

Examining World Bank Lending to China: Graduation or Modulation?

Scott Morris and Gailyn Portelance

Abstract

Under the World Bank's 2018 capital agreement, borrowing countries are expected to gradually reduce their portfolios once a base income threshold—the Graduation Discussion Income (GDI)—is reached. However, the agreement also affirms the case for ongoing lending to these countries. One justification is tied to external value beyond the borrowing country's borders (global public goods, or GPGs). Another is tied to building capacity within the borrowing country, which can mean a focus on sub-regions where poverty remains high and capacity weak. In this paper, we examine World Bank graduation policies and lending through the lens of China, which maintains a large portfolio of World Bank projects. China currently exceeds the GDI thresholds for IBRD borrowing at the national level, while income inequality within the country leaves many noncoastal provinces below the GDI per capita threshold. Aggregate and provincial-level analysis of World Bank lending in China shows that less than half of China's portfolio comprises activities clearly linked to GPGs, while a slight majority of projects are based in provinces with per capita income below the GDI threshold. A substantial number of World Bank projects in China focus on climate change mitigation and transportation infrastructure construction, while a smaller number relate to capacity building. Overall, we find evidence that China's borrowing is broadly consistent with the 2018 principles of institutional capacity strengthening and GPG-related engagement, although significant areas of bank engagement do not appear to fall within the parameters of these principles.

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The World Bank and its shareholders have wrestled with the question of eligibility for assistance since the bank's founding in 1944. In recent decades, the non-borrowing members (the United States in particular) have tended to press for clearer standards and a meaningful way to end country eligibility based on measures of economic progress, relying heavily on growth in per capita income within the borrowing country. The borrowing member countries, particularly countries like China that have seen the most economic progress, have tended to resist firm rules and automatic triggers, seeking to maintain access to the bank's preferential lending rates and technical support.

The eligibility issue came to the fore again early in 2018 as the bank's shareholders struck a deal to increase the bank's capital and lending capacity going forward. The written agreement reveals the contours of the debate. It affirms the need for a "graduation policy" that ultimately makes some countries ineligible for bank lending while also affirming that all countries who want access to IBRD assistance should get it.

Clearly, the World Bank's approach to country graduation remains contested among the bank's shareholders. This paper seeks to inform the ongoing debate by:

- reviewing the World Bank's rules pertaining to eligibility and graduation to ineligibility, including new language contained in the 2018 capital agreement (section I)
- examining the borrowing practices of countries that are deemed ready for graduation according to the rules (section II)
- assessing the borrowing practices of China as a leading borrower according to the policy framework in the 2018 capital agreement (sections III and IV)

In particular, the paper introduces new analysis of China's borrowing from the World Bank in order to better understand the degree to which bank policies around graduation affect the composition of projects for a major borrower. China is the focus of this analysis (among other possible graduation-eligible borrowers) because its project portfolio with the World Bank is large and its borrowing has been a target of criticism by the United States, the World Bank's largest shareholder.

We conclude with recommendations for how current World Bank policy on graduation, and the ongoing debate that drives it, could best be supported by changes in country-level operations to better align country portfolios with bank policy and modest changes in reporting practices to facilitate this alignment. On balance, we conclude that the way forward for the World Bank's engagement in countries like China calls for modulation rather than graduation.

I. IBRD Eligibility Rules

According to bank policy, countries remain eligible to borrow from the International Bank for Reconstruction and Development (IBRD) until they are able to sustain long-term

development programs without relying on bank financing. Thus, graduation is not an automatic consequence of passing an income threshold but is based on whether a country has reached a level of institutional development and capital-market access that enables it to sustain these programs. However, there is significant ambiguity surrounding what bank programs in graduation-eligible countries should look like, and little clarity, beyond these broad guidelines, on what exactly makes a country ready to graduate. Reinforcing this ambiguity is the fact that graduation from the IBRD has not represented an orderly, linear trajectory—of the 25 countries that have graduated from IBRD eligibility, eight have since “degraduated” or received additional loans after graduation.

The Elements of IBRD Graduation

The bank's Articles of Agreement provide the legal basis for IBRD graduation policy. Specifically, there are two relevant provisions (*italics added*):

- **Article III, section 4 (i):** The bank may make or guarantee a loan when “the bank is satisfied that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the bank are *reasonable* for the borrower.”
- **Article 1 (ii):** “When private capital is not available on *reasonable* terms, [the purpose of the bank is] to supplement private investment by providing, on suitable conditions, finance for productive purposes.”

Use of a “reasonableness” standard in both articles introduces considerable ambiguity to the question of eligibility and eventually to graduation. It also accounts for the ongoing debate attached to graduation policy. Various elements of policy relating to graduation have emerged over the years, adding some detail to the otherwise ambiguous nature of the language in the Articles. In 1973, the bank first proposed using the “rough benchmark” of \$1,000 gross national income (GNI) per capita, in 1970 dollars, to trigger a conversation of graduation.¹ The policy also included a provision that this threshold was to be adjusted yearly based on prices and exchange rates.

In 1982, the World Bank’s executive directors approved a more comprehensive policy that went beyond the limited focus outlined in the Articles of Agreement.² The new policy established that a graduation decision should be based on two key factors: a country's level of development and overall economic situation, and a country's capacity to sustain a long-term development program. They further directed the bank to assess these conditions by a country's ability to access capital markets on *reasonable* terms and a country's progress in establishing *key* institutions for economic and social development. The new policy stated that

¹ Jac C. Heckelman, Stephen Knack, F. Halsey Rogers, “Crossing the Threshold: An Analysis of IBRD Graduation Policy.” Policy Research Working Paper 5531, World Bank, January 2011.

² Ibrahim F.I. Shihata, *The World Bank Legal Papers*, 2000.

graduation should be “flexible and fair,” with graduation from new lending ideally occurring within five years after a country passes the threshold.

A year later, the bank affirmed that the GNI per capita guidelines should continue to be adjusted based on the annual rate of change of the SDR-deflator. Today (FY2018), the threshold for “initiating graduation” is \$6,895 per capita and is set to fall to \$6,795 per capital for FY2019.³

In 1984 bank policy further clarified that the GNI per capita threshold is one of many indicators of development and should only be used as a trigger to start the discussion of graduation on the basis of a country’s ability to access capital markets and its progress on institutions for economic and social development. Shortly after, five reports were published—for Cyprus, Oman, the Bahamas, Trinidad and Tobago, and Barbados—starting this very conversation of graduation.⁴ Three of these countries did in fact graduate within five years, though one (Trinidad and Tobago) reversed course in 1990 and remains eligible for IBRD lending today.

Policy Reforms in 2018

In April 2018, the World Bank’s shareholders reached an agreement to expand the bank’s capital. The agreement also outlined a set of policies pertaining to engagement in graduation-eligible countries.⁵ Importantly, the 2018 agreement does not adjust existing policy when it comes to basic eligibility for borrowing and reaffirms the core elements of the policy established in 1982.

In fact, the 2018 language puts the graduation decision in the hands of the borrowing country, indicating that the “[b]orrowing countries’ decision to graduate from IBRD involves a dialogue between the country and the bank, and takes place on a case-by-case basis reflecting country context.”⁶ Consistent with this approach, the 2018 report adopts the designation “Graduation Discussion Income” (GDI) to describe the threshold of per capita country income that will trigger a discussion about graduating from IBRD assistance.

Rather than adopting harder triggers for graduation or hastening the timeline for country graduations, the 2018 agreement focuses on the terms of engagement with countries that are above the graduation threshold. Specifically, it adopts three approaches:

- a limitation on the overall share of the IBRD **portfolio** allocated to these countries

³ Shantayanan Devarajan, Haishan Fu, Bala Bhaskar Kalimili, “Per Capita Income Guidelines for Operational Purposes,” World Bank, May 2018. The threshold for a given year is based on per capita income data from two years’ prior.

⁴ Ibrahim F.I. Shihata, *The World Bank Legal Papers*, 2000

⁵ World Bank Group, “Sustainable Financing for Sustainable Development: World Bank Group Capital Package Proposal,” April 2018

⁶ *Ibid.*, paragraph 32

- a hardening of **pricing** on IBRD lending to these countries
- an articulation of **principles** for the types of engagement by the IBRD in these countries

On portfolio shares, the agreement indicates that the share of non-crisis lending allocated to graduation-eligible or “GDI” countries will be targeted at 33 percent through FY2030 and 30 percent after FY2030. At current lending levels, these constraints do not appear to be binding and are consistent with historical lending levels (see figure 1 in section II). However, they may become binding over time as more countries exceed the per capita income threshold that determines graduation eligibility.

On pricing, the agreement adopts a very modest hardening in terms for GDI countries, introducing loan surcharges of 5 to 25 basis points for these countries. Compared to the cost of market borrowing for an illustrative list of affected countries, these surcharges are very small and still provides a substantial “discount” in borrowing for these countries relative to their cost of borrowing in bond markets.

Table 1. IBRD “discounts” to borrowing countries as compared to 10-year government bonds

	10-year government bond	IBRD “discount”
China	4.03	+0.51 to +1.01
Brazil	9.84	+6.32 to +6.82
Mexico	7.58	+4.06 to +4.56
Chile	4.57	+1.55
Turkey	11.45	+8.43
Romania	4.32	+1.30

Nonetheless, the agreement marks the first time that the bank has sought to differentiate pricing based on country income levels, with higher-income countries paying more.

On the principles guiding IBRD engagement in GDI countries, the agreement indicates that “new IBRD activities. . .will have a primary focus on interventions to strengthen policies and institutions required for sustainable IBRD graduation.”⁷ This language carries forward the vague standards of the 1982 policy.

However, additional language suggests that the bank’s engagement could include:

managing potential crisis risks that can have regional and global spillovers;. . .
delivery of regional and global public goods; innovative solutions to poverty and

⁷ Ibid., paragraph 9

shared prosperity challenges that can be scaled up. . .and generate lessons for lower income countries; and creating knowledge.⁸

Each of these examples illustrates a type of global public good, which suggests a strong intent to focus on engagements that can demonstrate value for other countries.

II. Borrowing Practices of Graduation-Eligible Countries

It is quickly becoming an IBRD world. In 1969 there were 62 IDA countries and 31 IBRD countries.⁹ As of 2017 the composition has flipped: there are now 24 IDA countries and 78 IBRD countries.¹⁰ Of the IBRD borrowing countries, 29 are currently above the GDI threshold, 8 of which are high-income countries.¹¹

Over the past 10 fiscal years, lending to GDI countries has accounted for a minority share of the IBRD portfolio, although the spike in crisis-lending circa 2009–2010 and its aftermath distorted these shares. Figure 1 shows, in real terms, the share of IBRD annual commitments to GDI countries both in aggregate and as a total share of IBRD lending, which has averaged about one-third of the portfolio over the decade.¹²

From this standpoint, the bank’s new policy to allocate 30 percent of resources to countries above the GDI seems to align with the existing pattern of IBRD lending.

Of the 30 countries that were graduation-eligible in FY 2018, 13 borrowed from the IBRD.¹³ Many countries, including Trinidad and Tobago, Suriname, St. Kitts and Nevis, Palau, and Malaysia, have not borrowed from the IBRD over the past 10 years, but their continuing eligibility reflects the bank’s concern that external shocks could place a country in a position where IBRD financing is necessary, a characterization seemingly at odds with the 1982 policy, which suggests a country should ideally graduate from new IBRD lending within five years of crossing the GDI. Currently, there are 10 countries—Brazil, Chile, Gabon, Lebanon, Mexico, Panama, Romania, Seychelles, Turkey, and Uruguay—that crossed the GDI five or more years ago yet received IBRD loans in FY 2018.

⁸ Ibid., paragraph 32

⁹ For a more comprehensive analysis of transformations in World Bank engagement since its establishment, see “[The World Bank at 75](#)” by Scott Morris and Madeline Gleave, Center for Global Development, March 2015.

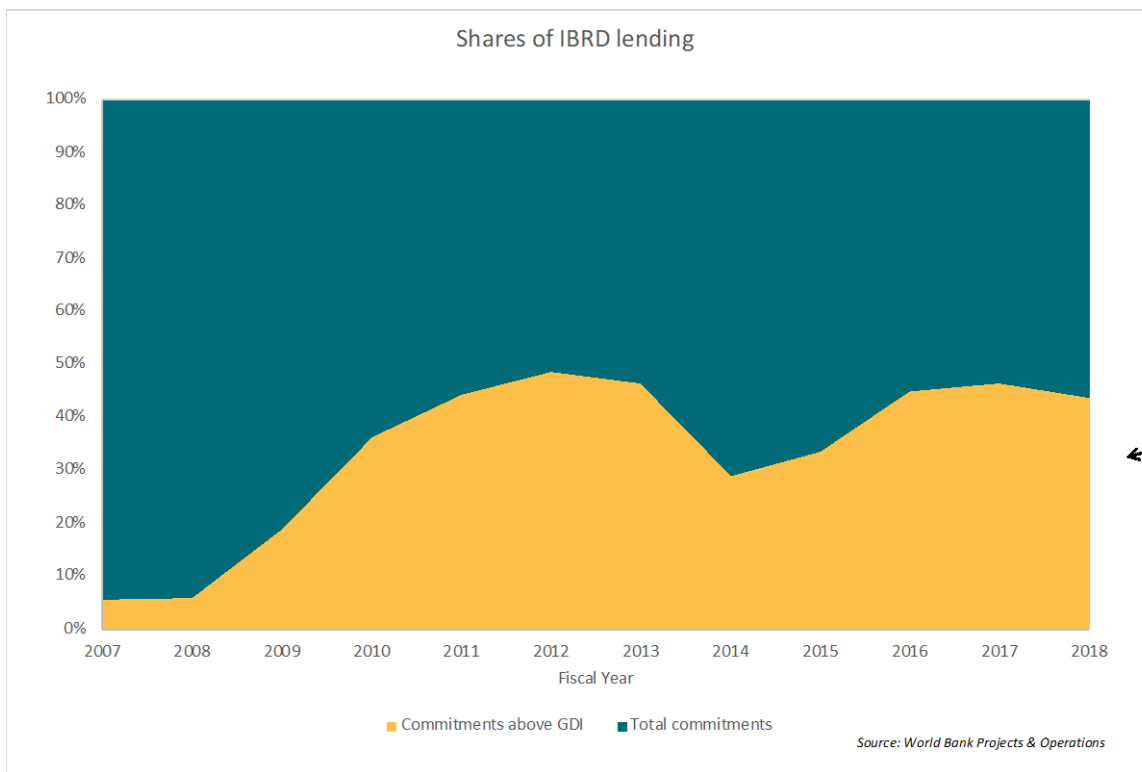
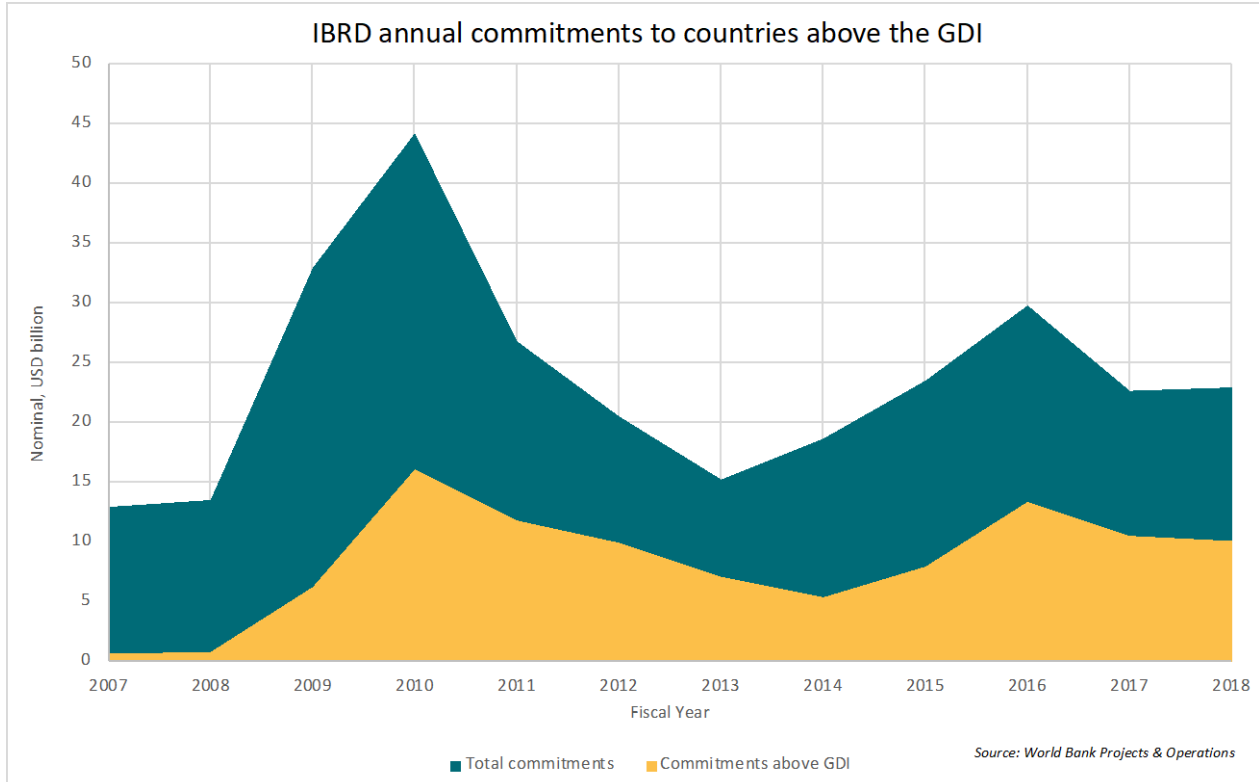
¹⁰ The 78 IBRD countries includes 9 “Blend” countries; see World Bank Policies, [Financial Terms and Conditions of Bank Financing](#).

¹¹ Six of these countries—Dominica, Grenada, Grenadines, the Maldives, St. Lucia, and St. Vincent—receive IDA financing on Small Economy terms.

¹² These figures were calculated by aggregating the total amount of lending for each country above and below the GDI given each fiscal years’ threshold. Not every country that exceeded the threshold in a given year exceeded it in all years.

¹³ Argentina, Brazil, Chile, China, Gabon, Lebanon, Mexico, Montenegro, Panama, Romania, Seychelles, Turkey, and Uruguay.

Figure 1.



Some research finds that observed correlates of graduation are generally consistent with stated bank policy. For example, among the IBRD graduates that have crossed the GDI, those that are wealthier and more institutionally developed, as well as those that are less vulnerable to trade, financial, and other shocks, are more likely to have graduated.¹⁴ Additionally, the bank's Independent Evaluation Group (IEG) recently concluded that IBRD support remains highly relevant for higher-income borrowers from two perspectives: in helping countries address certain developmental challenges (such as improving the quality of public sector institutions) and in having a key demonstration effect for other low-income countries.¹⁵

However, the IEG also found that broad systemic improvements to public sector institutions were less common, and despite noticeable individual project and country achievements, significant challenges persisted for achieving large and sustained improvements in the quality of basic public services and for strengthening national natural resource management institutions. Considering that 2018 principles for bank engagement in GDI countries emphasize institutional capacity building, further investigation into the constraints around lending in support of these activities is needed.

III. Examining China's IBRD Borrowing According to the 2018 Agreement

China represents a leading case for questions about IBRD eligibility and engagement following the 2018 capital agreement. It is one of 30 borrowing countries that sit above the FY 2018 GDI threshold of \$6,895. Since China first crossed the threshold in FY 2016, the IBRD has made commitments to the country totaling over \$7.8 billion. On a per capita basis, China is not the bank's wealthiest borrower. There are currently eight borrowing countries with higher per capita incomes. Nonetheless, China is among the bank's largest borrowers. Further, China's economy is the second largest in the world, and the Chinese government has become one of the largest official lenders to other countries, rivaling World Bank lending itself. This juxtaposition has made China emblematic of the need to encourage graduation in the eyes of key World Bank shareholders like the United States.¹⁶ But it also represents a test of whether the World Bank does in fact take a different approach in its wealthier borrowing countries and the degree to which the emphasis on global public goods in the 2018 agreement might already inform engagement in these countries.

¹⁴ Jac C. Heckelman, Stephen Knack, F. Halsey Rogers, "Crossing the Threshold: An Analysis of IBRD Graduation Policy." Policy Research Working Paper 5531, World Bank, January 2011.

¹⁵ World Bank, "World Bank Group Engagement in Upper-Middle-Income Countries: Evidence from IEG Evaluations." 2017. Independent Evaluation Group, Synthesis Report. Washington, DC: World Bank.

After a review of the portfolio of engagement in these countries, they found that the bank had a positive role in helping to address gaps in the quality of UMICs' public sector institutions; in accelerating growth in private sector productivity and innovation; in increasing the private financing of infrastructure; in ensuring improved quality of basic health, education, and urban services; and in providing crucial support to enhance UMIC's resilience to environmental and security shocks.

¹⁶ See Financial Times, "Mnuchin call for sweeping IMF and World Bank reform." October 13, 2017.

Overview of the World Bank-China Relationship

Despite the critical view of the United States, the relationship between the bank and China appears to be strong, such that it appears unlikely that China will seek to graduate from IBRD any time soon. Since graduating from IDA in 1999, three documents have shaped the World Bank's relationship with China: the Country Partnership Strategy (CPS) covering FY 2006–10;¹⁷ *China 2030: Building a Modern, Harmonious and Creative High-Income Society*;¹⁸ and the CPS covering FY 2013–16.¹⁹

The first CPS outlines a clear role for IBRD lending: to employ international expertise to help the government of China (GoC) “complete the transition to a market economy, improve the welfare of the poor and near-poor, and develop and implement sustainable resource-management practices.” The bank directly addresses the question as to why China is a client of the bank, stating that although the GoC can access international capital markets at similar or lower interest rates than what the IBRD charges, it still borrows from the IBRD because it values the non-financial services it provides as a part of its lending package. Indeed, whatever advantage China obtains from preferential IBRD lending rates, it applies to an extremely small amount of borrowing in context: over the past decade, IBRD commitments have hovered around \$2 billion per annum, for an economy that reached \$11 trillion in 2016.²⁰

The bank also clarifies in the 2006-10 CPS that while China remains eligible for IBRD lending, there is no reason to treat it differently from other borrowers, a position now at odds with the 2018 capital agreement.²¹ *China 2030*, developed in partnership between the bank and GoC, establishes the new era of China's development strategy and identifies China as an upper-middle-income country (UMIC) aiming to achieve high-income country status in the next couple of decades. There is no comment on China's impending “graduation” from IBRD's assistance.

The most recent CPS, covering FY13–16, characterizes World Bank engagement based on two strategic themes: supporting greener growth and promoting more inclusive development, and one cross cutting theme to advance China's relationship with the rest of the world.²² These themes of engagement are designed to align with China's 12th Five-Year

¹⁷ World Bank, “[Country Partnership Strategy for The People's Republic of China For the Period 2006–2010.](#)” May 2006.

¹⁸ World Bank and the Development Research Center of the State Council, the People's Republic of China, *China 2030: Building a Modern, Harmonious, and Creative Society*. 2013. Washington, DC: World Bank.

¹⁹ World Bank, “[Country Partnership Strategy for The People's Republic of China for the Period FY2013–FY2016.](#)” October 2012.

²⁰ Scott Morris, “[China Borrows a Lot of Money from the World Bank, and That's Okay.](#)” January 2018.

²¹ World Bank, “[Country Partnership Strategy for The People's Republic of China for the Period 2006-2010.](#)” May 2006, page 17.

²² The CPS broadly defines the strategic themes as including the following projects: Supporting Greener Growth (sustainable energy, urban environmental services, low-carbon urban transport, sustainable agricultural practices, sustainable natural resource management approaches, pollution management, and mechanisms for managing climate change); Promoting Inclusive Development (increase access to quality health services and social

Plan. In the CPS, the World Bank explicitly acknowledges that China has asked for new IBRD instruments (Development Policy Loans [DPLs] and Pay for Results [P4R]) to respond to the new economic context, and references China's growing role as a WBG stakeholder as donor to IDA. The bank states that its comparative advantage in China remains in its ability to provide and facilitate knowledge sharing both with China and in relation to other countries, particularly related to environmental remediation, health sector interventions, and in the energy and transport sectors.²³

The most recent CPS articulates an overall objective to focus on the less-developed western and inland provinces (“move west”) and on environmental objectives, particularly aligning with China's Air Pollution Prevention and Control Action plan which focuses on pollution control in or around the three-main urban and industrial regions: Beijing-Tianjin-Hebei (Jing-Jin-Ji). There is not yet a CPS for China beyond the most recent document covering FY13–16. However, in the most recent Performance and Learning review covering Bank engagement during this time, the bank categorizes current and pipeline projects under the three aforementioned thematic categories.

Aggregate and Provincial-Level Analysis of World Bank Lending to China

Taking the 2018 capital agreement as a new framework for engagement in graduation eligible countries, we seek to apply it to IBRD lending to China in practice. Specifically, we use provincial-level analysis to examine the degree to which China's borrowing on an aggregate basis is aligned with the principles for GDI countries established in the 2018 capital agreement: efforts to better enable graduation, including initiatives explicitly framed as “capacity building,” and support for global public goods (GPGs).

According to information available in project documents, the bank generally appears to orient engagement in China at the provincial level. A provincial or municipal government actor or a subnational project management office is the implementer for nearly every project. This allows for a basic analysis on the provincial distribution of cumulative project financing since China became graduation-eligible.

We find in project level analysis that just 44 percent of the China portfolio comprises activities that are clearly GPG-related (primarily pollution control and sustainable infrastructure) or designated strictly as capacity building. This suggests weak alignment with the 2018 principles.

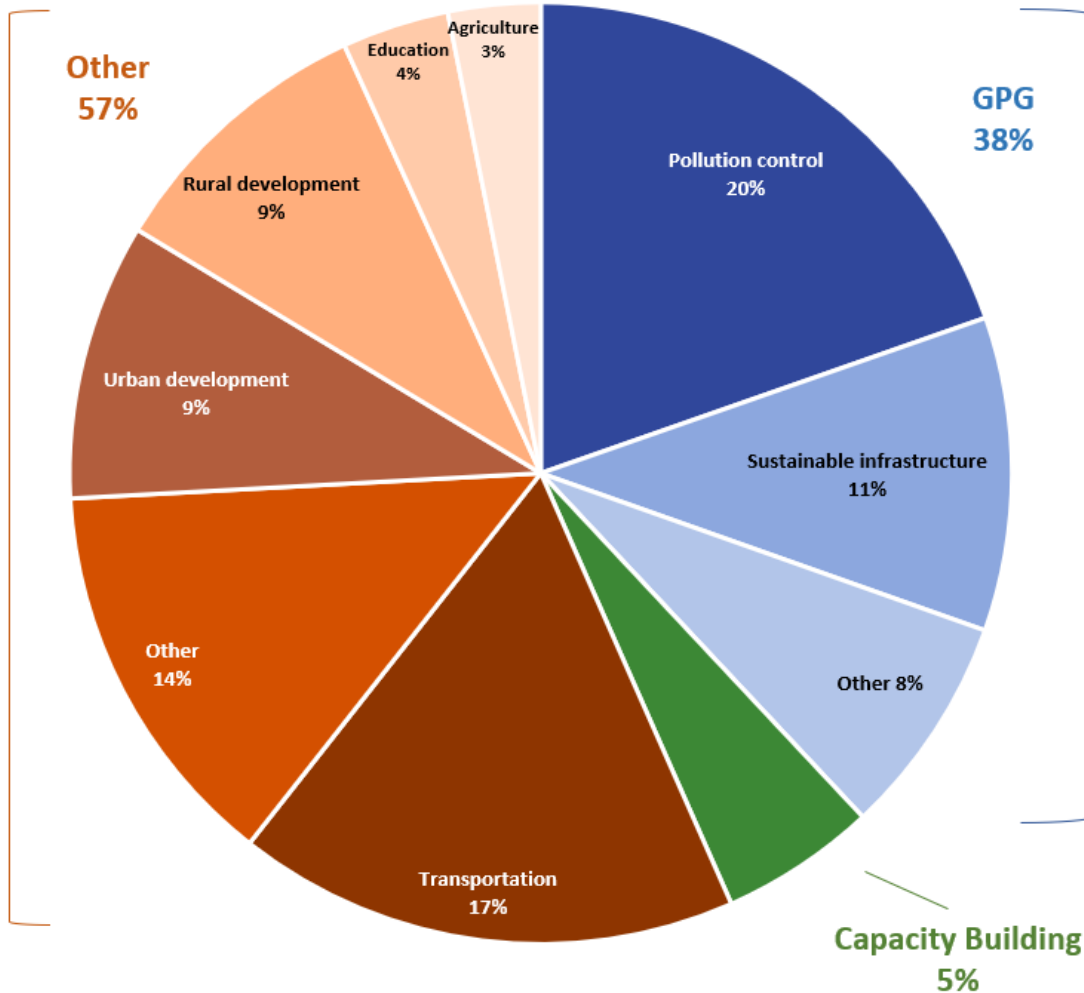
protection, strengthening skills development, enhancing opportunities in rural areas, and improving transport connectivity); Cross-cutting Theme (advance mutually beneficial relations with the world, by supporting China's South-South cooperation and China's role as a global stakeholder).

²³ World Bank Group, “[Performance and Learning Review of the Country Partnership Strategy for the People's Republic of China for the Period FY13- FY16.](#)” January 2016, page 13.

Figure 2.

IBRD commitments to China by volume and by sector, FY16-18, USD millions

TOTAL: \$7.89 billion



Source: World Bank Projects and Operations, authors calculations

Source: World Bank Projects and Operations, authors calculations

But a strict measure of capacity building may be overly limiting. The stated 2018 goal of “institutional strengthening” could also accommodate a broader rationale and approach to engagement. Namely, we interpret a key element of this rationale to be a focus on sub-regions within the country where economic progress has been weak. From a geographic perspective, World Bank focus on lower income provinces would generally support the principle of assisting the country toward graduation.

From this standpoint, we consider World Bank lending to China from a provincial perspective. First, we identify Chinese provinces in relation to the IBRD’s GDI threshold (see figure 3).

Just over half of Chinese provinces have per capita incomes below the GDI threshold, with 45 percent of provinces above the threshold. The latter are concentrated in the eastern half of country.

Next, we compare this distribution of provinces by income with the pattern of IBRD lending by identifying the location of projects supported through IBRD loans. Figure 4 compares the previous map illustrating provinces above and below the GDI with aggregated project pipeline commitments by province over the past three fiscal years.

As outlined in the CPS, bank projects by volume do appear to be concentrated in the inland provinces: about 83 percent of lending by volume are in noncoastal provinces, with the smaller share of lending in the coastal provinces where GDP per capita is significantly higher and growth has been rapid over the past decade.

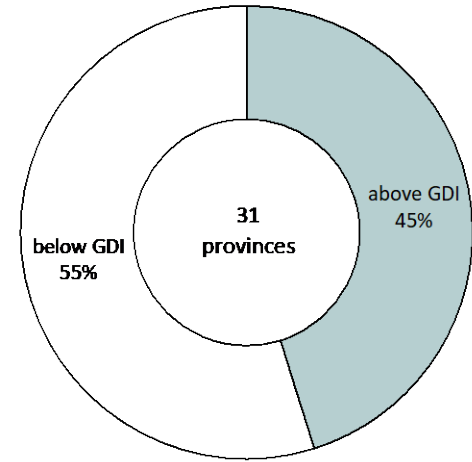
However, by a more precise measure of provincial-level per capita income, just 58 percent of lending has gone to provinces below the GDI threshold. If IBRD lending were designed to be strictly focused on the poorer provinces as a path toward graduation, then actual lending appears to have fallen well short.

Nonetheless, the 2018 agreement also emphasizes the value of GPG activities in GDI countries. From this standpoint, we consider the IBRD lending portfolio according to GPG alignment. Of the \$7.9 billion lending portfolio during the period, \$3 billion was devoted to GPG-related activities, 60 percent of which were in the wealthier provinces. In principle, we can expect leading GPG activities to be concentrated in areas of higher economic activity and therefore higher incomes. Specifically, climate mitigation efforts within China, which represent a clear GPG, are likely to be associated with provinces and regions where emissions are high. For example, a large concentration of climate-related financing is in the wealthier province of Hebei, where the bank and the GoC have focused efforts on pollution control. More generally, nearly two-thirds of GPG-related lending by volume is concentrated in GDI provinces, with just over a third in below-GDI provinces (see figure 5).

In sum, the majority of IBRD lending has been concentrated in China's below-GDI provinces. Of the lending that has gone to GDI provinces, 54 percent has been devoted to GPG activities. Of the non-GPG activities generally, there is a strong bias in favor of the below-GDI provinces. Seventy percent of the bank's non-GPG portfolio is allocated to these provinces. And of all of the bank financing going to below-GDI provinces, 74 percent is for non-GPG activities (see figures 6 and 7).

Figure 3.

14 Chinese provinces are above the Graduation Discussion Income over FY16-18



Note for all maps: This map template includes 31 provincial-level administrative divisions, including 22 provinces, four municipalities, and five autonomous regions. This template does not include the two Special Administrative Regions (SAR) of Macau and Hong Kong or Taiwan province. Authorities from these three regions report separate social and economic statistics to the World Bank.

Disclaimer: All maps in this paper are for illustrative purposes and does not imply the expression of any opinion on the part of the Center for Global Development concerning the legal status of any country or territory or concerning the delimitation of frontiers or boundaries.

Note: Evaluated against per capita income figures from 2014-16. The WB uses 2016 per capita figures for the FY 2018 GDI, 2015 per cap figures for the FY 2017 GDI, etc.

Source: World Bank Projects and Operations, World Bank: "How does the World Bank classify countries?"

Figure 4.

Provinces above and below the GDI (1st) vs. concentration of IBRD lending (2nd)

2nd map displays lending in aggregate nominal USD millions over a three-year period, FY16-FY18

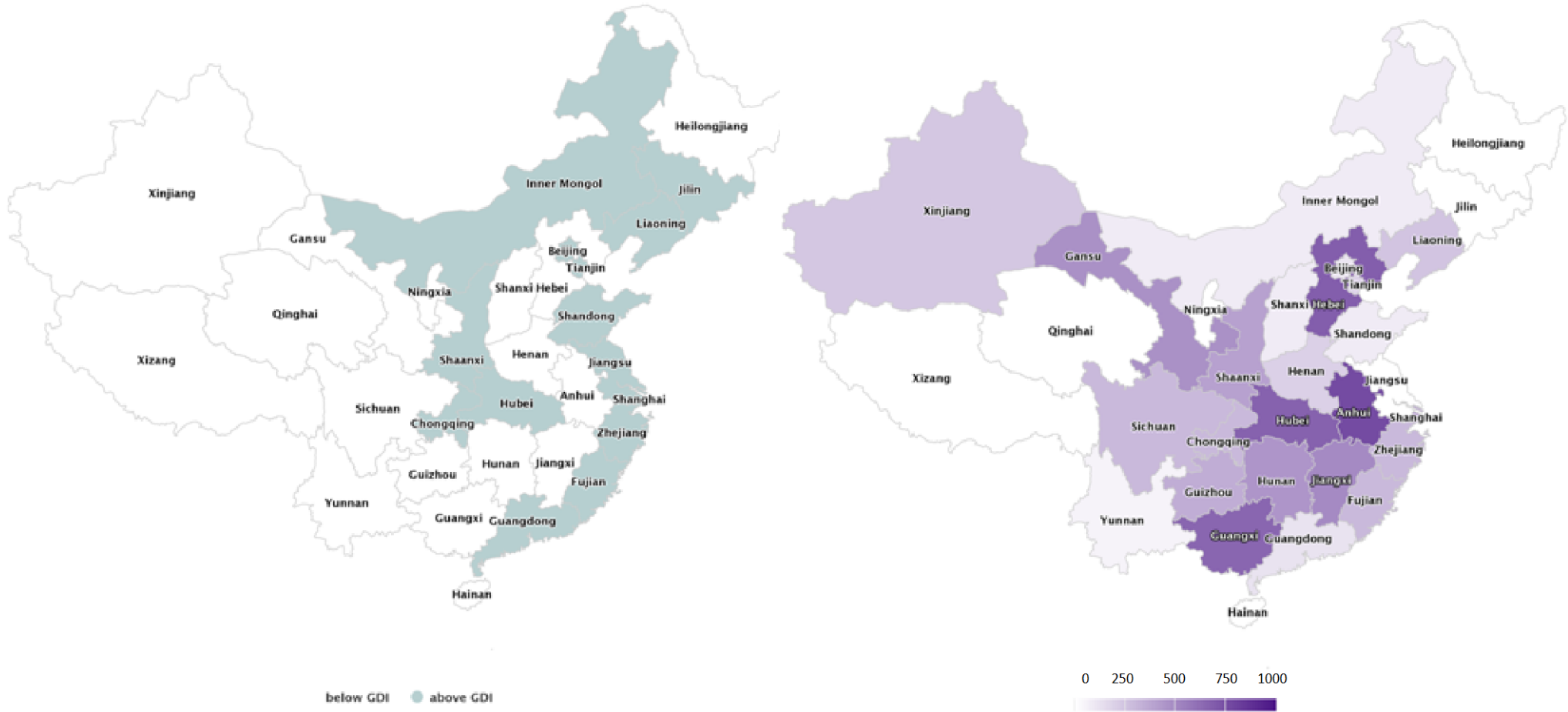


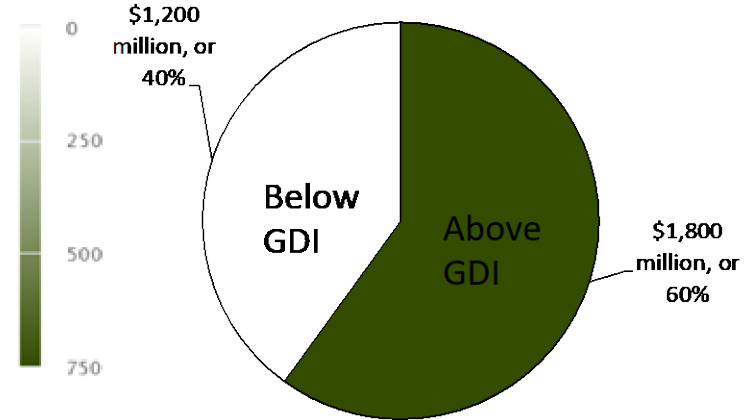
Figure 5.

Concentration of lending by province for Global Public Goods (GPGs) related projects

An "X" identifies a province above the GDI



Where are \$3 billion in GPG projects located (by province)?

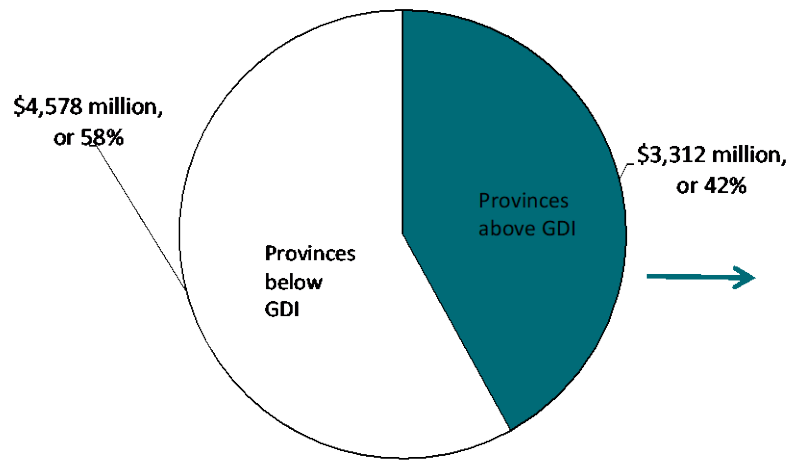


Source: World Bank Projects and Operations

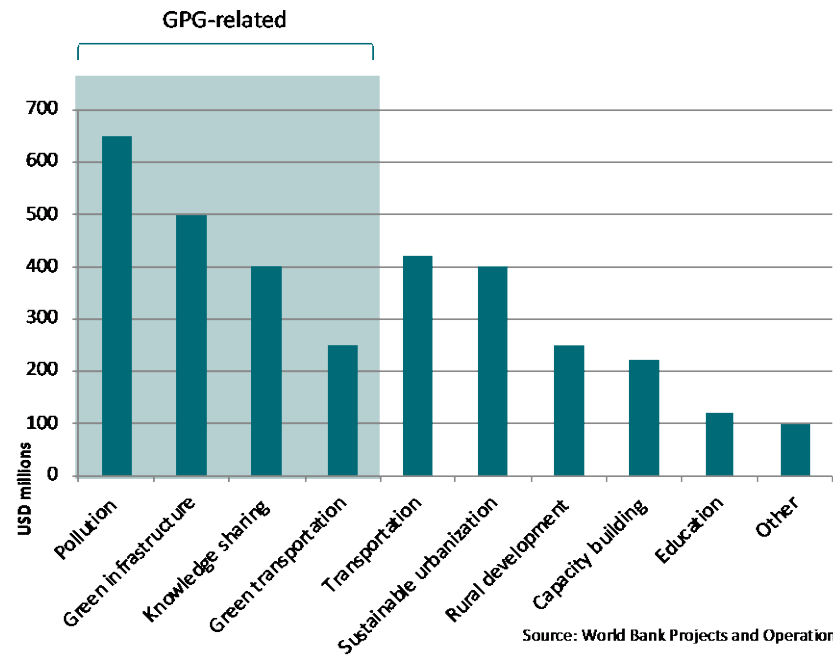
Figure 6.

Of \$7.89 billion in IBRD financing in China over FY16-FY18....

The majority has gone to poorer provinces



Projects in provinces above the GDI

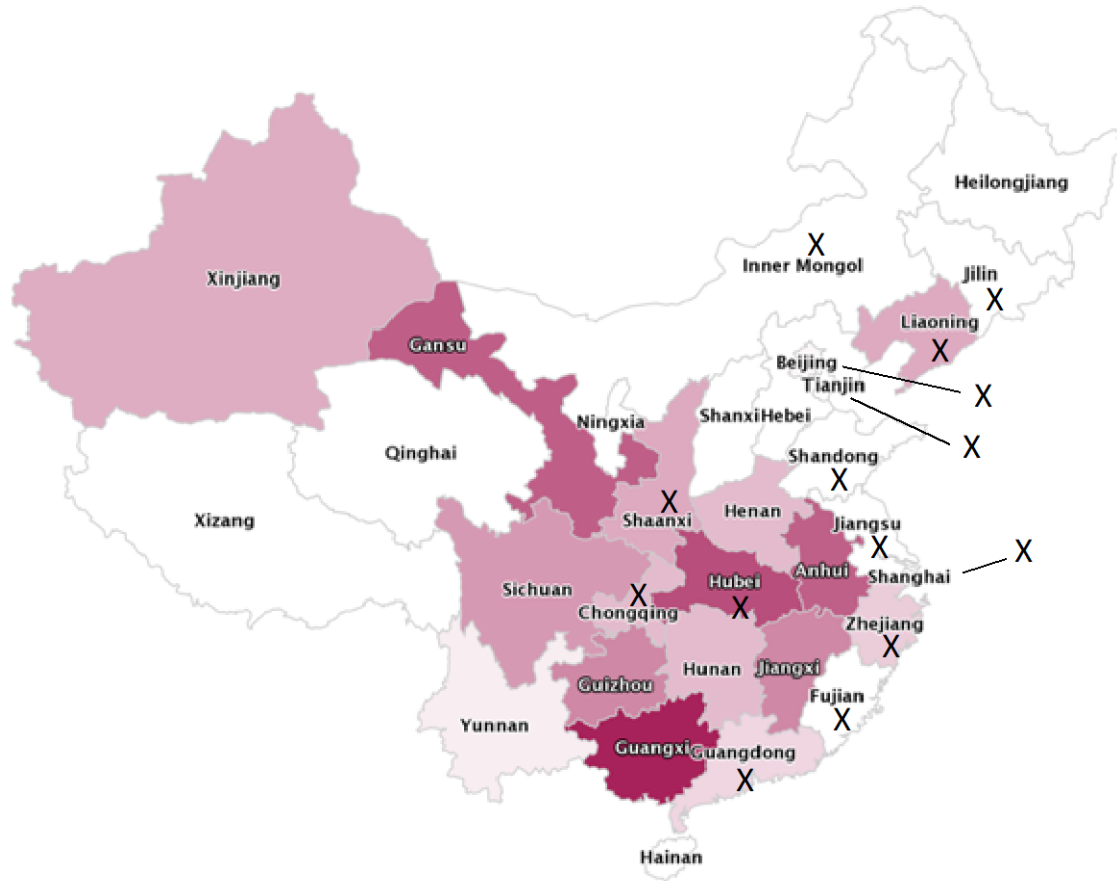


Source: World Bank Projects and Operations

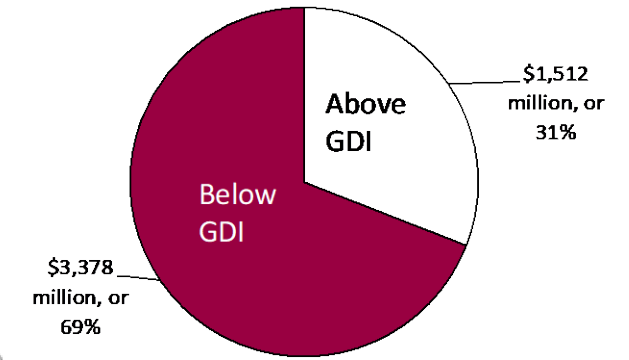
Figure 7.

Concentration of lending by province for non-GPG related projects

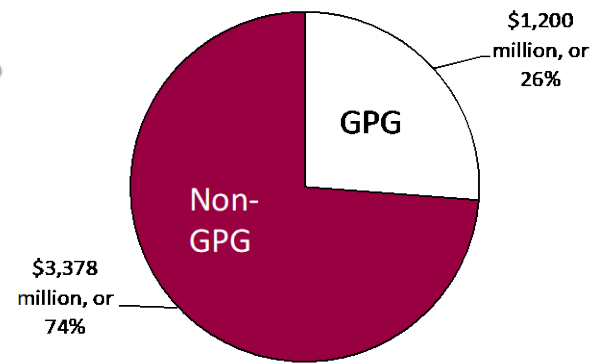
An "X" indicates a province above the GDI



Where are \$4.89 billion in non-GPG related projects located (by province)?



For all projects in provinces below the GDI:



Source: World Bank Projects and Operations

IV. Qualitative Assessment of World Bank Projects in China

This section uses projects examples to illustrate the categorizations used in figure 1 and in our provincial-level analysis, which sought to categorize World Bank projects according to GPGs, bolstering economic and political institutions to prepare for sustainable graduation, and projects that fall outside of these categories.

Global Public Goods in China: Trends and Focus Areas

A focus on global public goods does appear to genuinely define some of the World Bank-China partnership. GPGs account for 38 percent of the lending portfolio and encompass a range of activities and sectors, with climate change mitigation the leading objective.

Pollution control. Since 2013, the GoC has focused on and monitoring Particulate Matter (PM2.5), considered to be the most critical pollutant for public health.²⁴ In response to this concentrated focus, the bank is implementing projects to help mitigate PM2.5. For example, two projects totaling \$600 million are in Hebei—an air pollution prevention and control project and a clean heating project—where pollution levels are some of the highest in the country.²⁵ Additionally, the bank has focused on cleaning up water and land pollution in areas of both regional and global significance. For example, there are two projects in the provinces of Jiangxi and Zhejiang to control water pollution, the former targeting a large freshwater lake that flows into the Yangze river (a significant ocean polluter), and the latter cleaning up a lake to address, in part, broad negative ecological effects due to water pollution.²⁶ All three projects include a small provincial capacity building component. For example, the latter project will include an inter-provincial capacity building piece and focus on the institutional strengthening of the provincial project management office. Additionally, a project in the province of Hunan is oriented towards remediating brownfields and combatting soil pollution.²⁷ There are no pollution control projects in the province of Henan, which has the highest concentration of PM2.5 when weighted by population.²⁸

Sustainable infrastructure. In response to today's compelling development and climate imperatives, financing for sustainable infrastructure—mainly financing productive, efficient,

²⁴ PM2.5 is a particulate matter that causes a wide range of health effects, especially respiratory and cardiovascular systems. It is measured through primary particles (fine particles directly emitted from a source such as dust from construction sites), and secondary (produced through chemical reactions in the atmosphere, which includes SO₂, NO₂, and NH₃). These substances are emitted from the combustion of fossil fuels, use of fertilizers, livestock waste, and industrial production.

²⁵ [Hebei Clean Heating Project](#), [Hebei Air Pollution Prevention and Control Program](#)

²⁶ [Poyang Lake Basin Town Water Environment Management Project](#); [Zhejiang Qiandao Lake Xin'an River Basin Water Resources and Ecological Environment Protection Project](#)

²⁷ [Zhuzhou Brownfield Remediation Project](#)

²⁸ Angel Hsu, "[Provinces in China commit to air pollution targets.](#)" February 2014.

and green infrastructure investments—is a key component of the GPG agenda.²⁹ The IBRD’s financing in China reflects this effort in the areas of transportation and urbanization. For example, the bank is currently financing sustainable urban transport projects including supporting low carbon development of inland waterway transport capacity in Hubei province, focusing on data integration and utilization to improve green public transportation efficiency and reliability in Shaanxi province, and upgrading to a green metro system and encouraging public transportation in urban areas of Tianjin province.³⁰ Additionally, one urbanization project in Shanghai, another high emitter, will focus on providing sustainable long-term financing to green infrastructure in selected small towns.³¹ As will be discussed later, this appears to be one of few urban regeneration projects that has a clear climate-oriented program component.

Knowledge sharing. Part of the bank's strategy in China is to facilitate South-South knowledge sharing, and this objective is a key component of a few projects. One project focused on reforming two provincial health programs—in Anhui and Fujian—includes an explicit intention to facilitate study tours for Chinese officials to Brazil and Costa Rica to learn about health reforms in those countries and share the Chinese experience.³² Additionally, a project in the province of Chongqing is applying evidence-based approaches to urban regeneration to reduce environmental impact and introduce green solutions in select cities. The project aims to share these experiences across the municipality and globally, and situates the project among other cities around the world that are looking to apply such strategies.³³

Development policy data and research. A few projects indicate the bank's intention to help develop China's data collection frameworks. For example, one project aims to expand capacity for open data at the subnational level. Starting with Guangdong province as a pilot city, the bank aims to demonstrate how China is “a unique place to benefit from the use of technology and data to improve its development outcomes.” As illustrated above, the bank aims to support the development of an Intelligent Public Transport Management System in the Shaanxi province, using data integration and utilization to improve operations within the public bus system.³⁴

Capacity Building

In the previous section, we suggested that a focus on below-GDI provinces in itself reflects a core principle of the 2018 agreement: “institutional strengthening to promote graduation.”

²⁹ Nancy Birdsall and Scott Morris, “Multilateral Development Banking for This Century’s Development Challenges: five Recommendations to Shareholders of the Old and New Multilateral Development Banks.”

Center for Global Development, October 2016.

³⁰ China: Tianjin Urban Transport Improvement Project, China: Hubei Inland Waterway Improvement Project, Shaanxi Xi’an City Intelligent Public Transport Project.

³¹ Shanghai New Urbanization Financing and Innovation Project

³² China Health Reform Program (Anhui and Fujian)

³³ Chongqing New Urbanization Pilot and Demonstration Project

³⁴ Shaanxi Xi’an City Intelligent Public Transport Project; Capacity Building and Supporting Program for Open Data Initiatives in China;

Nonetheless, it is also worth considering the degree to which the bank is directly engaged in “institutional strengthening” or “capacity building” irrespective of provincial-level income.

A clearly identifiable focus on capacity building yields a much smaller number of World Bank projects within China, whether within non-GDI provinces or nationally. These projects account for just 5 percent of the overall portfolio.

The bank is currently implementing two subnational pilot programs to support fiscal sustainability and control subnational debt. In a fiscal sustainability project in Hunan, the bank states “the nature of Hunan’s current economic and fiscal situation breeds significant risks for local progress on poverty and social indicators,” implying a concerted effort by the bank to target subnational provinces that have a capacity problem.³⁵ The implementing agency is Hunan Provincial Financial Bureau, and project documents describe that “the operation is encouraged by the pride and determination of the Hunan Provincial Government.” The second pilot project is implemented by the Chongqing Municipality Finance Bureau and Dadukou District Government in Chongqing province. Project documentation indicates “the operation is encouraged by the pride and determination of Dadukou District to transform itself from one of many fiscally distressed local government in China into a positive example of fiscal turnaround that could be followed by other localities.”³⁶

There appears to be one national-level capacity-building project. The bank is currently implementing one project to provide technical assistance for China’s reforms in public finance. This is to align with China’s own program of reform for the nation’s tax system, of which, per bank documents, “many details of these reform plans are being developed or not yet proposed.” This project aims to supplement—at the request of the GoC—the fiscal plan by informing the design and implementation of reforms in these select areas.³⁷

The Rest of the Portfolio

Over half of the remaining bank portfolio in China is neither GPG-related or explicitly capacity-building. A large portion of these projects are in the transportation sector—and lack a clear sustainability related focus—in line with the bank's second pillar of promoting inclusive growth. Interestingly, these projects are often targeted towards provinces below the GDI, but will sometimes target incidences of high poverty in cities. For example, the bank is implementing three transportation projects in the province of Hubei alone (a province above the GDI): two projects developing freight logistics infrastructure through improved technologies in the low-income regions of Yichang and Xiaogan, a pilot project for a regional program focusing on improving transport amongst multiple cities in the

³⁵ [Hunan Fiscal Sustainability DPF](#)

³⁶ [Chongqing-Dadukou Fiscal Sustainability DPF](#)

³⁷ [Building a Modern Fiscal System Technical Assistance](#)

municipality of Wuhan.³⁸ In some cases, the bank makes a clear effort to focus a transport project in the poorest provinces. For example, the bank is aiding the Anhui provincial transport department to upgrade rural roads in various poor counties, which will include a capacity building piece oriented towards the municipalities. According to project documents, this is because as part of decentralization reform in a province like Anhui, municipalities and counties are now responsible for a significant share of transport budgets.³⁹

In Guizhou province, one of the poorest in China, the bank is implementing two transport projects. One project strengthens rural connectivity and transport in the poor city of Tongren, and in Qianxinan, another poor city, there is a focus on applying new technologies to evaluate rural accessibility, and the bank plans to train staff to use an open-source platform for quantifying and evaluating accessibility and focus on municipal capacity building.⁴⁰

The bank has financed three projects in the education sector, two of which are in provinces below the GDI. An early childhood education innovation project in Yunnan aims to boost enrollment and is being implemented by the Yunnan Provincial Department of Education (which has 10 percent of China's total population in poverty),⁴¹ and a technical and vocational education and training program in the second poorest province of Gansu is being implemented by the Gansu Provincial Department of Education.⁴² However, neither of these projects include a significant project component devoted to capacity building at either the subnational or municipal level. In Guangdong, one of the wealthiest provinces but with a large urban-rural divide, the bank is funding a compulsory education project in rural Guangdong, which is being implemented by the Guangdong Department of Education.⁴³ Similarly, there is no explicit project component that implies efforts to also help the provincial government build capacity and institutional strength.

One cluster of projects includes those that are focusing on town conservation, to promote “heritage-based sustainable tourism.” In Gansu, the bank aims to enable lower-income communities in historic cities, towns and villages to benefit from the overall BRI and maximize partnership with the private sector.⁴⁴ Finally, the bank is engaging on a variety of urban regeneration programs oriented at the city or municipal level. These projects tend to target poor cities or regions that have fallen behind during periods of rapid growth.⁴⁵ This is

³⁸ CN-Hubei Xiaogan Logistics Infrastructure; Three Gorges Modern Logistics Center Infrastructure Project; Wuhan Integrated Transport Development.

³⁹ Anhui Road Maintenance Innovation and Demonstration Project, Anhui Rural Road Improvement and Upgrading PforR, Wuhan Integrated Transport Development.

⁴⁰ Guizhou Tongren Rural Transport Project, Qianxinan Rural Transport Program for Results

⁴¹ Yunnan Early Childhood Education Innovation Project (YECEIP)

⁴² China: Gansu Technical and Vocational Education and Training Project

⁴³ China: Guangdong Compulsory Education Project

⁴⁴ CH-Second Gansu Cultural and Natural Heritage Protection and Development Project; Hubei Jingzhou Historic Town Conservation Project; Gansu Silk Road Revitalization Project

⁴⁵ Shaanxi Sustainable Towns Development Project; Shaanxi Poor Rural Areas Community Development Project; Guangxi Rural Poverty Alleviation Pilot Project

a part of the GoC's National New-Type Urbanization Plan (2014-2020), among other national directives, which aims to create a new urban development model by 2020.

V. Conclusion

The 2018 agreement to increase the World Bank's capital also established a consensus around core principles to guide bank policy on country eligibility for borrowing and approaches to graduation from borrowing. Our effort to apply these principles in practice to China's borrowing from the bank reveals a program of engagement that is broadly consistent with the 2018 principles, although significant areas of bank engagement do not appear to fall within the parameters of these principles.

This picture suggests that in China's case, shareholder discussions within the World Bank should be less about graduation and more about modulation. Specifically, the question of the bank's ongoing engagement with China as a borrower should focus on how best to align the entire portfolio with the 2018 principles and what adjustments in project-level selection and decisions might be necessary to achieve that.

The 2018 agreement points to further discussions within the institution aimed at elaborating the parameters and details of bank engagement in GDI countries and approaches to graduation. This language reveals the degree to which the question of graduation remains contested among the bank's shareholders. With the ongoing discussion and debate in mind, it will be helpful going forward for these discussions to include a consideration of consistent terminology and categorization of bank projects to better enable all shareholders to have a common understanding of the bank's lending practices in GDI countries. With this as a starting point, country programs can then seek greater discipline in lending practices such that nontrivial volumes of lending do not fall outside of agreed parameters for engagement or are otherwise hard to assess as consistent or inconsistent with these parameters.