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Statement before the House Financial Services Subcommittee on National Security, Illicit Finance, and International Financial Institutions

"International Financial Institutions in an Era of Great Power Competition."

A Testimony by:

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May 25, 2023

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Chairman Luetkemeyer, Ranking Member Beatty, and distinguished Members of the Committee, thank you for asking me to testify before you today. It is a privilege and an honor. The views represented in this testimony are my own and should not be taken as representing those of my current or former employers.

Currently, I hold an endowed chair at the Center for Strategic and International Studies (CSIS), researching how we might use American soft power and influence around the world. I served in the Bush Administration at USAID and worked for a time at the World Bank Group. I started my career in investment and commercial banking. I have been working and writing on the issue of Multilateral Development Banks for more than 12 years. I recently published a book, "The American Imperative: Reclaiming Global Leadership Through Soft Power" that discusses the role of MDBs in our competition with the Chinese Communist Party and Vladimir Putin's Russia. I am submitting a series of my CSIS reports and other articles for the record. Let me make several key points with my time today.

My main message is this: in this era of great power competition, if we do not meet the hopes and aspirations of developing countries then developing countries will turn to China, Russia, and others. We can't fight something with nothing. Multilateral Development Banks (MDBs) under U.S. and Western leadership are one way that we can respond with "something." Developing countries have options today that they did not have even 15 years ago. As we work toward tackling the challenges we are facing today, the role of the World Bank and the other MDBs must be rethought to answer the question of how the United States can use these institutions to further American interests and values. This testimony offers some recommendations for how the United States can engage with these institutions to our long-term benefit and that of our like-minded allies and partners.

The United States built and strengthened the Multilateral Development Bank system. MDBs provide money, advice, data, and convening power to developing countries and developing country problems. They are little understood or known in the United States, but they spend tens of billions of dollars and have enormous influence. If the United States exerts its influence over these institutions, they are 'force multipliers' of a U.S. led global system. If we disregard our leadership role, then other actors including China can exert influence over them or fill the void that ultimately threaten U.S. national security.

One of the temptations of these institutions is to turn themselves into virtual green finance institutions. This is an error. Environmental projects can be good for development, but those projects should be determined by "country ownership" – the idea endorsed by the United Nations that countries determine their own development priorities. Often, poor countries have other "asks" from the MDBs: infrastructure, social services such as education, and reliable energy including gas, hydro, nuclear, or oil, and even in some rare instances coal as in the case of Kosovo. It is hypocritical that we rely on these forms of energy ourselves but will not help poor countries access these forms of reliable energy through MDB financing. China will finance "all of the above energy" and so should the MDBs.

Before Covid-19, many developing countries were moving up[1] the development ladder and were on their way to being richer, freer, and more self-sufficient. The bottom line is that there is not going to be, nor has there ever been, enough foreign aid money from MDBs or elsewhere to be the main driver of progress. The United Nations and the MDBs recognize that foreign aid is important "catalytic" funding, but private investment and the resources collected through "domestic resource mobilization" – including taxes, government revenue, and local saving – are much bigger, and are what finance the development of societies. Money alone is not a sufficient driver of development; societies crucially need good governance and the domestic rule of law to create the conditions for development. MDBs can provide money for projects, catalyze private capital, and help improve various dimensions of good governance that societies may lack. After 80 years of World Bank-style development aid, the role of the World Bank and the other MDBs must be rethought as we work toward tackling the challenges we are facing today.

What are Multilateral Development Banks and what do they do?

The World Bank was set up with significant U.S. leadership in the aftermath of World War II to help rebuild Europe. The World Bank Group (WBG) consists of lenders of money to national governments and private sector investment and insurance arms. The World Bank is responsive to the "asks" of its borrowing countries as well as serving as the producer of influential research and collector of important data. There are a series of other regional development banks including the Inter-American Development Bank (IDB) set up in the Eisenhower Administration in 1959 in response to concerns that Latin America was going to fall to Communism. The Asian Development Bank (ADB) was an organization also created in the Cold War with significant leadership from Japan and support from the United States. Taiwan has been a member of the ADB since 1966 as an economy (under the name of "China, Taipei"), but is not a member of the World Bank, the International Monetary Fund (IMF), nor the United Nations (UN). The African Development Bank (AfDB) was set up in the post-colonial context of Africa in 1964. The United States. became a member in 1982 when non-African countries were invited to join. The European Bank for Reconstruction and Development (EBRD) was set up in 1991 as a response to the fall of the Soviet Union and has largely centered around the "post-Soviet" world with a focus on private enterprise.

What influence does the United States have over these institutions?

The United States has been instrumental[2] in creating the majority of these institutions and remains the largest, or one of the largest, financial contributing shareholders of every aforementioned MDB. Since the founding of these institutions, the U.S. has used its shareholding power to shape the policies and activities of MDBs in support of American foreign policy, security, and economic interests. MDBs indirectly further U.S. foreign security interests and encourage inclusive growth and stability.

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[1] https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/180307_Runde_CreatingModelIBRD_Web.pdf
[2] https://home.treasury.gov/system/files/206/2022_NAC_Report.pdf

The United States Executive branch and Legislative branch share control[3] and responsibility for the Unites States policy toward Multilateral Development Banks. The central role of Congress can be seen in the periodic capital increases for the banks along with the annual appropriation of funds for soft-money windows at these banks. Currently, the United States has unique 'veto'[4] power over Articles of Agreement. While the United States cannot veto a specific project or the day-to-day[5] activities of the banks, this control works in the interest of U.S. policy. It is in the United States' interest to ensure America's preponderant influence over all these institutions. Our redline should be that we retain enough shares in each of these organizations to ensure a dominant level of influence. This can be done either through maintaining our shareholder position, or by raising the share of voting power required to pass amendments to Articles of Agreement, thus safeguarding our current ability to direct key decisions within these institutions.

What is a 'Capital Increase' and should the MDBs receive a capital increase?

A "capital increase"[6] is when a Multilateral Development Bank increases the amount that it can lend through an increase in the bank's "base capital," thus allowing it to raise its borrowing on the international capital markets. Capital increases are political deals among countries. Congress has a voice and a vote in a capital increase.

The World Bank, the Asian Development Bank, and the African Development Bank do not need capital increases any time soon. If the World Bank comes for a capital increase to rebuild Ukraine, that might be worth a discussion.

The IDB and the EBRD may be different. The IDB received its 9th capital increase in 2010. The EBRD also received its last capital increase in 2010. Currently both institutions are requesting capital increases, and last session Senator Menendez introduced Senate Bill 616[7] (Inter-American Development Bank General Capital Increase Act of 2021) to provide a 10th capital increase to the IDB. There is also a discussion of "just" providing a capital increase to the Inter-American Bank's private sector arm, IDBInvest. As we evaluate the need for a capital increase for the IDB and/or IDBInvest, a discussion to grant Taiwan membership should be broached. Taiwan is losing diplomatic space in other areas, allowing Taiwan to buy shares of the IDB would give Taiwan a seat at the table in the Americas. In any notional capital increase, Taiwan should at least be offered the chance to purchase shares in any IDB/IDBInvest.

In the case of the EBRD, the Congress should only consider a capital increase if the EBRD agrees to use all the additional monies to help finance the reconstruction of Ukraine and other countries directly impacted by Russia's unprovoked invasion of Ukraine for the ten years after receiving its capital increase. Congress should seek iron clad guarantees that the EBRD not use these monies for "mission creep" into Sub-Saharan Africa. The EBRD earlier this month approved an expansion into Sub-Saharan Africa. I worry that once the EBRD gets a capital increase there will be a temptation to spend some of that money on projects other than Ukraine,

[3] https://crsreports.congress.gov/product/pdf/R/R41537
[4] https://crsreports.congress.gov/product/pdf/IF/IF10676
[5] https://crsreports.congress.gov/product/pdf/IF/IF11361
[6] https://sgp.fas.org/crs/misc/R41672.pdf
[7] https://www.congress.gov/bill/117th-congress/senate-bill/616

or the area directly impacted by the war. I have for years argued against expansion into Sub-Saharan Africa because I believe the EBRD should largely focus on the post-Soviet region and especially Ukraine. I think the expansion of the EBRD into Africa is an implicit critique of the unwieldy shareholding structure of the AfDB which too heavily favors the Africa borrowers of the African Development Bank.

If the Administration comes to Congress for a capital increase for the EBRD, an expansion into Sub-Saharan Africa should be slowed (preferably a freeze on new activities in Africa for at least five years) as part of any capital increase. A capital increase with a major focus on Ukraine by the EBRD should also offer Taiwan a chance to buy shares under the "China, Taipei" formula. Taiwan has a stake in Ukraine's victory as a decisive Ukrainian victory will help China think twice about invading Taiwan. Taiwan should be allowed to purchase shares given Taiwan's stake in Ukraine's victory and our need for partners to burden share on Ukraine's reconstruction.

In the recent past, some Secretaries of the Treasury have invested the time to work with Congressional committees on a capital increases, and some previous Secretaries have not. If the Biden Administration supports a capital increase for any of these institutions, I would expect Secretary Yellen to personally invest the time to meet individually with members of Congress to directly ask for support for such an important allocation of additional money.

How should we think about these institutions in the context of the emerging market debt crisis?

Emerging markets debt will complicate global development for the foreseeable future. The MDBs play a number of roles in responding to this debt crisis, including as a convener and data collector, and they have a role to play in terms of debt deals that might be worked out on a country-by-country basis. The World Bank and the MDBs may also provide new money on a net basis, whether through grants or highly concessional loans. The MDBs and the IMF remain the lender of last resort as other lenders, potentially including China, reduce their lending.

Debt crises are not new. For the better part of half a century, developing nations borrowed from a handful of bilateral governments and development banks. However, developing countries have increasingly borrowed from China and an atomized universe of private sector investors over the past two decades. Much of this debt is then traded into the hands of hedge funds creating additional coordination complications should these counties default on their loans. The Covid-19 pandemic, cost of living spikes, and increased interest rates in G7 countries have raised the threat[8] that many developing countries will default on their debt, with the potential of causing political instability around the world.

China is now a big part of the emerging markets debt problem. There is limited knowledge of the terms and amount that China has lent to developing nations, and China has thus far resisted disclosing the terms of its bilateral lending as required by the IMF Articles. In fact, in many of its loan agreements China incorporates prohibitions on the borrower disclosing the terms of lending to the Paris Club, a club of developed countries that lend money to developing countries. The

[8] https://thehill.com/opinion/international/3733009-president-biden-should-raise-developing-country-debt-with-xi/

G20 has attempted to institute several mechanisms to offset this issue, including the "Common Framework for Debt Treatments," which has tried (and failed) to get China and all the lenders on the same page to renegotiate debt. For a number of reasons, China is a very difficult partner in this collective action problem.

What role does China play in the MDBs?

China borrows from the World Bank and the Asian Development Bank. This needs to stop. China hides behind the fiction that it is a developing country to take advantage of developing country privileges including borrowing at lower than commercial interest rates. It is the world's second largest economy. Every dollar the World Bank lends to China is a dollar that could be used for lower income countries or economic reconstruction in war-torn or fragile countries. China can finance its own development.

China has increased[9] its financial contributions over the last decade to MDBs. China holds between 0.004 and 4.78 percent of all the shares of the MDBs. To compare, the United States holds just over 30 percent of the IDB and 17.25 percent of the World Bank. Between 2013 and 2022, Chinese firms were awarded 2.9 percent[10] of total World Bank contracts (the third highest) but almost one third[11] of World Bank contract dollars, a value ten times larger than that awarded to U.S. firms.

Between 2016 and 2018[12], the World Bank lent[13] approximately $6 billion to China. Unfortunately, MDBs have a strong incentive to lend to China because it helps with the "business model" of lending to middle income countries with good credit ratings[14] to cross subsidize lending to poor countries with a bad credit rating. MDBs will also say that lending to China is a way to have a "window" into China. The shareholders led by the United States need to end lending to China.

How does the "Belt and Road" figure in all of this?

China launched the Belt and Road Initiative (BRI) in 2013[15] as a combination of construction and financing projects for roads, airports, ports, and energy across greater Asia. China has now surpassed the World Bank and other MDBs as the world's biggest[16] official creditor. For example, in 2020 China's export credit agency (ECA) financing, approximately $18 billion[17], outpaced that of all G7 ECA financing combined.

[9] https://www.cgdev.org/blog/mapping-chinas-rise-multilateral-system
[10] https://www.gao.gov/products/gao-23-105543
[11] https://www.bloomberg.com/news/articles/2023-05-11/china-got-lion-s-share-of-world-bank-contracts-us-agency-finds#xj4y7vzkg
[12] https://www.npr.org/sections/goatsandsoda/2019/01/31/689960866/flush-with-cash-china-continues-to-borrow-billions-from-world-bank
[13] https://datatopics.worldbank.org/debt/ids/countryanalytical/CHN
[14] https://www.fitchratings.com/research/sovereigns/china-would-support-mdbs-when-it-is-major-shareholder-25-10-2021
[15] https://www.cfr.org/task-force-report/chinas-belt-and-road-implications-for-the-united-states/introduction
[16] https://hbr.org/2020/02/how-much-money-does-the-world-owe-china
[17] https://crsreports.congress.gov/product/pdf/IF/IF10017

Infrastructure is now a strategic issue[18], and China's BRI pledging trillions of dollars on investment has attracted over 130 countries[19] since its inception. Unfortunately for the West, BRI is an ambitious and hopeful project that speaks to the aspirations of China's friends and potential friends. To counter the BRI, the United States needs an alternative positive narrative that says more than "don't work with China." Hoping that BRI fails is not a strategy. We need a higher quality infrastructure and energy alternative to the BRI over the next 20 years, and the MDBs in partnership with private capital should be a part of such a strategy.

What is the role of MDBs as stewards of environmental protection?

Under the Paris Agreement of 2015, each signatory had to file a national Climate Action Plan. If these plans include oil and gas infrastructure, then the MDBs should respect that. The United States should not be telling countries what to put in their Action Plans. Instead, the United States should urge the MDBs to use their analytical rigor on infrastructure to help borrowers to identify climate relevant projects that will pay for themselves, both to repay the Bank loan and to incentivize the private sector to invest as well.

Additionally, MDBs do very little to fund mining and mineral processing and nuclear power. Natural gas accounts for 23 percent[20] of global energy consumption. Developing countries will seek funding elsewhere, including China and Russia, to finance gas and nuclear projects. Since 2015, the World Bank has provided less than $15 billion[21] to directly finance fossil fuels, compared to the $109 billion provided for climate projects.

In 2021, the U.S. Department of Treasury announced their Fossil Fuel Energy Guidance for Multilateral Development Banks[22] in response to President Biden's Executive Order 14008, Tackling the Climate Crisis At Home and Abroad.[23] Outlined in the guidance, MDBs "should only consider investing in fossil fuel production *if* a less carbon-intensive option is not feasible." The Biden Administration has stated that they will strongly oppose[24] projects focused on oil, including processing transport fuels with few exceptions. I disagree with this policy. Congress has a voice on this issue and should use it.

To achieve a carbon transition, we will have to produce 40 times the amount of cobalt and lithium, much of which are found in the developing world. MDBs have little interest in mining and metals production. Minerals are the new oil. China controls as much as 40% of the world's metals processing. I cannot imagine the United States and our allies moving to a dependence on

[18] https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/190423_Hadley%20et%20al_HigherRoads_report_WEB.pdf
[19] https://www.cfr.org/blog/countries-chinas-belt-and-road-initiative-whos-and-whos-out
[20] https://www.bu.edu/gdp/files/2022/06/GEGI_PB_020_EN.pdf
[21] https://www.theguardian.com/business/2022/oct/06/world-bank-has-given-nearly-15bn-to-fossil-fuel-projects-since-paris-deal
[22] https://home.treasury.gov/system/files/136/Fossil-Fuel-Energy-Guidance-for-the-Multilateral-Development-Banks.pdf
[23] https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/27/executive-order-on-tackling-the-climate-crisis-at-home-and-abroad/
[24] https://home.treasury.gov/faq-for-new-fossil-fuel-energy-guidance-for-the-multilateral-development-banks

China for minerals and metals processing. MDBs, at the behest of their shareholders, need to do more in this area.

If the Administration comes to Congress for a capital increase for any of these MDBs, Congress should condition new capital increases on the revision to U.S. policy opposing support for oil and gas projects. Energy will be a critical component[25] to help nations address challenges related to food shortages and agricultural productivity challenges, and investing in energy projects should remain a priority for MDBs. A more balanced approach to energy involving both renewables (including hydroelectricity) and non-renewables (with an emphasis on natural gas) should be adopted.

How should the World Bank and other MDBs approach "Global Public Goods"?

Public goods are those that are available to all and that can be used and enjoyed over and over again by anyone without diminishing the benefits they deliver to others. A light house is an example of a "local public good." Global public goods include data collection or the metric system. The World Bank Group and the MDBs provide several global public goods through the data they collect, the research they conduct, and the solutions they provide through vehicles such as "trust funds." The World Bank Group has established a special fund for climate projects called the Global Environmental Facility (GEF). Since its founding in 1991, the GEF has provided over $22 billion[26] for projects dedicated to confronting climate change. In addition, the World Bank Group provided a data driven global public good, the Doing Business Indicators, for 15 years starting in 2002. Some critics (many of whom are in favor of the World Bank doing more in global public goods) did not like the Doing Business Indicators for what they saw as a "pro private sector" bias and member states were embarrassed by how they ranked compared to other states. The Doing Business Indicators were unfortunately ended because of a scandal related to the manipulation of data[27] for 3 out of 130 plus countries including the People's Republic of China in *the Doing Business 2018* and *Doing Business 2020* reports. If there is an interest in global public goods for the World Bank Group, then those in favor of global public goods might start by calling for the re-establishment of the Doing Business Indicators, including the country rankings by the incoming World Bank President, Mr. Ajay Banga.

The most recent debate on global public goods is not really about data or the GEF. Rather the debate seems to be about whether the World Bank Group should focus on the needs of countries who prefer energy and infrastructure or focus on environmental projects (generally renewable energy projects) related to climate change and deliver projects for health and education ("basic human needs"). I believe the World Bank Group should remain focused on the projects selected by the World Bank's clients.

Recommendations:

[25] https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/191011_RundeandBandura_AfDB.pdf
[26] https://www.thegef.org/who-we-are/organization
[27] https://thedocs.worldbank.org/en/doc/84a922cc9273b7b120d49ad3b9e9d3f9-0090012021/original/DB-Investigation-Findings-and-Report-to-the-Board-of-Executive-Directors-September-15-2021.pdf

First, the United States needs to lead these institutions and use them as a force multiplier of a Western form of development. We can't fight something with nothing. The MDBs are part of our "something."

Second, mobilizing private investment should be a central focus of all these institutions. Foreign aid and public sector lending alone is not what makes development "happen," and these flows are much smaller than flows of private capital. Mobilizing private capital should be a focus around developing quality infrastructure, fostering greater intraregional trade, and developing resilient (and cleaner) energy systems.

Third, the World Bank Group should largely respond to client-driven demands such as infrastructure, energy, and power. There is a coordinated push for what amounts to a "donor driven" environmental agenda that goes against the concepts of "country ownership." If we only finance renewables, China, Russia, and others will finance the other forms of energy that countries actually want and need.

Fourth, the World Bank needs much closer alignment[28] with the regional development banks, especially the African Development Bank (AfDB) and the Asian Development Bank (ADB). The strategies of the World Bank and AfDB, the IDB, and the ADB should be far closer aligned, including for the timing of strategic plans by country. For example, if the World Bank and the AfDB have plans to work in Nigeria, both their five-year plans should begin and end within the same window. In addition, there should be every three years a meeting of the Boards of Governors of for example the African Development Bank and the World Bank and the World Bank and other regional development banks to spur conversation, and collaboration.

Fifth, these institutions need a more credible graduation policy for middle-income countries. Every serious review of the World Bank Group since 2001 has called for this. The IDB has never graduated a borrower country and the EBRD has only formally graduated one.

Sixth, any future capital increases for regional development banks such as the IDB or the EBRD should allow for Taiwan to join as an economy under the formula of "China, Taipei" just as Taiwan is a member of the ADB.

[28] https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/210216_Runde_Capital_Increase.pdf?VersionId=MCBtIQjAIXtTJ7xuT4MMePLCXCyrp.RM