

## The World Bank and China

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As we try to understand global imbalances and global governance, it is useful to examine the role of an important family of international governance organizations—namely, the United Nations and its various sibling organizations (the World Bank, International Monetary Fund, World Trade Organization, and so on). Today I would like to review the World Bank’s role in China’s economic development over the past three decades and then explore the possible future paths for this valuable collaboration. To date, IDA credits and IBRD loans to China, taken together, have reached about US\$44 billion, of which US\$38 billion has been disbursed and US\$6 billion remains in the pipeline. Of this money, about US\$17 billion has already been repaid.<sup>1</sup>

Five years ago, the World Bank and the Government of China (GoC) crafted a mutually agreed Country Partnership Strategy (CPS) for 2006-2010. This document expressed a clear desire on both sides for a continuing role for the Bank in China, despite China’s graduation from IDA soft money in 1999, and suggested that the IBRD hard money loans are the necessary basis for this continuing partnership<sup>2</sup>. However, I find this argument unpersuasive. Indeed, in my view the reality is that since at least 1994, if not earlier, this has been a game of mutual “let’s pretend.” The World Bank pretends to lend IBRD money to China, and China pretends to borrow money from the Bank. However, the reality is different. From about 1994, when China’s annual increments to its foreign exchange reserves (the purchase of U.S. Treasurys) exceeded the annual inflow of IBRD funding, the Bank stopped financing economic development in China and shifted to indirect (and presumably inadvertent) financing of the American government’s budgetary deficit instead.<sup>3</sup>

Even for those who are uncomfortable with my characterization of the current lending as a game of make-believe, it must be clear that China will soon graduate from IBRD hard money. By World Bank calculations, China's national income per capita in 2009 (on the new PPP basis) is estimated at US\$6,710, and the entry level into "high income" is US\$12,196.<sup>4</sup> China's goal for the next decade is to double the GDP once again, and China's robust success at this effort over each of the preceding three decades suggests that this is a reasonable prediction. This will bring China to mandatory graduation from IBRD funding in about ten years.

As the Bank and GoC draft the next CPS for 2011-2015, one tempting approach will be to repeat the arguments from the 2006-2010 version. But I think a better approach would be to think beyond the era of IBRD lending/borrowing, which even on the official view is nearing its end. What might the new era look like? Let me suggest two possible visions for your consideration. But before I do that, let me highlight some background information about difficulties built into the Bank's structure and mandate, which illuminate some important generic issues in global governance.

The World Bank, like its sibling organizations the IMF, WTO, etc., has nation states as its members. Thus, these organizations in form and function are all clubs, not parliaments. By their nature, these organizations must function largely by consensus. This arrangement can be quite frustrating at times, but there is no obvious alternative basis for membership. For the World Bank, this creates a deep structural problem. The Bank's mandate is to combat poverty, but poverty is an important problem in all countries, rich or poor, and raising GDP at the national level is an imperfect proxy for directly attacking poverty. In the Bank's categories, China is already "upper middle income" and (as I have

suggested above) will probably graduate to “high income” in another decade or so. Yet in 2020 there will still be many millions of desperately poor people in China. As Bank staff members have pointed out to the Government of China, even targeting anti-poverty measures county (县) by county is unfortunately too coarse a filter for fully effective resource allocation, because many residents of China’s poor counties are not poor, and at the same time many poor people live in non-poor counties. The Chinese authorities have accepted the validity of this criticism and have tried to refine their targeting mechanisms. But if “rich *county*/poor *county*” is too coarse a filter for fully effective anti-poverty work in China, think how much worse the “rich *country*/poor *country*” distinction is for the World Bank itself in its resource allocation.

The difficulty with targeting anti-poverty programs country by country (the World Bank’s traditional, but I think increasingly outdated, way of doing business) has recently been highlighted by Andy Sumner’s research paper entitled “Global Poverty and the New Bottom Billion.” As Sumner writes:<sup>5</sup>

In 1990, we estimate that 93 per cent of the world’s poor people lived in low-income countries. In contrast, in 2007-8 we estimate that three-quarters of the world’s approximately 1.3bn poor people now live in middle-income countries ... a startling change over two decades.

In this context, Robert Zoellick, the Bank’s President, has recently insisted that the Bank needs to make profound changes in how the Bank conducts development research.<sup>6</sup> My own reaction is that the more interesting—and more important—question is whether the Bank needs to make serious changes in how it targets its anti-poverty programs.

A second structural frustration for the Bank’s anti-poverty work is that residents of isolated villages have trouble repaying loans at commercial interest rates. In pro-poor

programs, hard money is a poor substitute for soft money, and China has been disqualified from the IDA soft money for some time. To some extent, the Bank tries to circumvent this difficulty by burying soft money projects within IBRD lending, but there are distinct limits to this solution. Look, for example, at the Bank's most recent highway project in China (the Ningxia Highway Project). Under this project, US\$224 million of Bank money will be put into the four-lane Guyaozi-Qingtongxia expressway, but only US\$8 million of Bank money will be put into the improvement of local roads in poor isolated villages. And, as the Project Appraisal Document reveals, the Ningxia authorities were reluctant to allocate even that US\$8 million pittance to non-revenue roads.<sup>7</sup>

With these structural difficulties in mind, let me return to my earlier question—namely, how should the Bank and the GoC think about the Country Partnership Strategy for 2011-2015? Let me explore two different visions for your consideration.

***First Vision:*** Imagine a world in which the poorer sub-units of a country could qualify for World Bank funding after the country as a whole has graduated. Of course, the Bank's membership would presumably remain on a nation-state basis, and therefore any loans to localities would have to be approved by the respective national government, to avoid stepping on sovereignty toes. By my calculations [see Table 1], a number of Chinese provinces, particularly Guizhou, Yunnan, Tibet and Gansu, will probably still remain eligible for IBRD funding after China as a larger unit ceases to qualify. In terms of Hollis Chenery's classic two-gap development model,<sup>8</sup> China clearly does not suffer from either a shortage of savings or a shortage of foreign exchange, yet some of the provinces may well suffer from such shortages, and World Bank funding might help to close the gap. Of course, this is a radical vision for the Bank. But, as Deng Xiaoping's

reforms have demonstrated, just because a reform is radical doesn't necessarily make it a bad idea.

*Second Vision:* The World Bank consists of three disparate but interconnected organizations: (1) an international commercial bank (the IBRD), (2) an international concessional aid agency (the IDA), and (3) a research institute focused on the unresolved global issues of development economics. (For present purposes, I put aside IFC and MIGA, which have rather different functions and with which I am less familiar.) The 2006-2010 CPS argues that the justification for continued IBRD lending to China is that the think tank function ("Analytical and Advisory Activities" in World Bank parlance, or AAA for short) cannot be delivered to China as a free-standing activity. But, to repeat my earlier point, I don't find the argument persuasive. Somewhat analogous to the Bank's operations in Tokyo, the Bank could maintain an office in Beijing for other purposes (including IFC activities, presumably), long after the end of the IDA and IBRD lending, and AAA could continue to be supported by this office.

Let me be clear. I think that some of the very best analytical research and policy advice that has been done on China's development challenges has been provided by World Bank staff members and consultants, and a strong case can be made for continuing this contribution. I would cite immediately Alan Piazza's work on many aspects of rural poverty, Shaohua Chen and Martin Ravallion's work on the accurate measure of the poverty line and its meaning, and David Dollar's work (with his colleague Shang-Jin Wei from the IMF) on investment efficiency in China, to name just a few of the valuable Bank research contributors.<sup>9</sup> At the same time, however, it must be acknowledged that a very extensive community of excellent research expertise, both Chinese and non-Chinese, now

exists outside the Bank, both at universities and at free-standing institutions such as the International Food Policy Research Institute, the National Bureau of Economic Research, the Peterson Institute for International Economics, etc.—to say nothing of the Chinese Economists Society (中国留美经济学会). In this context, we can perhaps summarize by suggesting that the Bank’s research on China remains invaluable, but is no longer as indispensable as it once was.

In closing, as the Bank and GoC craft the 2011-2015 version of their CPS, let me suggest that they would do well to abandon the charade of the 2006-2010 CPS and confront more openly the challenges and opportunities that lie ahead.

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<sup>1</sup> The World Bank, “World Bank Client Connection: China,” 25 July 2010.

<sup>2</sup> The World Bank, “Country Partnership Strategy for the People’s Republic of China for the Period 2006-2010,” May 23, 2006.

<sup>3</sup> For the annual increments of foreign exchange reserves, see the State Administration of Foreign Exchange website at [www.safe.gov.cn](http://www.safe.gov.cn), under “Data and Statistics.”

<sup>4</sup> From the World Bank Indicators database, revised 9 July 2010.

<sup>5</sup> Andy Sumner, “Global Poverty and the New Bottom Billion: What If Three-Quarters of the World’s Poor Live in Middle Income Countries?,” Institute of Development Studies Working Paper, September 2010. See also Paul Collier, *The Bottom Billion: Why the Poorest Countries Are Failing and What Can Be Done About It*, Oxford, 2007, and the World Bank, “From Poor Areas to Poor People: China’s Evolving Poverty Reduction Agenda—An Assessment of Poverty and Inequality in China,” WB Report No. 47349-CN (2009).

<sup>6</sup> Quoted in “Measuring Global Poverty: Whose Problem Now?,” *The Economist*, 2 October 2010, p. 65.

<sup>7</sup> The World Bank, “Project Appraisal Document on a Proposed Loan in the Amount of US\$250 million to the People’s Republic of China for a Ningxia Highway Project,” 15 April 2010 (Report No. 50976-CN).

<sup>8</sup> Hollis B. Chenery and Alan M. Strout, “Foreign Assistance and Economic Development,” *American Economic Review* LVI:4 (September 1966), 679-733.

<sup>9</sup> For example, Alan Piazza et al., *China: Overcoming Rural Poverty*, World Bank Report 22137 (2001); Alan Piazza and Echo H. Liang, “Reducing Absolute Poverty in China: Current Status and Issues,” *Journal of International Affairs*, September 1998; Shaohua Chen and Martin Ravallion, “China Is Poorer than We

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Thought, But No Less Successful in the Fight against Poverty,” World Bank Policy Research Working Paper 4621 (2008); David Dollar and Shang-Jin Wei, “Das (Wasted) Kapital: Firm Ownership and Investment Efficiency in China,” National Bureau of Economic Research Working Paper 13103 (2007); and David Dollar, “Remarkable Progress, Remaining Vulnerability among China’s Poor,” <http://blogs.worldbank.org/eastasiapacific>, April 2009.

**Table 1****Province-by-Province Potential for World Bank “Graduation”  
by the Year 2020**

Province	Scaling Factor	Est. PPP Income per capita in 2009 (US\$6,710 x Scaling Factor)	Compound Real Growth Rate Needed to Reach US\$12,196 by 2020
Beijing	2.52	\$16,881	n/a
Tianjin	1.59	\$10,673	1.2%
Hebei	0.75	\$5,065	8.3%
Shanxi	0.74	\$4,932	8.6%
Inner Mongolia	0.94	\$6,304	6.2%
Liaoning	1.06	\$7,110	5.0%
Jilin	0.89	\$5,958	6.7%
Heilongjiang	0.80	\$5,343	7.8%
Shanghai	3.23	\$21,656	n/a
Jiangsu	1.28	\$8,622	3.2%
Zhejiang	1.67	\$11,220	0.8%
Anhui	0.70	\$4,711	9.0%
Fujian	1.17	\$7,830	4.1%
Jiangxi	0.63	\$4,197	10.2%
Shandong	1.07	\$7,208	4.9%
Henan	0.68	\$4,589	9.3%
Hubei	0.87	\$5,814	7.0%
Hunan	0.83	\$5,570	7.4%
Guangdong	1.68	\$11,304	0.7%
Guangxi	0.66	\$4,452	9.6%
Hainan	0.74	\$4,956	8.5%
Chongqing	0.87	\$5,842	6.9%
Sichuan	0.70	\$4,694	9.1%
Guizhou	0.54	\$3,621	11.7%
Yunnan	0.61	\$4,064	10.5%
Tibet	0.43	\$2,870	14.1%
Shaanxi	0.70	\$4,706	9.0%
Gansu	0.57	\$3,815	11.1%
Qinghai	0.66	\$4,444	9.6%
Ningxia	0.77	\$5,192	8.1%
Xinjiang	0.65	\$4,365	9.8%

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Note: The scaling factor is calculated from National Bureau of Statistics province-by-province household consumption expenditures in 2007. The average compound growth rate needed to rise from \$6,710 in 2009 to \$12,196 in 2020 is 5.6%, so there is every reason to predict that the country as a whole will graduate from IBRD qualification by 2020. But equally, a number of low-income provinces almost certainly will not.