

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered in the narrow neck of the hourglass. The top bulb is filled with a dark blue color, and the bottom bulb is filled with a light blue color. The globe is centered in the narrow neck of the hourglass.

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Report 97-518

China and the Multilateral Development Banks

Jonathan E. Sanford, Foreign Affairs and National Defense Division

October 31, 1997

Abstract. The prospects for the future of multilateral development bank assistance in China are uncertain. In a few years, the World Bank will have to cut its level of International Bank for Reconstruction and Development lending or waive its rule against lending more than 10 percent of its funds to one country. If U.S. influence in the World Bank diminishes, Japan and some other countries may want to revisit the question of terminating International Development Association (IDA) assistance to China. Likewise, it is not evident what will replace IDA as a source of credit for social programs and non-commercial agricultural development. The Chinese government has not shown that it is willing to borrow market-rate money to fund these activities.

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China and the Multilateral Development Banks

Updated October 31, 1997

Jonathan Sanford
Analyst in International Political Economy
Foreign Affairs, Defense, and Trade Division

<http://wikileaks.org/wiki/CRS-97-518>

China and the Multilateral Development Banks

Summary

Congress is currently considering appropriations for U.S. contributions to the World Bank and other multilateral development banks (MDBs) as well as separate legislation that would require U.S. representatives to these institutions to oppose all concessional loans to China. The World Bank and Asian Development Bank (ADB) are together the largest source of foreign development assistance to the People's Republic of China. In recent years, the multilateral development banks (MDBs) have lent approximately \$4 billion annually to China. The ADB makes only market-based loans to China. Most World Bank loans to China are also on near-market terms and lending from its concessional loan "window," the International Development Association (IDA) is scheduled to end by 1999.

The MDB market-based loan facilities mainly finance the construction of infrastructure and industrial facilities. Agricultural development, loans for social programs, and funding to directly promote economic reform have accounted for only a small portion of MDB market-based loans. Environmentally oriented loans have become a significant fraction in recent years. IDA concessional loans, on the other hand, have focused mainly on social programs and on agricultural projects in impoverished regions. A significant, though smaller, share has also gone for environment and economic reform programs.

MDB lending to China dipped substantially following the government's attack on protesters in Tiananmen Square in June 1989. The world's largest industrial countries, the Group of Seven (G-7), which control a majority of the voting stock in the World Bank and ADB, agreed in 1990 that they would support only MDB loans for basic human needs. The United States still opposes unrestricted lending to China, but most other countries have relaxed their opposition and now support unrestricted MDB lending to China. The United States does not have a veto or other capacity to block approval of MDB loans it does not support.

U.S. relations with other IDA donors have been strained in recent years over U.S. arrears and efforts to impose U.S. priorities on MDB lending policies. In 1996, the other IDA donors gave the United States a chance to catch up on its payments to IDA — instead of making new contributions — but it did not do so. Some have argued that U.S. influence in the MDBs should be diminished if the United States is not willing to carry its share of their costs.

The prospects for the future of MDB assistance in China are uncertain. In a few years, the World Bank will have to cut its level of IBRD lending or waive its rule against lending more than 10% of its funds to one country. If U.S. influence in the World Bank diminishes, Japan and some other countries may want to revisit the question of terminating IDA assistance to China. It is not evident what will replace IDA as a source of credit for social programs and non-commercial agricultural development, since the Chinese government has not shown that it is willing to borrow market-rate money to fund these activities.

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China and the Multilateral Development Banks

Should the MDBs Lend to China?

The World Bank and Asian Development Bank (ADB) have been large and growing sources of loans for China. In 1985, the World Bank and ADB agreed to lend China \$1.1 billion. Ten years later, the annual total for their loan commitments to China had quadrupled, to \$4.3 billion in both 1995 and 1996.

Today, many debate what role the MDBs should play in the world's most populous country. Resources are scarce at the multilateral development banks (MDBs) and there are many alternative claimants for available funds. China has one of the fastest growing economies in the developing world, yet it is also the home of many very impoverished people. Some people ask whether the United States, Japan, and other major countries should help finance the development of a country that may be their international rival in the coming century. Should the MDBs stop making low-cost concessional rate loans to China? Should they make these loans only for activities that promote poverty alleviation, environmental preservation, and economic reform? Should they lend at all, given China's questionable record as regards official respect for internationally recognized human rights, its military buildup, and its apparent readiness to use force in settling international disputes? Alternatively, can the MDBs justify *not* lending to China, given its low per capita income, the prevalence of poverty in its less developed regions, and the Chinese government's apparent orientation towards development?

This report does not attempt to answer these questions. Rather, it provides a brief analysis of China's relationship with the MDBs to highlight some issues and help Members of Congress, congressional staff, and observers better understand the context for the current debates in Congress and the multilateral agencies. For further information, see the following CRS products: CRS Report 97-211, *Appropriations for FY1998: Foreign Operations, Export Financing and Related Programs*, by Lary Nowels; CRS Issue Brief 96008, *Multilateral Development Banks: Issues for the 105th Congress*, by Jonathan Sanford; and CRS Report 97-933, *China: Pending Legislation*, by Kerry Dumbaugh.

What Activities Do MDB Loans Support in China?

China borrows more from both the World Bank and ADB than any other single country. Its share in World Bank commitments increased from 6.5% in 1985 to 12.7% in 1996. More dramatically, ADB assistance to China grew from zero in 1985

to 19.9% of all 1996 commitments. China has increased its access to foreign credit quite rapidly — receipts from new loan disbursements from all sources of foreign

Table 2. MDB Loans to China, 1985-97
(millions of U.S. dollars)

<u>Bank</u>	<u>World Bank Group</u>			<u>Asian Development</u>	
		<u>IBRD</u>	<u>IDA</u>	<u>IFC</u>	<u>Reg Loans</u>
<u>Priv Sector</u>					
1985	659.6	442.3	17.0	--	--
1986	687.0	450.0	--	--	--
1987	867.4	556.2	8.0	133.3	--
1988	1,053.7	639.9	15.0	282.9	3.0
1989	833.4	515.0	3.0	39.7	--
1990	--	590.0	--	50.0	--
1991	601.5	977.8	--	498.3	14.3
1992	1,577.7	948.6	16.4	853.0	50.0
1993	2,155.0	1,017.0	43.2	1,050.0	--
1994	2,145.0	925.0	83.4	1,167.0	--
1995	2,369.5	630.0	104.2	1,201.0	--
1996	2,490.0	480.0	184.5	1,040.0	102.0
1997	2,490.0	325.0	133.6	906.0*	NA

*Through Sept. 3, 1997. Many ADB loans are approved between October and December. Table excludes guarantees not involving some use of MDB resources.
Source: Annual reports of the World Bank, IFC, and ADB, relevant years.

debt grew from \$6.1 billion in 1985 to \$26.8 billion in 1994. MDB disbursements accounted for 13% of China's new receipts of long-term credit in 1995.¹

The World Bank provides aid to China through its four main "windows:" the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the International Finance Corporation, and the Multilateral Investment Guarantee Agency (MIGA). The IBRD, the original World Bank, lends on market-based terms.² IDA, the Bank's concessional loan
(text continues page 5)

¹World Bank. *World Debt Tables, 1993-4*, Vol. 2, p. 90. Long-term disbursements were \$5.3 billion; the net flow of short-term debt was \$819 million. *Global Development Finance, 1996*. [New name for series.] Vol. 2, p. 152. Long-term debt disbursements were \$21.955 billion; the net inflow of short-term debt was \$4.842 billion. MDB disbursements in 1995 were \$2.838 billion; less than a third (\$838 million) was concessional MDB aid.

²BRD loans are repayable over 12 to 25 years, depending on the type of project. Its floating interest rate is pegged one-half of 1% higher than the average price the IBRD pays to borrow money in world commercial capital markets. In recent years, it has generally been around 7.5%.

Table 3. MDB Lending to China, by Bank and Type of Activity^a
(millions of U.S. dollars)

World Bank (IBRD)	<i>infra- structure</i>	<i>industry</i>	<i>agri- culture</i>	<i>social sectors</i>	<i>environ- ment</i>	<i>economic reform</i>
Total	\$9,861	\$2,869	\$885	\$558	\$1,240	\$28
1985	\$545	\$97	\$17	\$0	\$0	\$0
1986	\$583	\$87	\$0	\$17	\$0	\$0
1987	\$355	\$448	\$20	\$45	\$0	\$0
1988	\$624	\$190	\$240	\$0	\$0	\$0
1989	\$243	\$591	\$0	\$0	\$0	\$0
1990	\$0	\$0	\$0	\$0	\$0	\$0
1991	\$100	\$200	\$222	\$79	\$0	\$0
1992	\$1,450	\$82	\$0	\$46	\$0	\$0
1993	\$1,330	\$151	\$325	\$0	\$349	\$0
1994	\$1,984	\$0	\$0	\$0	\$161	\$0
1995	\$1,128	\$623	\$0	\$360	\$230	\$28
1996	\$1,520	\$400	\$60	\$10	\$500	\$0
1997	\$2,330	\$170	\$120	\$40	\$0	\$0
Intl Develop Assoc (IDA)	<i>infra- structure</i>	<i>industry</i>	<i>agri- culture</i>	<i>social sectors</i>	<i>environ- ment</i>	<i>economic reform</i>
Total	\$743	\$230	\$3,638	\$2,449	\$774	\$317
1985	\$30	\$0	\$187	\$225	\$0	\$0
1986	\$70	\$25	\$150	\$185	\$0	\$20
1987	\$125	\$50	\$260	\$100	\$0	\$21
1988	\$99	\$0	\$474	\$67	\$0	\$0
1989	\$191	\$0	\$215	\$109	\$0	\$0
1990	\$0	\$0	\$510	\$80	\$0	\$0
1991	\$131	\$65	\$562	\$89	\$0	\$131
1992	\$97	\$0	\$287	\$450	\$115	\$0
1993	\$0	\$0	\$427	\$330	\$149	\$110
1994	\$0	\$0	\$465	\$110	\$350	\$0
1995	\$0	\$0	\$0	\$485	\$110	\$35
1996	\$0	\$90	\$100	\$220	\$50	\$0
1997	\$0	\$0	\$0	\$325	\$0	\$0
Asian Develop Bank (ADB)	<i>infra- structure</i>	<i>industry</i>	<i>agri- culture</i>	<i>social sectors</i>	<i>environ- ment</i>	
Total	\$2,711	\$1,283	\$205	\$160	\$518	
1985	\$0	\$0	\$0	\$0	\$0	
1986	\$0	\$0	\$0	\$0	\$0	
1987	\$0	\$133	\$0	\$0	\$0	
1988	\$0	\$283	\$0	\$0	\$0	
1989	\$40	\$0	\$0	\$0	\$0	
1990	\$0	\$0	\$50	\$0	\$0	
1991	\$28	\$22	\$0	\$0	\$0	
1992	\$407	\$338	\$55	\$0	\$103	
1993	\$610	\$300	\$0	\$0	\$140	
1994	\$773	\$77	\$0	\$160	\$158	
1995	\$853	\$130	\$100	\$0	\$118	
1996	\$652	\$280	\$70	\$0	\$140	

^a See footnotes 5,6, 7, and 8 for changed categorization of certain projects.

What is China's Per Capita Income?

There are two methods for calculating a country's per capita income. Both are valid but they are not interchangeable.

Per Capita GNP in Dollars. The first method, which the World Bank uses for determining IDA eligibility, calculates a developing country's per capita income in dollars through a simple conversion process. The per capita Gross National Product (GNP) is measured in local currency and converted to dollars using the average exchange rate for the past three years as adjusted for inflation. China's annual per capita GNP in 1995 was about 5,200 yuan. On the basis of this calculation, the World Bank said in 1996 that China's per capita annual income the previous year was \$620.

This system is useful for comparing the income levels of countries when the ability to buy imported goods is an issue. It gives an unrealistic picture of local living standards, however, since products not traded internationally (services, rent, etc.) are valued by an exchange rate applicable only to traded goods. Actual living standards can be much higher than implied in this dollar figure.

The system is also subject to technical problems and relies on GNP calculations that may not be very accurate. For example, many transactions are outside the purview of official data collection. The Bank made adjustments in the base data for China in 1994 and 1995. Earlier World Bank data reported that China's per capita GNP stood at \$370 in 1993. Two years later, according to World Bank figures, China's per capita GNP was \$620. China's economy was not two-thirds larger in 1995 than it had been in 1993. Technical changes in the method of calculation account for much of the apparent change in the Bank's figures for China's per capita annual income. The Bank made no similar recalculation of income figures for other countries.

Purchasing Power Parity. The second method seeks to establish purchasing power parity (PPP) using a fixed market basket of goods and services to compare income levels in different countries. People's ability to purchase the items in the basket will vary from country to country. However, the items are valued according to a common standard, regardless of their local price. The World Bank says China's PPP income in 1995 was \$2,920 (slightly higher than those of El Salvador and the Philippines).

The PPP system allows better comparisons of living standards among countries. However, it prices the income generated in a country's domestic economy as though it were useable in the international economy and it does not take the varying quality of goods sold in different countries into account. Thus, it tends to blur the differences in countries' relative capacity to purchase imported goods. The World Bank uses the per capita GNP in dollars method as its benchmark for determining countries' eligibility for IDA aid. IDA loans mainly finance the purchase of foreign goods. The World Bank has not specified an alternative measure using the PPP methodology for determining whether countries are eligible for IDA loans.

affiliate, lends on low-cost terms, mainly to countries with per capita incomes below \$869 annually.³ Most have per capita income levels below \$400. The IFC mainly

³ IDA loans for China are repayable over 35 years, including a 10-year grace period. The borrower pays a 3/4 of 1% service charge on the disbursed balance.

helps private domestic firms in developing countries.⁴ MIGA insures or guarantees foreign investors in developing countries against various non-commercial risks (expropriation, etc.). Its exposure in China is about \$112 million and is not discussed here.

In 1996, assistance to China comprised about 17% of all new IBRD loan commitments and 7% of all loan commitments approved by the IDA. Loans or equity investments for China accounted for less than 3% of all new commitments by the IFC in 1996.

China is what the World Bank calls a “blend” country. That is, it receives loans from both the IBRD and IDA. Theoretically, the projects the Bank finances in China could be funded by either the IBRD or IDA, depending whether the Bank decides China can afford to service additional non-concessional debt. In practice, the World Bank has used its market-rate loans and its concessional loans in China to finance activity in different sectors. The IBRD has concentrated mainly on infrastructure or industrial projects, whereas IDA has focused much more on agriculture and social development activities.

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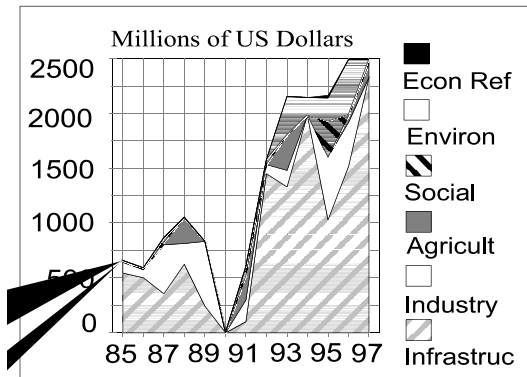


Figure 1. IBRD Assistance to China, Types of Activities

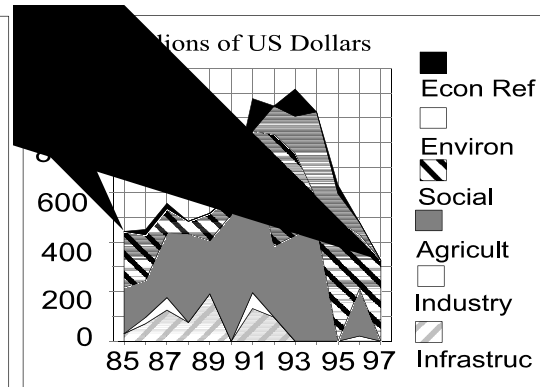


Figure 2. IDA Assistance to China, Types of Activities

Between 1985 and 1997, as Figure 1 indicates, the IBRD targeted 68% of its funds it lent to China for the construction of infrastructure and 16% for industry, mining, or oil and gas production. Most of these projects were located in areas experiencing rapid economic growth, mainly in urban or coastal regions. Another

⁴ IFC loans carry commercial interest rates. IFC equity investments involve no participation in management. Most IFC projects in China have focused on the industrial or mining sectors. In some countries (but not China), the IFC also lends to or invests in private utility companies.

6% went for agricultural development.⁵ (These are represented by the four grey triangles having their widest points in 1988, 1991, 1993, and 1997.) About 3% of all IBRD lending to China has financed social projects.⁶ (The main allocation of social sector lending occurred in 1995, represented by the striped triangle shown for that year.) Projects oriented towards effecting improvements in the environment comprised almost 7% of the total. Loans to facilitate or encourage economic policy reform accounted for one-tenth of 1% of all IBRD lending to China. The 1995 loan for this purpose is represented by a small black spot at the top in that part of the graph.

By contrast, as Figure 2 shows, IDA has used 9% of the money it lent to China for infrastructure and 2% for industry, mining or oil and gas production. (The latter is represented by the four small white triangles centering on 1987, 1989, 1991, and 1996.) Most IDA assistance to China went to finance agricultural development projects (43% of total IDA lending), mainly in the poorer or less developed regions. Another 33% went for social sector (mainly health, primary education or direct poverty-alleviation) projects. Environmental projects comprised more than 9% of the total. Loans to encourage or facilitate economic policy reform accounted for the remaining 4% of all IDA aid to China.

The pattern of ADB activity in China resembles that of the IBRD. As Figure 3 shows, infrastructure accounted for 56% and industry accounted for 29% of ADB lending to China. The two agriculture loans in the figure comprised less than 3% of the total. One (represented by a thin grey triangle in 1992) funded a commercially oriented project developing tropical crops. The other (a thin grey triangle in 1996) funded a

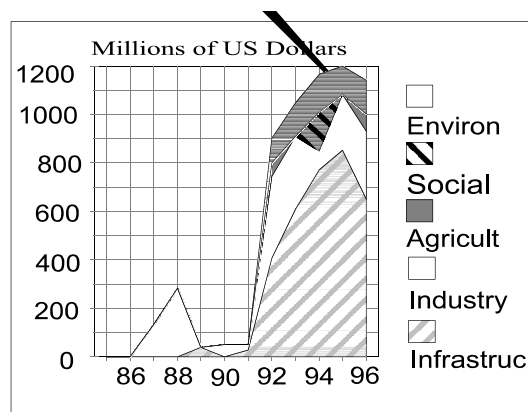


Figure 3. ADB Assistance to China, Types of Activity

⁵ The agriculture share would be slightly higher if two IBRD loans in 1996 (\$80 million for seed sector commercialization and \$150 million to strengthen the animal feed industry) were counted as agriculture rather than industry. The World Bank lists them among its agriculture loans. The published descriptions of the projects suggest, however, that they are more industrial in their focus and they have been included in that category here. The parallel \$20 million IDA seed sector loan has been treated here similarly.

⁶ The proportion lent by the IBRD for social sector projects in 1996 would be higher if the \$250 million sewerage project in Shanghai and the \$125 million wastewater and solid waste disposal project in Hubei were counted in the urban development category (per the World Bank categorization). However, the published project descriptions show that environmental measures comprise the bulk of the activities funded by the projects. Thus, they are treated as environmental projects here, as is the parallel \$25 million IDA project in Hubei. Control of industrial pollution was a major focus of the \$170 million IBRD industry sector loan in 1996, but this loan is assigned here to the industrial category because improvements in the efficiency of production facilities in the steel industry was also a central concern.

marine aquaculture project.⁷ Environmental projects comprised another 11 percent.⁸ The one social project, accounting for less than 3% of the total (the striped triangle in 1994) funded an urban water delivery system.

The ADB lends to China through its ordinary capital (market-based loan) “window.” In 1996, commitments to China comprised 28.4% of all such loans approved by the ADB. This includes some equity investments financed by that window’s private sector assistance facility. By agreement among the ADB member countries, neither China nor India receive concessional assistance from the Asian Bank, though their levels of per capita income might qualify them for such aid.

The ADB has not lent directly to fund economic reform in China. The promotion of reform — for example, better management or accounting practices and more market-oriented policies or procedures for state firms — has been built into many ADB and World Bank loans and is not reflected in the sectoral statistics. The Chinese government has been willing to adopt economic reforms when it sees that these will strengthen its economic situation. China is particularly sensitive to any appearance that it was compelled to adopt reforms as a result of conditions in MDB loans or other leverage applied by the multilateral agencies.

The IMF and China

This report does not discuss the International Monetary Fund and China. The IMF is an international monetary, not a development assistance, agency. It does not make project loans. China last borrowed from the IMF during 1986-7, when it drew the equivalent of \$777 million from its reserve tranche. The loan was fully repaid by April 1992. A country’s reserve tranche is, in effect, its own money, though it must repay the money and pay interest on the outstanding balance when it borrows these funds. IMF conditionality for loans of this sort is not rigorous. China’s current reserve position in the IMF is worth approximately the equivalent of \$1.3 billion.

⁷ Two other agriculture sector loans (1990 and 1995) helped the state agricultural bank modernize agro-industry. As with similar World Bank loans, these are counted here as industrial loans.

⁸ The ADB made two loans in 1996 for energy conservation and pollution control in industry. It categorizes them as energy or industrial projects. Environmental protection was a major purpose of these loans. In recognition of their dual focus, one of them was counted here as an environmental project. Likewise, the \$28 million ADB loan for environmental improvement in municipal wastewater treatment was treated here as an environmental project rather than (as per the ADB classification) as social infrastructure.

Tiananmen Square and MDB Lending to China

The Tiananmen Square bloodshed in June 1989 caused a sharp (albeit temporary) break in MDB treatment of China. Lending fell substantially. The United States and other major member countries urged the MDBs to stop lending in light of the human rights situation in China. Although the World Bank and ADB have no provisions in their Articles of Agreement specifically taking human rights conditions into account, World Bank and ADB management justified their suspension of new lending for China on grounds they were waiting to see if the crackdown on political expression would be followed by a slowdown or reversal of China's support for economic liberalization and reform.

The Chinese crackdown on dissidents came in the last month of the World Bank's July-through-June fiscal year, a time when many new projects would normally be sent to its Board of Executive Directors for final approval. Top Bank management withdrew its plans to recommend several new China loans that month and the volume of IBRD, IDA, and IFC lending to China fell considerably. The ADB, whose fiscal year runs from January to December, had lent only a small amount to China in 1989 when further action on new loans was suspended, as management waited to see what was happening in China.

In early 1990, representatives of the Group of Seven leading developed countries (G-7) — who together with other countries in the European Union own well over a majority of the World Bank and ADB's voting stock — agreed that their representatives at the MDBs could support a limited flow of lending to China so long as the loans were targeted to fund activities meeting basic human needs (BHN). The IBRD made no loans to China during its fiscal 1990, while IDA made six loans (for earthquake reconstruction, agricultural development in poor provinces, vocational education, and afforestation) between February and June 1990. The ADB made only one loan (to support an agricultural development bank) in late November.

At the Houston summit meeting in mid-1990, leaders of the G-7 countries decided to maintain their policy of limited support for MDB aid to China. However, they added two new criteria that would garner their support — loans to facilitate economic reform and loans for projects benefitting the environment. Following the Houston summit, the volume of MDB lending to China increased substantially. By 1992, it was almost one-quarter larger in dollar terms than the amount lent in 1988.

According to the Treasury Department, the United States continues to support the policy approved at the Houston summit. To do otherwise would contradict the requirements of U.S. law as well as Administration and congressional preferences. Other countries, however, have broadened their attitude towards MDB lending for China in subsequent years. Two factors seem to be at work.

First, the determination of the G-7 countries to only support MDB loans that would promote basic human needs, environmental protection or economic policy reform has proven hard to sustain. Many MDB loans to China have some link to economic policy reform or an environmental component. Thus, in the absence of a

clearer definition of the terms, those criteria could be used to justify G-7 support for a wide variety of loans.

Second, as the events 1989 recede, most G-7 countries are giving other foreign policy and trade factors higher precedence in their MDB policy calculations. Many seem to have abandoned the Houston criteria entirely, as these seem to apply only tangentially to many of the MDB loans approved in recent years.

U.S. Law and U.S. Votes on MDB China Loans

Existing Legislation

Section 701(a) of the International Financial Institutions (IFI) Act (P.L. 95-118), adopted in 1977, requires the United States to oppose MDB loans to countries evidencing a pattern of gross violations of internationally recognized human rights. The U.S. representatives at the MDBs may vote for loans to such countries only if they are deemed to meet basic human needs (BHN). Other countries do not seem to have similar requirements governing their votes in the MDBs. Sections 701(c) and 1701(b)(9) of the IFI Act require the Administration to submit quarterly and annual reports to Congress indicating what MDB loans it supported or opposed and whether those loans meet basic needs.

These reports show that between 1985 and 1995, the United States supported 111 of 182 loans approved by the World Bank Group (including the IFC) and 15 of 92 loans approved by the ADB. (See Table 3.) Before the Tiananmen square events in 1989, the United States supported 70 of 74 approved by the two banks. Later, it voted for only 56 of 200 MDB loans. The BHN exception was the criterion justifying these 56 votes. The United States abstained or voted “no” on all other loans to China. The U.S. representative abstained on a World Bank rural water and sanitation loan for China in January 1992 even though the Administration’s quarterly report to Congress said it had a BHN orientation.⁹

Table 3. U.S. Votes on MDB Loans to China, 1985-1995

	<u>Total Loans</u>		<u>Supported by U.S.</u>	
	<u>WB</u>	<u>ADB</u>	<u>WB</u>	<u>ADB</u>
1985	12	0	12	0
1986	10	0	10	0
1987	15	2	13	2
1988	15	4	15	3
1989	14	1	14	1
1990	11	1	10	0
1991	22	13	11	0
1992	19	14	11	0
1993	20	14	7	0
1994	22	18	9	5
1995	21	25	7	4

⁹ The U.S. Administration is required by law to report annually to Congress and the public how it votes on MDB loans. The last report submitted covers 1991. Lack of staff reportedly has prevented the Treasury Department from both filing the required reports and monitoring U.S. participation in the MDBs. For U.S. votes between 1985 and 1991, see: [U.S. Treasury Department] *International Finance: Annual Report of the Chairman of the National Advisory Council on International Monetary and Financial Policies [NAC] to the President and to the Congress* The unpublished quarterly reports to Congress show that the United
(continued...)

The concept “basic human needs” has no clear meaning in U.S. law. The human rights guidelines for U.S. votes in the MDBs were adopted in 1977. The concept “basic human needs” was borrowed from laws governing the U.S. bilateral foreign aid program. Section 102(b)(4) of the Foreign Assistance Act (FAA) of 1961 (which governs U.S. bilateral aid) says that activities aimed at improving health conditions (particularly infant mortality), education (particularly literacy), control of population growth, increased income equality, reduced unemployment or underemployment, and agricultural development aid for the rural poor could be defined as meeting basic human needs.

Other provisions of the FAA of 1961 say that alternative criteria — equitable growth, better conditions for women, improved development administration, protection of the environment and natural resources, promotion of private investment, economic policy reform designed to achieve economic growth with equity, etc. — may also be key elements of U.S. development aid policy. It is not clear, however, whether these other criteria exemplify the concept “basic human needs”. Some might argue that the context is sufficiently general that any criteria promoting growth with equity or poverty alleviation might be included in the term. In recent years, the Clinton Administration has made “sustainable development” a key component of U.S. development aid policy. Environmental considerations are a major element of this concept.

Since the G-7 conference in Houston in 1992, the MDBs have increased considerably the number of their projects in China and in other countries that are labeled “environmental”. The Treasury Department indicates, though, that some “environment creep” in loan titles is evident. Projects categorized under this label today might have been listed otherwise in prior years. In addition, MDB environment projects now often contain funding for many related activities. Some—water and sewerage or toxic waste disposal, for example—are clearly BHN activities. Others are not. Some aspects — reclamation or alteration of watercourses in the context of flood control or industrial upgrades at steel plants, for example — may not even be “environmental.”

(...continued)

States voted subsequently in the World Bank to support the following loans: (1992) educational development for poor provinces, Tianjin urban development and environment, and Sichuan agricultural development; (1993) Chingchan water and environment, effective teaching, Zhejiang municipal development, agricultural support services, South Jiangsu environment, rural health workers, and Tangshan/Chengde environmental improvement; (1994) red soils development, Songliao Plain agricultural development, Xiaolongdi resettlement, loess plateau watershed rehabilitation, forest resource development, enterprise housing and social security reform (2), Liaoning environment, and basic education for poor and minority areas; (1995) southwest poverty reduction (2), iodine deficiency disorders control (2), disease prevention, and labor market development (2). In the ADB, the United States voted to support: (1994) northern grassland ecosystem improvement technical assistance (TA), Dalian water supply, comprehensive maternal and child health, Beijing urban transport TA, and Beijing environmental improvement; (1995) agricultural development bank, commercial finance and management TA, Fujian soil conservation and rural development, and Fujian soil and water conservation TA.

It would seem that the inclusion of BHN activities in a multi-purpose environmental loan may be deemed sufficient to justify U.S. support, providing the other components in the loan are not blatantly unacceptable. In large part, the prospect for U.S. support depends on the way the MDBs “package” their loans. Thirteen of the MDB loans for China that the U.S. supported — citing the BHN provisions in Section 701(a) — were environmental projects. However, the published descriptions of at least ten of them make no mention of activities focusing primarily on public health or assistance to the poor. These include four general environment projects, an afforestation project, a watershed rehabilitation project, and two urban environmental improvement projects. The ADB soil conservation project was linked to rural development. Several small ADB loans, which the United States supported, were intended to provide technical assistance to the Chinese agencies responsible for soil or water conservation and grassland management, and provided no direct assistance to the public. If this trend continues, the BHN waiver in Section 701(a) could be used (if the Administration wished) to justify U.S. support for a broad range of MDB assistance for China.

Proposed Legislation

Two bills pending before Congress in 1997 would affect the future U.S. response to any MDB or IMF loans for China.¹⁰ One, titled “The Communist China Subsidy Reduction Act of 1997” (H.R. 2605), was introduced October 2, 1997, by Representative Gerald Solomon. The other, titled “The China Policy Act of 1997” (S. 1164), was introduced September 17 by Senator Spencer Abraham.

H.R. 2605. This bill would require the U.S. representatives at the MDBs and the International Monetary Fund (IMF) “to use the voice and vote of the United States to oppose” all concessional assistance to China. China is currently eligible for concessional assistance from the IDA and the IMF’s Enhanced Structural Adjustment Facility (ESAF).

The bill is more stringent than existing law, as it allows no exemptions to its requirement. As noted earlier, Sec. 701 of the International Financial Institutions Act allows the Secretary of the Treasury to waive, for loans that meet basic human needs, the requirement that the U.S. representatives at the MDBs oppose all assistance to countries that violate internationally recognized human rights. Similarly, Sec. 43 of the Bretton Woods Agreements Act allows the Treasury Secretary to waive the requirement that the United States oppose all IMF assistance to “communist dictatorships” if the Secretary certifies to Congress that the IMF loan is in the best interest of a majority of the people in the borrower country and the loan will help stabilize the country’s balance of payments situation and relieve severe constraints in its labor and capital markets.

By itself, U.S. opposition to IMF or MDB assistance to China would not be sufficient to kill a loan. A majority vote of the IMF or MDB executive board is required for passage. The United States has 13.2% of the vote in the ADB, 17.03% of the IBRD, 15.29% of the IDA, and 18.25% of the IMF.

¹⁰ For a fuller list of legislation related to China, see *China: Pending Legislation in 1997*, CRS Report 97-933 (updated continuously).

The House Banking Committee has waived jurisdiction for H.R. 2605. The Rules Committee is likely to report it for consideration by the House in November 1997. A earlier bill (H.R. 2196), with broader sanctions against MDB lending to China, was introduced by Representative Solomon and referred to the House Banking Committee.

S. 1164. This bill requires the U.S. representatives at the multilateral banks and the IMF to vote against virtually all loans to China. Opposition in the form of abstentions would not be sufficient. The United States can vote for loans to China if they meet “basic human needs.” However, the definition of that term is drawn so tightly (only disaster reconstruction and famine relief) that it excludes virtually all aid China is likely to receive from the IMF and multilateral. Paradoxically, though, the language of the bill would seem to allow the United States to support any MDB loans for China that were targeted for disaster relief even if they include only funding for the reconstruction of infrastructure and economic facilities.

The Senate Foreign Relations Committee held hearings on the Abraham bill on September 11, 1997. The future prospects for the bill are unknown. The requirements in a previous version of the bill (S. 810), cutting the U.S. payments to the multilateral banks dollar-for-dollar or proportionally whenever they lent to China, were not included in the current bill.

Perspectives on the Future

The U.S. government has opposed long MDB concessional aid to China on grounds that it can afford to borrow more of its foreign credit on commercial terms and its potential for absorbing the lion’s share of existing MDB resources. Even before the Tiananmen Square crackdown, when U.S. relations with China were less complicated, the U.S. Administration opposed the extension of ADB concessional aid to China when lending began in 1987. Other countries, however, were willing to see China borrow concessional funds from the ADB. However, they eventually acquiesced to the U.S. argument that Asian Development Bank concessional funds were too scarce and that little would be left over for the smaller Asian countries if India and China were eligible to borrow those funds.

In the World Bank, the U.S. Administration has argued for a reduction in IDA lending to China. In part, the U.S. view has been justified on grounds that IDA resources are limited and the poor countries in Africa and the other low-income countries in Asia have fewer alternatives than do China and India. More pointedly, though, the U.S. view has been buttressed with arguments that China’s favorable balance of payments situation, its substantial foreign reserves (\$75 billion in December 1995) and its growing capacity to attract foreign investment and commercial credit obviate China’s need for IDA aid.

In the agreement among the donor countries undergirding the IDA ninth replenishment (signed in 1990), the World Bank’s major member countries agreed that the combined lending to IDA’s two largest borrowers (China and India) should not exceed 30% of IDA resources during the three-year replenishment period. In late 1992, in the IDA tenth replenishment agreement, the IDA donors declined to reduce

these countries combined share of IDA further. They did agree, however, that lending to the “blend” countries (China being arguably the most prominent member of that group) should see their combined access to IDA resources reduced from the 40 percent level approved in 1990 to a lower combined total of 30% to 35%. Given the strong pressure for continued IDA lending to some of the other countries in the “blend” group (Egypt, Pakistan, and India, for example), the IDA 10 agreement seemed to put clear limits on IDA’s ability to provide aid to China.

In the IDA eleventh replenishment agreement, initialed March 19, 1996, in Tokyo, the other donor countries finally agreed that IDA lending to China should stop. China will be eligible to borrow from IDA 11, but the lending framework the World Bank presented to justify the new replenishment indicated it would receive only about 4% of IDA lending during the IDA 11 period. China would graduate from IDA in 1999.

Japan was reportedly one of the countries that most stoutly resisted the effort to reduce and ultimately terminate IDA assistance to China. The Japanese reportedly believe that efforts on their part to facilitate strong economic growth in China and to strengthen their economic relationship with China should be an important aspect of their foreign policy. In recent years, China has been the largest single recipient of Japan’s foreign aid. For example, in 1994-95, China received almost 20% of the net \$10 billion Japan disbursed annually for bilateral development aid.¹¹ China also receives many export credits and other near-market rate official loans from Japan.

The Chinese government has agreed this would be its last replenishment. The question whether China’s borrowing from IDA would taper down to zero or whether it would continue at a constant level throughout the replenishment period was not resolved. The United States is the principal sponsor of the plan to end China’s eligibility for IDA aid. If U.S. influence in the World Bank remains strong, one may expect to see the volume of IDA lending to China decline in the next few years. If U.S. influence wanes and that of Japan grows, the plan to reduce or terminate IDA aid to China may be reconsidered.

Member countries such as the United States can delay by a few weeks the consideration of any loan (including China loans) by the MDB executive boards. However, no country has a veto over World Bank or ADB lending.¹²

¹¹ Development Assistance Committee (DAC), *Development Cooperation, 1996 Report*. Paris: Organization for Economic Cooperation and Development (OECD), 1997, pp. A30 and A76. The United States, by comparison, gave China almost none of the average \$6.45 billion in net bilateral development aid it disbursed during those two years. *Ibid.*, pp. A36 and 82. The Peace Corps, at about \$900,000 annually, is the only foreign aid the United States currently provides to China. Compensation to volunteers comprises most of those funds.

¹² The United States is the largest single member of the World Bank, with a 17% voting share in the IBRD, 15.3% in IDA, and 22.7% in the IFC. In the ADB, it is the second largest member, with a 8% voting share. Japan has a 15.6% share in the ADB. The U.S. share would be equal to Japan’s if the United States purchased all the stock available to it.

Congress is considering legislation in 1997 to formally authorize U.S. participation in IDA 11.¹³ The other IDA donor countries approved their comparable legislation in 1996. Congressional efforts to bar IDA from using U.S.-contributed funds for China have a low chance of success. The World Bank made it clear in the past (as for example the struggle in the late 1970s about IDA aid to Vietnam¹⁴) that it will not accept earmarked contributions that direct or restrict the way it can use those funds. Congress could make the reduction or termination of IDA lending to China a condition for U.S. participation in IDA 11. The other donors might acquiesce if (as stipulated in the new IDA agreement) this merely sought a guarantee that China's eligibility would end with IDA 11. The other IDA donors will likely resist, however, if the United States seeks to end Chinese borrowing from IDA any earlier than now planned.

The effects of a termination of IDA lending to China can only be surmised. On the one hand, if the Chinese government decides to rely more on foreign investment and commercial credit to fund China's development, it may well adopt more market-oriented economic policy and institutional reforms in order to make itself more attractive to lenders. On the other hand, the Chinese government may feel it needs to intervene more in the economy in order to deal with the consequences of increased economic reform. Private capital would probably flow mainly to the fast-growing urban and coastal regions, rather than to the poorer inland provinces. This could magnify existing social and economic strains and inter-regional tensions. One concern is whether the central government will have the authority and capacity to control or mitigate these tensions. Another is whether the exercise of such authority would be compatible with efforts to allow individuals and localities more autonomy and a larger role in the economic and public policy process.

It is unlikely that private capital will fund the kinds of projects IDA has financed in recent years.¹⁵ The question is whether China will be willing to borrow regular IBRD and ADB money to fund these activities. As noted before, IDA has emphasized poverty-alleviation, agricultural development, and other social sector programs. The IBRD and ADB have lent relatively little for these purposes. Many other countries (Indonesia, for example) use MDB market-rate money for these purposes. The Chinese government showed little indication in 1996 that it is prepared to do this also. IBRD lending for social sector, poverty alleviation, and agriculture projects may increase as the volume of IDA lending declines. The descriptions of projects under consideration for China, however, provide only slight support for this conclusion.¹⁶

¹³ See Title III of the Senate-passed version of H.R. 2159, the Foreign Operations Appropriations Act for Fiscal Year 1998.

¹⁴ See: Jonathan E. Sanford, "Restrictions on United States Contributions to the Multilateral Development Banks" in *The George Washington Journal of International Law and Economics*, 15:3 (1981), pp. 561-573.

¹⁵ For additional information, see *Multilateral Development Banks and Capital Flows to Developing Countries*, CRS Report 97-881, September 17, 1997.

¹⁶ The World Bank's *Monthly Operational Summary* dated December 6, 1996 shows 42 projects for China at various stages of preparation. Most will come to the Bank's executive (continued...)

It is doubtful, in any case, whether China will be able to replace the funds it previously borrowed from IDA with increased borrowing from the IBRD. The World Bank's rules stipulate that no country may account for more than 10% of the IBRD's outstanding loans over a period of time. The Bank has made exceptions, as in the case of Indonesia and Mexico, which accounted for 9.96% and 11.07% respectively of the IBRD's outstanding loans at the close of the Bank's fiscal 1997. It makes such exceptions reluctantly, however. At the end of 1997, loans to China comprised 7.5% of the IBRD's outstanding loans.

However, if the World Bank keeps lending to China at its current rate, that country's share of IBRD lending will soon exceed 10% of the total. At the end of the Bank's fiscal 1997, China's share of all IBRD loan commitments — including loans that had been approved but not yet disbursed — totaled 10.65%. The comparable figures for Indonesia and Mexico were 9.75% and 9.7%. In other words, the current pace of IBRD lending to China is pushing up its share of the Bank's total loan balance, whereas the IBRD's slower rates of current lending to Indonesia and Mexico are gradually reducing their share of the IBRD's loan portfolio.

If the IBRD continues lending to China at its current rate, the share of its disbursed loans allocated to China will exceed 10% within two years. The IBRD member countries could raise the loan ceiling for China. However, this step would be controversial and a number of major countries might oppose it.¹⁷ China may not wish to risk its prestige on such an application. In any case, given its current level of exposure in China, the World Bank may have problems justifying a further

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board for approval in the next two years. Of these 18 (accounting for most of the money) are for power or transport infrastructure, with funding from the IBRD. Eight others are for environmental (mainly pollution control) projects, 7 with IBRD funding and one (afforestation with an anti-poverty element) with minority IDA funding. Another 5 will promote enterprise reform (mainly for state firms or finance institutions). Two of these (with no discernable poverty orientation) will be partly funded by IDA. All this seems to replicate the previous pattern. A possible change may be found in the funding for planned projects in the agriculture and social sectors. Of the 4 planned agriculture projects, three have a commercial or market orientation and are scheduled for IBRD funding. The last, a \$150 million poverty and environment project in the Tarim Basin, however, will be funded by the IBRD (60%) and IDA (40%). The prior Tarim Basin project (1992) was financed solely by IDA. Likewise, the IBRD seems slated to play a larger role in funding the 6 planned projects in the social sector. Two health projects will be financed solely by IDA. However, one of the two water and sewerage projects and one of the two education undertakings (for higher education reform) will receive partial IBRD funding, as will the Qinba Mountains poverty reduction project. Even so, total IBRD funding for these social sector projects is not expected to exceed \$150 million. In effect, the share of IBRD lending for social and poverty-oriented projects would grow slightly (to perhaps \$240 million over two years) if all the projects in the MOS are implemented. Total World Bank lending for these kinds of project would fall, however, as the volume of IDA lending diminishes.

¹⁷ *The Economist* concluded that the prospects for an increase in China's loan ceiling are doubtful, saying "Not all rich-country members of the G7 are yet convinced that China's economic reforms are irreversible. They would probably object to a still greater share of the Bank's lending going to China." See: "China: A problem with the Bank." July 13, 1996, pp. 32-33.

increase in its annual volume of IBRD lending to compensate for the coming reduction in IDA aid.

To date, as the previous analysis shows, IDA has financed a major share of the World Bank's social sector and poverty alleviation projects in China. The issue is whether China will be willing to finance these kinds of projects with IBRD money as its access to IDA resources declines.

China may be willing to do this if its access to IBRD credit is not restricted, its foreign trade situation remains positive, and its net income from exports to the United States and other developed countries remains strong. To repay its growing debt to multilateral and commercial lenders, China will need to increase its net income from foreign trade.

China's debt-service ratio — the ratio of its total debt payments (principal and interest) to its total export earnings — was 9.9% in 1996. This is relatively low, considering the fact that the average low-income country had a debt-service ratio of 15.0% and the average middle-income country had a debt-service ratio of 16.8% that year. On the other hand, China's foreign debt burden has been growing quite rapidly. Between 1990 and 1995, the low-income countries increased their aggregate foreign debt by 31.8%, while middle-income countries expanded the size of their foreign debt by 42.9%. During this same period, China raised its total foreign debt from \$55.3 billion to \$118.1 billion, an increase of 113.5%.¹⁸

China's foreign exchange reserves (total reserves minus gold, a standard IMF benchmark) totaled \$127.82 billion in July 1997. This was the largest body of reserves held by any developing country. Some have suggested, on the basis of the size of its reserves, that China can afford to borrow more from commercial lenders and less from multilateral banks. A contrary argument could be made when the size of China's foreign exchange reserves are compared to the size of its foreign trade. In relation to its annual import bill, China's foreign exchange reserves in mid-1997 were comparable to those of India, Bolivia, and Egypt, all of them current IDA borrowers.¹⁹

If China's export situation declines, because of a turndown in the world economy or because of foreign policy-induced restrictions on its trade opportunities, the Chinese government's willingness to borrow market-rate World Bank funds for agriculture and social sector projects may decline. In that case, it seems likely that

¹⁸ World Bank. *Global Development Finance, 1997*, vol. 2, pp. 42, 46, and 152.

¹⁹ China's import bill (c.i.f.) for 1996 totaled \$138.94 billion. In other words, its total reserves were sufficient to finance 92.0% of its annual imports. By comparison, India's total foreign exchange reserves in July 1997 were sufficient to have funded 71.5% of its 1996 imports. The comparable figures for Egypt and Bolivia were 141.0% and 70.9%. India, Egypt, and Bolivia continue to be eligible for assistance from IDA. To be sure, most poor countries have much lower reserve-to-import ratios. Those for Senegal, Pakistan, and Honduras, for example, were 21.9%, 11.5% and 29.4%, respectively. See: International Monetary Fund. *International Financial Statistics*, October 1997, relevant pages for each country cited.

a reduction in IDA lending to China will lead to a diminution in MDB lending for social projects and other programs aimed at the direct alleviation of poverty.