China Borrows a Lot of Money from the World Bank, and That's Okay

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As the World Bank makes a case to its shareholders for a capital increase this year, they are grappling with an uncomfortable truth: one of their biggest borrowers, China, happens to hold the world's largest foreign exchange reserves, is one of the largest recipients of foreign direct investment, enjoys some of the best borrowing terms of any sovereign borrower, and is itself the world's largest sovereign lender.

The World Bank was created to support countries that could not access capital on reasonable terms to meet their development needs. That doesn't seem to describe China today, a point that US officials are quick to point out in the current discussions around the World Bank's own capital needs.

So, is there actually a case for China's continued borrowing? And why in fact *does* China continue to borrow?

On the latter, it's clear enough that China does not borrow to meet a financing need, or even to exploit a financial subsidy. Annual bank lending to China of about $2 billion means almost literally nothing in an $11 trillion economy. And with China's favorable borrowing terms in bond markets, the implicit subsidy it receives on IBRD loans is just 50 basis points or so. These two facts combine to suggest that Chinese officials care very little about the bank's lending as lending per se.

Beijing officials have often characterized their borrowing as a useful way to achieve a number of aims: project-level standards and disciplines that help improve operations at the local and provincial levels, particularly in western China where capacity remains low; incentives to boost domestic investment on behalf of climate mitigation; and more generally, access to expertise across a range of sectors in support of development goals. In each of these arguments, officials make a particular case about the effectiveness of lending relative to other modes of engagement, such as technical assistance or bank studies.

But should the case that China makes for itself carry the day with the rest of the World Bank's shareholders? On balance, I think so and generally see four reasons to continue the bank's China lending:

1. The bank's founding mission, defined around meeting capital needs at the national level, has evolved in recent years, such that countries that have ready access to capital markets also demonstrate the value of using World Bank loans to incentivize and prioritize development objectives. This holds in two important ways. First, it helps address the paradox of today's development landscape, which is partly defined by large economies with large poor populations. When these populations are regionally or locally concentrated, bank loans can help national governments prioritize engagement in these areas. Second, there is a global "public goods" agenda, with climate change mitigation at the forefront, that requires action from large economies. Bank loans similarly help to incentivize investments in these areas by offering subsidies (modest in China's case) for public goods-related activities.

2. China's borrowing is a useful "market" signal when it comes to assessing the quality of World Bank assistance. Unlike the bank's poorest borrowers, for whom bank loans are a critical source of public financing, China will only continue to borrow to the degree it sees a net benefit to the loan package. This likely entails some weighing of non-financial costs (e.g., the degree to which bank projects are cumbersome) and benefits (the degree to which the bank delivers on the elements described earlier). Because China can afford to have a take-it-or-leave-

it attitude, the country's borrowing gives us a clearer picture of the quality of effort provided by the bank over time. It's good to know that China sees value now, and it will also be good to know if they render a different judgement in the future.

3. World Bank lending may not deliver a significant financial benefit to China, but it does significantly benefit the bank's balance sheet by virtue of China's creditworthiness. Put simply, the bank could not simply swap out $2 billion a year to China for El Salvador and Vietnam. There are legitimate questions about the fair allocation of scarce World Bank capital, but it is not the case that one dollar less of China lending is one dollar more available to other countries.

4. Finally, there can be no "China" graduation policy. China is situated among 56 upper-middle-income borrowing countries, and any policy aimed at ending lending to China would have to do the same for many of these countries. This could be problematic in individual cases and in toto. Does the United States also feel strongly that Mexico should no longer be able to borrow from the World Bank? Turkey? What about the 30 other borrowing countries at or above China's level of per capita income?

Graduating China from World Bank assistance may be misguided, but asking more from China and other higher-income borrowers is not. CGD's High-Level Panel on the Future of Multilateral Development Banking last year identified differentiated loan pricing as a useful way to seek more from these borrowers in return for the benefits they derive from bank engagement. Their role as donors to the bank should also be on the table, whether as contributors to the International Development Association (IDA) or through other mechanisms in support of public goods. China has already stepped up considerably as an IDA donor and would be smart to continue this trajectory. Defining a new relationship with the bank as leading shareholder, client, and donor could increase China's influence in the institution in ways that are not wholly positive, but for the institution itself, such a role would better reflect the needs of today's global agenda.

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Zinsch — I looked at the spreadsheet. The formula double counts some rows in the middle. The denominator is therefore wrong. And the …

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