university degree and be an experienced researcher affiliated with a reputable university or research institute with at least 10 years of expertise on reform of factor markets. The specialist will lead the preparation of subreport 3 and work in close coordination with the team. The specialist must be fluent in English. The specialist will

- (i) take responsibility for the quality and timely preparation of subreport 3 under the analytical guidance of the team leader;
- (ii) review international experiences and best practices in reform of factor markets in collaboration with the international consultant;
- (iii) identify key issues and priorities related to the reform of factor markets in the PRC, including the preparation of a reform road map;
- (iv) draft relevant policy recommendations for the implementation of the proposed reforms in the context of the PRC; and
- (v) assist the team leader in (a) preparing inception, midterm, and final reports, (b) making arrangements for workshops and conferences, and (c) participating in workshops and seminars as a resource person, as needed.

4. **Economists** (3 economists, 9 person-months total, intermittent). The three national economists will have relevant university degrees and be researchers affiliated with a reputable universities or research institutes with at least 5 years of expertise in economic reforms in the PRC. They will work for 3 months each. The specialists must be fluent in English and have expertise in financial sector reform, land reform, labor market reform, and other relevant economic structural transformations. Each specialist will support the preparation of the assigned subreport and assist the team leader and the subreport leaders, as needed.

5. **Economist, subreport 1 (state-owned enterprises reform)**. The economist will

- (i) review the national and international literature and collect relevant data for all topics under subreport 1;
- (ii) prepare relevant research inputs under the analytical guidance of the team leader for tasks listed under subreport 1;
- (iii) advise the international consultant on the major constraints of the implementation of laws and regulations in the PRC;
- (iv) provide logistical support and interpretation, as needed, during meetings with government officials; and
- (v) assist the team leader and the subreport leader in making (a) preparations for the inception, midterm, and final reports, and (b) arrangements for workshops and conferences, as needed.

6. **Economist, subreport 2 (reform and regulation of monopolies)**. The economist will

- (i) review the national and international literature and collect relevant data for all topics under subreport 2;
- (ii) prepare relevant research inputs under the analytical guidance of the team leader and the subreport leader for tasks listed under subreport 2;

- (iii) advise the international consultant on the major constraints of the implementation of laws and regulations in the PRC;
- (iv) provide logistical support and interpretation, as needed, during meetings with government officials; and
- (v) assist the team leader in making (a) preparations for the inception, midterm, and final reports, and (b) arrangements for workshops and conferences, as needed.

7. **Economist, subreport 3 (reform of factor markets).** The economist will

- (i) review the national and international literature and collect relevant data for all topics under subreport 3;
- (ii) prepare relevant research inputs under the analytical guidance of the team leader and the subreport leader for tasks listed under subreport 3;
- (iii) advise the international consultant on the major constraints of the implementation of laws and regulations in the PRC;
- (iv) provide logistical support and interpretation, as needed, during meetings with government officials; and
- (v) assist the team leader in making (a) preparations for the inception, midterm, and final reports, and (b) arrangements for workshops and conferences, as needed.

B. International Consultant

8. **Economist** (2 person-months total, intermittent). The economist will have strong expertise and extensive experience in diverse aspects of structural economic reforms in transition economies. The specialist must have a master's degree or higher qualification in economics. The specialist must have at least 15 years of experience supported by relevant publications and professional experience and affiliation with a reputable university or research institute. The specialist should have professional experience and knowledge of the economic transformation of the PRC. The specialist will perform the following tasks:

- (i) prepare a report reviewing selected international experiences and practices to support the promotion of a decisive role of the market in the allocation of resources;
- (ii) adapt lessons from successful international experiences in similar reforms to the country-specific conditions in the PRC, and draft relevant policy recommendations;
- (iii) support the team leader in the preparation of the policy brief targeting policy makers in the PRC to guide the implementation of identified reforms;
- (iv) provide inputs to the team leader for the preparation of inception, midterm, and final reports, as needed; and
- (v) participate in workshops as a resource person, as needed.