



1. Project Data

Operation ID P157406	Operation Name Hunan Fiscal Sustainability DPO
Country China	Practice Area(Lead) Macroeconomics, Trade and Investment

L/C/TF Number(s) IBRD-86610	Closing Date (Original) 31-Dec-2017	Total Financing (USD) 200,000,000.00
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Bank Approval Date 10-Jan-2017	Closing Date (Actual) 31-Dec-2017
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	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	200,000,000.00	0.00
Revised Commitment	200,000,000.00	0.00
Actual	200,000,000.00	0.00

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2. Project Objectives and Policy Areas

a. Objectives

According to the Program Document (page 6), the program development objective of the Hunan Fiscal Sustainability Development Policy Financing (DPF) was to support the Hunan Provincial Government to "achieve fiscal sustainability through a forward-looking, comprehensive, and transparent public finance framework that integrates budget, public investment, and debt management".



b. Pillars/Policy Areas

The DPF had four pillars:

Fiscal Sustainability supported the development and use of a medium-term fiscal and debt sustainability framework and budget to manage risks and to promote fiscal sustainability;

Capital Budgeting supported the development of an integrated approach to capital budgeting to improve efficiency;

Monitoring and Regulating Sub-Provincial Government Debt supported the development of an effective system at the provincial government level to monitor the financial health of local governments and to incentivize local governments to pursue prudent debt management; and

Transparency aimed to enhance transparency and accountability in the use of budgetary resources.

c. Comments on Program Cost, Financing, and Dates

The DPF consisted of an IBRD loan for US\$200 million. It was approved on January 10, 2017, became effective on December 31, 2017, and closed a year later than originally scheduled on December 31, 2018. The ICR does not give reasons for the delay in effectiveness. The loan was fully disbursed in a single tranche.

3. Relevance of Objectives & Design

a. Relevance of Objectives

At the national level, the objective of the DPF was aligned with the World Bank Group country strategy for China at the time of program appraisal and program closing. The "Country Partnership Strategy (CPS) for the Period FY2013-FY2016" was organized around three strategic themes: (a) supporting greener growth; (b) promoting more inclusive development; and, (c) advancing mutually beneficial relations with the world. On fiscal reforms, the CPS (page 18) advanced support for "reforming subnational inter-governmental fiscal relations, building up a medium-term fiscal framework at both the national and subnational levels, improving fiscal transparency and debt management, and introducing accrual-based public accounting and performance budgeting". The objective of the DPF was aligned with the foregoing statement in the CPS. A new CPS for China had not been finalized at the time of this ICR Review, but according to the ICR (page 23), the DPF objective was aligned with the second objective of the third Bank Group engagement area in the draft CPS, "demonstrating approaches to more effective and sustainable fiscal management and infrastructure financing".

At both the national and subnational levels, the objective of the DPF was also relevant to the fiscal reforms advanced by the Third Plenum Decisions of 2013-14 ("Overall Programme for Deepening Reform of the



Fiscal System"), the new China Budget Law of 2014, and the implementing regulations issued by the State Council in 2014 ("Decision Deepening Reform of the Budget Management System"). The national budget reform program mandated both central and local governments to: (a) prepare unified budgets; (b) conduct comprehensive debt sustainability analyses; (c) reorient annual budgeting and capital investment planning to a multi-year framework; (d) ensure that local debts are repayable based on the revenue generating abilities of local governments; (e) prepare and publish detailed fiscal and financial reports; and, (f) subject all revenues and expenditures to popular oversight. The reform program also: (a) allowed provincial governments to directly issue debt for provinces and municipalities, but under the strict control of the central government and of local legislatures; (b) created mechanisms, including debt swaps (the substitution of maturing local government financing vehicle (LGFV) debt with local government bonds), to restructure accumulated local government debt; and (c) provided for the phase out of LGFVs and their conversion into state-owned enterprises (SOEs) with strictly commercial (non-government) debt would not carry official repayment obligations on the part of the government. (LGFVs are entities organized by local governments, often backed by land revenues and public assets that borrow from banks and institutional investors to fund local infrastructure and real estate development projects).

The objective of the DPF was also relevant to the development priorities of Hunan Province at the time of program appraisal and closure. Like most provincial governments, Hunan Province had ramped up capital investment spending in pursuit of the country's high growth objectives, with public fixed investment spending, highly concentrated in the transport sector, accounting for 12 percent of provincial GDP in 2015. With public fixed investment largely financed by debt issued by LGFVs, urban development investment corporations (UDICs), and public benefit state-owned enterprises (PBSOEs), Hunan Province's direct government debt topped 21 percent of provincial GDP, and public liabilities 48 percent of provincial GDP by the end of 2015. (UDICs are state-owned enterprises that finance, build, and operate urban infrastructure and land development projects, while PBSOEs are state-owned enterprises that provide public benefit goods and services). The DPF aimed to take the province's public finances and debt to more fiscally-sustainable paths in the medium term.

Rating

High

b. Relevance of Design

The results framework was logical. A medium-term framework for budgeting would help enhance the province's fiscal and debt sustainability. An integrated approach to capital budgeting would improve efficiency. A system for the regulation and monitoring by the province of sub-provincial government debt would enhance debt sustainability among sub-provincial governments. Better budgetary and debt reporting would promote fiscal accountability and transparency.

Fiscal and debt sustainability was defined in this operation as a budgetary and financial plan for which the comprehensive-debt-to-regional-GDP ratio stabilized over the medium-term in a suitable debt sustainability



analysis (DSA) stress-test when road toll revenues and GDP growth were lower than expected. Using this definition, adopting a budget and financial plan for which the debt-to-GDP ratio stabilized under these conditions would amount to “achieving” fiscal and debt sustainability, compared to the preceding period when the province’s fiscal plans were not sustainable. In operational terms, however, a stabilization of the debt-to-GDP ratio would normally take time and therefore fall beyond the duration of a short-term DPF operation. For this reason “strengthening” fiscal and debt sustainability would have been a better statement of the project objective than “achieving” fiscal and debt sustainability.

Nonetheless, the prior actions were largely appropriate to helping achieve fiscal and debt sustainability in the medium-term. Adopting a Medium-Term Fiscal Strategy (MTFS), which was well informed by a comprehensive DSA, would help address deficiencies arising from the short-term focus of the annual budgeting system and the financing framework that had resulted in the unsustainable accumulation of public liabilities. Designing a method for formulating a three-year rolling capital investment plan, adopting such a plan for the transport, water, irrigation and social housing sectors for 2016-18, together with establishing an Interagency Committee for Public Investment Financing, would begin to address shortcomings with the disconnected capital budgeting framework and the fragmented institutional system for capital investment planning and oversight. Adopting a debt management framework and devising an allocation scheme for new borrowing and for debt swaps among the province’s constituent local governments would enable the province to better manage public debt under the new fiscal regime that has devolved borrowing from the central to the provincial governments. Mandating a system of annual disclosures of budgets and biannual reports of debt would start to address the lack of transparency with subnational finances.

The development policy loan --- which aims to support policy and institutional reforms through budget financing --- was the preferred instrument to advance subnational fiscal reforms in Hunan Province. The DPF provided some amount of budget support to the Hunan Provincial Government (the DPF proceeds were on-lent by the central government to the provincial government), which was projected to post primary fiscal deficits through 2025 albeit on a narrowing trend. The size of the budget support was not large relative to the province’s financing needs but had a longer maturity and cost less than market finance. More importantly, the program of policy and institutional reforms was central to the DPF. The fiscal reform program objectives were to be achieved through a set of eight prior actions and eight time-bound outcome targets. Previously, the Bank had engaged China on subnational fiscal reforms through technical assistance operations, including one in Shanghai, the province-level municipality. Technical assistance could deliver knowledge, expertise, and training, but it could not require policy or structural reform actions and measures like the DPF could.

The institutional design for the DPF recognized the operational risks posed by the multiplicity of agencies involved in local public finance and the limited technical capacity of local government staff to undertake structural reforms. The DPF required the creation of a provincial-level Interagency Committee for Public Investment Financing and Debt Risk Management, reporting directly to the Provincial Governor, and consisting of the provincial-level Department of Finance, Reform and Development Commission, Audit Office, and Finance Office to review the province’s medium-term fiscal plan and capital budget, assess the policy framework for debt management, process information about provincial debt and liabilities, and endorse capital projects requiring major financing and having contingent risks. The Department of Finance was



designated the implementing agency of the DPF, and technical assistance would be provided to the provincial government and its agencies to implement the reform program.

The macroeconomic framework was adequate. At the national level, the International Monetary Fund (IMF) "Staff Report on the China 2016 Article IV Consultation" of August 2016 concluded that China continued to transition to a more balanced and sustainable growth path. Although moderating (from 6.9 percent in 2015 to 6.6 percent in 2016), economic growth was being driven increasingly by consumption and by services consistent with the country's economic rebalancing goals. There had been progress on structural reforms in many areas, notably: urbanization; interest rate liberalization; and, the internationalization of the Renminbi, although decisive action was still needed to reduce reliance on state-led and credit-financed investment; improve resource allocation and governance in SOEs; and, address the corporate debt problem. The IMF urged the government to continue with efforts to "fully implement the new budget law, improve fiscal transparency, and modernize the tax system". At the subnational level, the Program Document (pages 14-16) reported that Hunan Province had grown rapidly at an average annual provincial GDP growth rate of 10.4 percent in the five years ending in 2015 (the average annual national GDP growth rate for China was 7.9 percent over the same period), driven by fixed investment, including infrastructure investment, rapid credit growth, and a structural shift from agriculture to manufacturing and services. The provincial government projected growth to average 8.5 percent in 2016-20, with consumption and productivity driving growth as investment moderated. An ongoing fiscal reform program consistent with the national budget reform strategy would help the province to achieve a more robust and sustainable growth path.

Rating
High

4. Achievement of Objectives (Efficacy)

Objective 1

Objective

To achieve fiscal sustainability through a forward-looking, comprehensive, and transparent public finance framework that integrates budget, public investment, and debt management.

Rationale

All eight of the program outcome targets were achieved.

The Hunan Provincial Government reported public liabilities of 14 percent of provincial GDP in 2016, meeting the target that public liabilities not exceed 15 percent of GDP in 2016, from 14.1 percent of GDP in 2015 (baseline). The provincial government also maintained public liabilities at 14 percent of provincial GDP in 2017. Earlier, the provincial government adopted a MTFs in April 2016, setting plans for provincial public investment spending consistent with fiscal and debt sustainability goals (prior action 1). The MTFs covered,



in addition to the provincial budget, the public investment plans of local government financing vehicles (LGFVs), public benefit state-owned enterprises (PBSOEs), public-private partnerships (PPPs), and special purpose vehicles (SPVs) and was informed by a debt sustainability analysis that utilized a comprehensive measure of public liabilities. (PPPs in China offer resources and participate in the provision of public services, while subnational SPVs provide debt financing for large-scale urban infrastructure projects). The MTFs kept current expenditure growth at a moderate rate, froze provincial public investment spending for five years at the level in 2015, and reallocated transport investment spending from highways, in which past investment had been heavy, to trunks roads and airports.

The provincial government covered seven sectors in the integrated capital financing plan by 2017, exceeding the target to cover three sectors by 2016 (the province did not have an integrated capital financing plan in 2015). The sector-by-sector approach was a way for the provincial government to systematically create an integrated provincial capital financing plan over a three-year period, starting with the transportation sector --- which had historically accounted for 80 percent of subnational debt --- in 2015, adding the water and irrigation and the social housing sectors in 2016, and covering most other sectors by 2017. The provincial government had introduced a three-year rolling capital financing planning framework (prior action 2) in February 2016 and adopted the Three-Year Rolling Capital Financing Plan for the transport, water and irrigation, and social housing sectors for 2016-18 (prior action 3) in August 2016. The provincial government extended the three-year rolling plan to include all capital investment by UDICs, SPVs, and PPPs, covering some 90 percent of all provincial-level public investment in 2016-18 and upholding its commitment to maintain the medium-term planning framework across economic sectors and funding entities.

The Interagency Committee for Public Investment Financing and Debt Risk Management issued opinions in 2016 on the MTFs and the Three-Year Rolling Capital Financing Plan for transportation, water and irrigation, and social housing for 2016-18, meeting the target. The provincial government had established the interagency committee in January 2016 (prior action 4), to serve a gatekeeping function for assessing the costs, benefits, and risks of public investment projects. The interagency committee would also collect information about capital project financing plans, provincial and sub-provincial debt, and contingent risks and liabilities. Previously, Hunan Province, along with other provinces in China, had a fragmented system for vetting public investment projects with numerous planning bodies and implementing bodies working on off-budget funded projects.

Eighty percent of local governments in Hunan Province disclosed their debt data and their fund use plans for new borrowing online in 2016, exceeding the target of 40 percent (there had not been any disclosure of this information in 2015). The achievement was sustained with 82 percent of local governments in Hunan Province disclosing online in 2017 their debt data and fund use plans for new borrowing. Earlier, the provincial government established an early warning system for local government debt in December 2015, following a central government directive, and issued a decree using the early warning system indicators for formulating debt limits, allocating bond swaps, and setting new borrowing quotas. For this DPF, the provincial government extended the early warning system by requiring fiscal consolidation plans from debt-stressed counties, and introducing penalties on counties violating debt rules (prior action 5). The provincial government would eventually extend the coverage of the early warning system, after the closing of this DPF,



to include the liabilities of public-benefit SOEs and PPPs. Hunan Province also approved a Debt Management Framework to strengthen the regulation and transparency of sub-provincial government debts by requiring the disclosure of basic debt data, the disclosure of a fund use plan for new borrowing, and the submission of risk mitigation plans for local governments classified as "red" or "orange" in early warning systems (prior action 6).

The percentage of local governments in Hunan Province classified as "red" (under the early warning system) that did not have a risk mitigation plan was 30 percent in 2016, outperforming the target (from 100 percent in 2015 to 40 percent in 2016). The achievement was sustained with the percentage further reduced to 15 percent in 2017. The risk mitigation plans, together with the early warning system on debt, the allocation scheme for new borrowing and for bond swaps, and the overall debt management framework, were all directed at helping the Hunan Provincial Government manage the new inter-governmental fiscal regime in China, which allow provinces to issue debt directly for themselves and municipalities.

The number of biannual comprehensive debt reports that were posted on the Internet with a lag of less than four months from end-June 2016, end-December 2016 and end-June 2017 was three in 2017, meeting the target.

The number of local governments in Hunan Province that disclosed all their debt and financial information online totaled ten in 2016, meeting the target (from none in 2015). The achievement was sustained with the number of local governments disclosing all their debt and financial information online rising to 12 in 2017. Previously, the provincial government created an Internet platform for local governments to publish their subnational debt and financial data in May 2016 (prior action 8). There are no available data on website hits.

The number of citizens' budget reports and budget performance reports that were disclosed in less than four months from year-end was two in 2016, meeting the target (the number was zero in the baseline in 2015). Previously, the provincial government created an Internet platform for local governments to publish their annual budget reports and budget performance reports in May 2016 (prior action 7). The annual citizens' budget reports, together with the biannual debt reporting system, were directed at enhancing fiscal accountability and transparency among subnational governments. As with the Internet site on subnational debt, there are no available data on website hits for this site, but the Shanghai Economic and Finance University raised Hunan Province's ranking on budget transparency to second among all provinces following the online publication of the budget data. The budget as well as debt data are reportedly sought by academic and research institutions.

In summary, the provincial government adopted a multi-year fiscal strategy and a three-year rolling capital investment financing plan for the transportation, water and irrigation, and social housing sectors, created an interagency body for public investment financing, adopted a debt management framework and a system for allocating new borrowing and bond swaps among sub-provincial governments, and started publishing citizens' annual budget reports and biannual debt reports. The results in 2016 were all positive: public liabilities were kept under 15 percent of provincial GDP; seven (or four more sectors than planned) were



covered in the integrated capital investment financing plan; the Interagency Committee issued opinions on the MTFs and the Three Year Rolling Capital Investment Financing Plan; 80 percent of local governments (or twice the target) published debt data online; only 30 percent of local governments classified as "red" under the early warning system were unable to submit risk mitigation plans; three biannual debt reports were published online with less than a four-month lag from end-June 2016, end-2016, and end-June 2017, meeting the target; ten sub-provincial governments reported debt and financial data online as targeted; and two citizens' budget reports were published online less than six months from year-end as targeted.

Rating
High

5. Outcome

The outcome of the program is assessed as highly satisfactory. The program development objective was highly relevant to the Bank Group country partnership strategy in China, to the national budget reform program of China's central and local governments, and to the fiscal reform priorities of the Hunan Provincial Government. The program design was highly relevant, with the results framework logical, the prior actions directed at beginning to address constraints to the attainment of fiscal and debt sustainability in the province's public finances in the medium-term, and the macroeconomic framework adequate at both the national and subnational level. The efficacy of the objective for the Hunan Provincial Government "to achieve fiscal sustainability through a forward-looking, comprehensive, and transparent public finance framework that integrates budget, public investment, and debt management" was high with all eight program outcome targets met.

a. Outcome Rating

Highly Satisfactory

6. Rationale for Risk to Development Outcome Rating

The risks to the sustainability of the program development outcomes are rated as modest.

Policy risk: The ability of the Hunan Provincial Government to sustain its fiscal reform plan following the objectives of the DPF will likely be challenged by any change in economic policy priorities by the central government. In 2015-16, fiscal adjustment plans across China were derailed by mandates from the central government to increase subnational public investment to boost economic growth. Although such mandates



cannot be countermanded, they could impact fiscal reforms.

Institutional capacity risk: According to the ICR (page 28), Hunan Province reported heavy personnel changes in the Finance Department since the DPF. The provincial government, however, has taken measures to sustain its institutional and technical capacity for, among other things, conducting debt sustainability analyses, a vital analytical skill needed for designing sustainable fiscal plans, by continuing to train staff in these areas.

a. Risk to Development Outcome Rating

Modest

7. Assessment of Bank Performance

a. Quality-at-Entry

Preparation of the DPF drew on the insights and experience gained from a long engagement with China's government on budget reform and inter-governmental budgetary relations. The Bank and China's Development Research Center of the State Council (DRC) collaborated to draft a comprehensive proposal to reform urban finance, that was incorporated in the joint Bank-DRC flagship report "Urban China" in 2014, covering tax and tax administration, inter-governmental fiscal arrangements, land finance, urban infrastructure financing, and local debt management. The reform plan has since served to inform proposed operations at the subnational level.

The Bank drew on analytical work to support the design of prior actions for the DPF. Apart from the "Urban China" (2014) report and another joint Bank-DRC work, "China 2030" (2013), the other analytical pieces underpinning the prior actions included work on: fiscal sustainability measures (5 reports); integrated capital budgeting measures (3 reports); measures related to the regulation and management of the sub-provincial government debt (4 reports); and, the transparency measures (4 reports).

The Bank extended TA to the Hunan Provincial Government for program preparation. Bank staff, and other international experts with knowledge of, and experience with, other subnational public finance reforms programs globally (India, Brazil, and Nigeria) delivered TA services to the provincial government.

The Bank identified eight operational risks to the successful implementation of the DPF, the principal ones (rated as substantial) were: segmentation in the roles of various government agencies in subnational public finance; limited implementation capacity at the subnational level; and subnational budgetary pressures that could delay implementation of the program's institutional reform measures. To mitigate the risks, the Bank: encouraged close cooperation between the Provincial Development and Reform Commission, which remained responsible for investment planning, and the Provincial Finance Bureau, which was responsible for the budget; planned for technical assistance to the Hunan Provincial Government staff on data collection, fiscal sustainability analysis, and multi-year budget planning; and advised on the need to recalibrate subnational budgetary reform plans in response to local and national



budgetary developments.

The Bank designed an M&E plan, consisting of a set of measurable indicators that generally reflected the results of the policy and institutional reforms undertaken by the Hunan Provincial Government (see Section 9.A).

Quality-at-Entry Rating
Highly Satisfactory

b. Quality of supervision

According to the ICR (page 30), the Bank supervised the DPF closely, fielding nine missions to Hunan during program preparation and implementation. The Bank maintained an ongoing policy dialogue with the Hunan Provincial Government during program implementation, filing Aide Memoires covering discussions on various aspects of the program. The details of these discussions during implementation are however not available.

The Bank extended TA to the provincial government during program implementation on topics including policy, regulations, and operational norms. According to the ICR (page 30), the Bank's performance was commendable for: the close collaboration with the provincial authorities during program preparation and implementation; the high quality of the advice provided; and the respectful stance taken in the Bank's exercise of its oversight functions.

Quality of Supervision Rating
Satisfactory

Overall Bank Performance Rating
Highly Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

The Hunan Government was strongly committed to the objectives of the DPF and persevered to implement the reform plan under difficult conditions --- the provincial government was set to rationalize and reduce capital investment spending at a time when the central government sought to boost capital investment to support economic growth. To integrate planning and budgeting, the provincial government had to persuade LGFVs, PBSOEs, SPVs, PPPs, and sub-provincial agencies to participate and cooperate in the endeavor. The adoption of fiscal sustainability principles required reductions in capital investment spending that were larger than originally anticipated and hence encountered resistance to the implementation of the program. The provincial government eventually prevailed and created a system that valued systematic investment planning and the monitoring and measurement of sub-provincial fiscal risks.



Government Performance Rating

Highly Satisfactory

b. Implementing Agency Performance

The Finance Department of the Hunan Provincial Government acted as implementing agency of the DPF and was responsible for coordinating all activities under the reform program as well as executing several of the operation's prior actions.

According to the ICR (page 31), the Finance Department organized a dedicated team that: supervised compliance with the DPF commitments, coordinated communication between the provincial government and the Bank, and facilitated Bank supervision missions. The team had previously piloted fiscal reforms in Hunan Province before the development of the DPF operation. For the DPF activities that were its principal responsibility, the bureau introduced the regulations required to implement the reform plans.

The dialogue with the Bank dealt with debt sustainability assessment and focused on the extension of the DSA to sub-provincial governments in Hunan Province. According to the Bank project team, the dialogue led to a request for a Program for Results (PforR) financing from the Bank for a fiscal institutions operation that was subsequently endorsed by the central government. An identification mission has been fielded for the proposal, which will support fiscal risk management at county governments.

Implementing Agency Performance Rating

Satisfactory

Overall Borrower Performance Rating

Highly Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

The M&E plan for the DPF called for the use of eight indicators to measure the outcomes of the fiscal reform program (see Section 4). The indicators were measurable. They generally reflected the impact of the reforms except for the indicator on the issuance of opinions by the Interagency Committee, which was more output- rather than outcome-oriented. Moreover, at least two other indicators --- the number of debt reports and the number of budget and budget performance reports that were disclosed online --- appear to be incomplete measures of the outcome of the transparency initiatives as they stopped short of measuring the views, downloads, or use of the posted information by interested parties or by the public at large.

The plan also called for the Finance Department of the provincial government to implement the M&E. The Department would track progress with the prior actions and the outcome indicators. It would also



collaborate with the Interagency Committee for Public Investment Financing and Debt Risk Management to collect and analyze information and data pertaining to capital project financing plans, provincial and sub-provincial debt, and contingent risks and liabilities.

b. M&E Implementation

The Department of Finance implemented the program M&E according to plan. The Department organized "dedicated groups" that were responsible for monitoring each of the reform pillars, prior actions, and outcome indicators. The Department also undertook preparatory work for the Bank's supervision missions, according to the ICR (page 21).

c. M&E Utilization

Data on the budget, capital investment plans and projects, and public sector liabilities collected from the M&E were used for the Debt Sustainability Analysis. This, in turn, helped inform the provincial government's capital investment and capital financing plans.

According to the ICR (page 22), the Department of Finance has continued to monitor progress with the fiscal reform plans.

M&E Quality Rating

Substantial

10. Other Issues

a. Environmental and Social Effects

Environmental Effects: The program did not trigger any environmental safeguards. According to the Program Document (pages 38-39), the DPF, which supported improvements in the public finance framework of the provincial government, was expected to have a neutral environmental impact. Overall, Hunan Province's policy framework and institutional capacity to manage environmental issues was considered adequate for the operation.

Social Effects: According to the Program Document (pages 37-38), the direct poverty and social impact of the DPF was expected to be negligible in the short-run, but positive in the medium- to long-term. In the near-term: (a) reductions in provincial capital expenditures would only affect transportation and irrigation projects; (b) in transportation, reductions in provincial investment spending on major motorways would not have a material adverse social impact as the province had previously built an extensive network of major highways; (c) reductions in provincial investment spending on trunk and rural roads would be partly compensated by



sub-provincial government spending on these categories; and, (d) reductions in provincial current expenditures would affect wages, but wages had been growing at a faster rate than inflation. In the medium- to long-term: (a) a more moderate growth rate of provincial government capital spending would not materially adversely affect employment, as provincial government investment spending comprised only 13 percent of province-wide public investment spending; (b) the province has a robust labor market, including in sectors other than infrastructure construction, with declining unemployment rates; and, (c) an improved integrated capital budgeting system would help improve the efficiency of investment spending, with positive economic and social effects.

b. Fiduciary Compliance

Financial Management: The DPF followed Bank standard disbursement procedures for development policy loans. According to the Program Document (pages 39-40), a Bank review had determined that Hunan Province had made significant progress modernizing its public financial management system, with the integration of its four budgets, the reform of its system of earmarked funds, the adoption of a single treasury account system in 2014, and the pilot effort toward an accrual-based accounting and financial reporting system. Moreover, the Bank had determined that the central bank’s foreign exchange operating and control system were satisfactory for purposes of the DPF.

Procurement: According to the Program Document (page 39), Hunan Providence had a well-functioning procurement system, including an operating Internet site for publishing bidding opportunities, functioning procurement transaction centers, a competent bid evaluation expert pool, protocols for handling complaints, and arrangements for supervision and oversight of the procurement process. A review of the provincial procurement system yielded reasonable assurances that procurements activities were fair, open, effective and efficient.

c. Unintended impacts (Positive or Negative)

d. Other

11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Highly Satisfactory	Highly Satisfactory	---



Risk to Development Outcome	Modest	Modest	---
Bank Performance	Highly Satisfactory	Highly Satisfactory	---
Borrower Performance	Highly Satisfactory	Highly Satisfactory	---
Quality of ICR		High	---

Note

When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.

The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

Three lessons are drawn from the ICR (pages 32-34), with some adaptation.

Development policy lending --- which aims to support policy and institutional reforms through budget financing -- was an effective instrument in advancing subnational fiscal reforms in Hunan Province in China. The DPF achieved results through prior actions and time-bound outcome targets, which technical assistance (the main modality for Bank engagement with China on budget reforms over several years), could not easily deliver. The single tranche nature of the operation did not detract from the requirement for multi-year institutional reforms as the Bank engaged Hunan Province in extensive policy dialogue from concept review in December 2015 to program approval in January 2017. Moreover, the Hunan Provincial Government continued to engage the Bank in policy dialogue about fiscal reform through 2018, taking a continuing interest in the DPF reform objectives.

Subnational fiscal reform in China's provinces will require concurrent fiscal reform at the central government level, given the complex nature of inter-governmental fiscal relations in China. The experience with this DPF showed that fostering the sustainability of provincial finances is not straightforward because: (a) the central government continues to issue expenditure mandates to subnational governments, and the mandates are commonly unfunded; (b) inter-governmental transfers, including general and earmarked transfers from the central government, are often volatile, complicating medium-term budget planning; and, (c) relationships between provincial governments and LGFVs, UDICs, and PBSOEs that finance public investments and receive budget subsidies are complex. Even as LGFVs are phased out and replaced by commercial SOEs, the continued existence and operations of PBSOEs and the emergence of PPPs and SPVs will keep inter-governmental fiscal relations complex.

Considering the difficulties encountered by the Hunan Provincial Government in conducting a comprehensive DSA, a simplified DSA framework would be better suited for future fiscal reform initiatives in other provinces across China. The provincial government struggled to determine its off-budget liabilities, contingent liabilities, and off-balance sheet liabilities of LGFVs, UDICs, and PBSOEs. The Bank is reportedly working with the Fiscal Academy of the central government's Ministry of Finance to develop a simplified DSA template that could be used at the provincial level to support subnational fiscal analysis and planning.



13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR provides a comprehensive record of the project. It adequately documents the context of the project (pages 6-9), the results framework (pages 9-10), and the project design (page 10-15).

The assessment of the program's results is evidence-based. The ICR provides a useful summary of the operational performance, set within the results framework for the project. It offers a detailed narrative supporting the efficacy ratings of the program (pages 23-27), and detailed accounting of the prior actions (page 16-19).

The analysis of the project outputs and outcomes is candid. The ICR elaborates on both the positive and negative factors that affected program outcomes (pages 19-21), the Bank's performance (pages 29-30), and the government's performance (pages 30-31).

Comments by the borrower and the provincial government on the operation (pages 38-40) provide useful insights both for deepening fiscal reforms in Hunan Province and for possibly replicating the DPF in other provinces in China.

a. Quality of ICR Rating

High