

PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

April 19, 2015
Report No.: AB7842

Operation Name	Chongqing-Dadukou District Fiscal Sustainability DPF
Region	EAST ASIA AND PACIFIC
Country	China
Sector	Sub-national government administration (85%); Central government administration (15%)
Operation ID	P157404
Lending Instrument	Development Policy Lending
Borrower(s)	PEOPLE'S REPUBLIC OF CHINA
Implementing Agency	Chongqing Municipality Finance Bureau (CMFB) and Dadukou District Government
Date PID Prepared	April 19, 2015
Estimated Date of Appraisal	May 4, 2016
Estimated Date of Board Approval	July 28, 2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.
Other Decision <i>{Optional}</i>	<i>Teams can add more if they wish or delete this row if no other decisions are added</i>

I. Key development issues and rationale for Bank involvement

While growth in China remains quite high by international standards, macroeconomic risks have increased in the form of rapidly rising debt. Subnational governments account for a good share of this new debt. From negligible levels before 2008, subnational debt in China reached an estimated 40 percent of Gross Domestic Product (GDP) by the end of 2014. Although subnational governments were not allowed to incur explicit deficits or borrow funds directly until 2015, they nevertheless accumulated debt quite rapidly in off-budget vehicles (Urban Development Investment Corporations (UDICs)) that carried out public investments. The Chinese Government has recognized the need to control this rapid increase in debt, particularly given the risks from a possible economic slowdown, declining marginal returns from investment, and weaker land markets.

The Chinese Government introduced a major reform in 2014 to bring subnational debt under control and reorient subnational officials and budgetary institutions toward fiscal / debt sustainability. The Government has also requested that the World Bank work in two pilot regions to assist this transition: Chongqing Municipality and Hunan Province. Given the importance of local level finance for the success of this reform, Chongqing Municipality has chosen to concentrate this World Bank Development Policy Financing (DPF) for US\$ 200 million in a single pilot local government: Dadukou District. The expectation of the Chinese Government,

Chongqing Municipality, and the district administration is that Dadukou can become a model for subnational fiscal reform that can be scaled up to other local governments in China. The fundamental goal of the operation is to help Dadukou District implement reforms and policies to manage its finances in a fiscally sustainable, more efficient, and more transparent manner.

II. Proposed Objective(s)

This Chongqing-Dadukou District Development Policy Financing (CDDDPF) supports Chongqing-Dadukou District Government to ensure its fiscal sustainability by developing a forward-looking, comprehensive and transparent public finance regime that integrates budget, public investment and debt management. The three pillars of the DPF are (a) Fiscal Sustainability, (b) integrated Capital Financing Plan, and (c) Transparency.

Following a comprehensive fiscal sustainability analysis, a first objective is that Dadukou adopts budgetary ceilings that can ensure the sustainability of the District's finances under a baseline scenario and appropriate stress test. By reforming the nature of capital investment plan, and moving to a more integrated approach, Dadukou District will achieve a second objective of the operation in improving the efficiency of public investment. The integrated approach to investment plan is also fundamental to achieving the first objective in that it allows the proper assessment of the implications of proposed investment programs for fiscal sustainability. The disclosure of comprehensive financial information, a Medium Term Strategy, and integrated capital investment plan to the public will promote a third objective of greater transparency. The third objective will also be promoted through reforms of these UDICs toward the goal of drawing a clear line of separation between their commercial operations and those of government.

III. Preliminary Description

The DPF program in Dadukou is divided into three pillars: fiscal sustainability, an integrated capital financing plan, and transparency.

For **pillar 1**, the two prior actions are a Medium Term Fiscal Strategy consistent with fiscal sustainability and a 2016 annual budget that is consistent with this Strategy:

- a) *Prior action #1*: The Government of Dadukou District has adopted and published a medium-term fiscal strategy, grounded in a debt sustainability analysis, which sets a target for district-level public investment financing that is consistent with debt sustainability.
- b) *Prior action #2*: The Government of Dadukou District has submitted to Dadukou District People's Congress an annual budget for 2016 that corresponds to a Medium-Term Fiscal Strategy plan which is consistent with debt sustainability.

Pillar 1 will be monitored by a result indicator on the financing gap (enlarged deficit) measured as the difference between budgetary revenues and consolidated expenditures, including off-budgetary expenditures related to public investment.

Under **pillar 2**, Dadukou adopts its first integrated 3-year capital investment plan that includes all planned financial outlays related to public investment on and off budget. This plan is

consistent with the Medium Term Fiscal Strategy. It also institutionalizes the practice of a three-year capital investment plan by issuing a decree on its annual formulation and division of responsibilities.

- (a) *Prior action #3:* The Government of Dadukou District has issued a three-year rolling capital investment plan that is consistent with the ceilings on public investment outlays in the Medium-Term Fiscal Strategy for public investment projects during 2016, and for commitments made in 2016 for public investment outlays in the years 2017-2018.
- (b) *Prior action #4:* The Government of Dadukou District has issued a decree that specifies the time frame and division of institutional responsibilities for the annual formulation of a three year rolling capital investment plan, beginning in 2016.

Pillar 2 will be measured by results indicators on implementation of the capital investment plan in 2016 – that actual investment remains under the aggregate ceiling in the plan and variance of executed with planned investment decreases (budget credibility).

Under **pillar 3**, Dadukou begins a policy of disclosing its comprehensive financial reports and institutes an accounting division in the UDICs to begin the separation of government and commercial finances

- (a) *Prior action #5* The Government of Dadukou District has adopted a decree for regular annual disclosure of comprehensive government financial reporting that reveals the assets, liabilities, incomes, expenses, and net worth of government business enterprises.
- (b) *Prior action #6* The Government of Dadukou District has issued a regulation which sets forth a clear division between government and commercial activities, incomes, expenses, assets, and liabilities of its two urban development investment corporations, namely Dasheng and Jinqiao

Pillar 3 will be measured by the presence of the first prepared comprehensive financial report on the website and the degree to which the UDICs begin to work on the basis of explicit commissioned contracts with the Government.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Chongqing-Dadukou is undergoing a significant fiscal consolidation effort. The local economy suffered from the relocation of an important steel plant in 2011. Large-scale public investment to rehabilitate the district from an industrial base to a livable city has led to accumulation of massive debt. The District has now planned for severely constraining further growth of public investment. While Chongqing-Dadukou aims to attract private investment to support economic growth despite a tight fiscal stance, the nature of Chongqing-Dadukou's current overall economic and fiscal situation implies some risks for local progress on poverty and social indicators.

The potential negative social impact from expenditure compression in Dadukou District is mitigated by a number of factors. Firstly, the proposed fiscal consolidation does not target on

budget or current expenditures, almost all of which are determined in size by central regulations and norms. Thus, current social spending should not suffer. Second, the introduction of the integrated investment plan will help prioritize capital outlays for maximal development impact in line with priorities of Dadukou that emphasize social infrastructure. Third, the small size of Dadukou and its place in the heart of Chongqing Municipality disciplines the District into supplying comparable services to other parts of the city. The most direct welfare impact from the fiscal consolidation could be slower renovation or replacement of social infrastructure. However, this consolidation would have been inevitable even without this operation, as growth in investment spending was on an unsustainable path.

Environment Aspects

The proposed CDDDPF will not entail direct environmental impacts as its exclusive focus is enhance budgetary management and transparency of the Government. The prior actions do not have any clear implications for the environment. In general, the Dadukou District Government has given a high priority to the environment and targets green growth. The debt distress addressed by this operation is due in part to the relocation of a polluting steel factory out of Dadukou in 2011 for environmental reasons.

V. Tentative financing

Source:	(\$m.)
Borrower:	0
International Bank for Reconstruction and Development	200
Borrower/Recipient	
Total	200

VI. Contact point

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