Testimony of

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Chairman Young, Senator Merkley,

Thank you for the opportunity to testify today. My name is Scott Morris and I am a senior fellow and director of the US development policy program at the Center for Global Development, a non-partisan think tank in Washington, DC. I previously served as the Deputy Assistant Secretary for Development Finance and Debt at the US Treasury from 2009 through 2012.

You have raised a critical set of issues and challenges in this hearing, and I will try to do justice to at least some of them. I will focus my remarks on the importance of the International Financial Institutions (IFIs) for US interests, the role that China is playing today in development finance, and the US response to China's emergence as a leading development actor.

The Value of the IFIs

All the IFIs, which includes the IMF as well as the leading multilateral development banks (MDBs)[1], have been key partners for the United States since the creation of the World Bank and IMF over seven decades ago. This is not coincidental. The United States has been the leading architect and remains the largest shareholder or "owner" across the IFIs.

But even if they were of our making, how do they continue to serve our interests? Let me try to answer that question by focusing on the multilateral development banks.

- First, the MDBs amplify US assistance, both by drawing in other countries' money and by their own AAA-rated borrowing on capital markets. In 2017, the United States contributed $1.8 billion to MDB programs (just 5% of the US foreign assistance budget). In doing so, we directly leveraged over $120 billion in MDB on-the-ground

[1] The World Bank, Inter-American Development Bank, Asian Development Bank, African Development Bank, and the European Bank for Reconstruction and Development.

assistance that year. That's three and half times as much as the US spends directly on foreign assistance globally.

- Second, by virtue of their lending model, the MDBs can operate at a scale and across a range of sectors (infrastructure in particular), that the United States alone cannot, given our reliance on grant financing in our bilateral programs. This includes a presence in a wide range of developing countries and settings, including places where we have US troops on the ground. This is why US military leadership past and present has been among the leading advocates for the MDBs.

- Finally, the MDBs have been rated as the most effective development institutions by multiple systematic reviews of aid and development finance. More so than any other financing mechanism, this means that US taxpayers stand a greater chance of getting the results that they pay for and not paying more than they should when it comes to MDB-financed projects. Surveys of developing country officials also reveal a strong preference for working with the MDBs compared to other sources of aid, suggesting that when we pursue our development objectives through these institutions, we stand a good chance of having committed partners on the other side of the transaction.

Continued US leadership in these institutions depends on our willingness to provide financial support, and on this point the Trump administration's record is mixed. Last spring, Treasury Secretary Mnuchin announced US support for a capital increase at the World Bank, a positive move that will enable the bank to continue to operate in a large group of developing countries, the so-called "middle income countries." These World Bank borrowers are not among the poorest but include countries like India and the Philippines where the United States has important ties and interests. I hope this committee will give timely consideration to the capital increase when the administration brings it forward next year.

At the same time, the administration's support for the MDBs when it comes to the poorest countries has not been as strong. The administration has scaled back commitments for the World Bank's low-income country financing arm, the International Development Association (IDA), as well as those of the other MDBs. This has been a mistake. It diminishes US standing and limits the potential to fully engage in poorest countries where they are needed the most.

Looking ahead, given the administration's overall posture on the foreign assistance budget, there's a risk that the US contribution for the World Bank's capital increase will come at the expense of our other multilateral contributions, and particularly IDA. But if there is to be a trade off in the budget to make room for the capital increase, this is not the right one. It will mean that the poorest countries will shoulder the burden of more financing for middle income countries at the World Bank. Surely there must be room in the remaining 95 percent of the foreign assistance budget to absorb this important and modest funding commitment.

China's Borrowing from the World Bank and ADB

Let me turn now to the question of China's relationship with the MDBs, particularly the World Bank and Asian Development Bank (ADB). In both cases, China remains one of the largest borrowers, something that has attracted criticism from the Trump administration and the Obama administration before it. Yet, neither administration has succeeded in halting MDB lending to China by fiat, and I want to encourage a different way of thinking about this issue.

First, we should recognize that much of the value of the IFIs for the United States derives from their multilateral character. It greatly oversimplifies things to suggest they are strictly a US tool, available to do our bidding no matter what the issue. The reality is that when we want to get something done in these multilateral institutions, we need to work with other countries. In turn, these institutions are most effective when they have the buy-in of the largest number of their member countries. And when the United States is seeking something from them that doesn't have broad-based support, it can be a tough road.

China's borrowing from the World Bank and ADB is such a case. I think it's misguided to push too hard on this issue, particularly when there is a better alternative with broader support, one that the Trump administration has already had some success in pursuing. Our objectives here ought to be twofold: to make the most of MDB engagement in China in terms of US interests and to extract the most from China in return.

Making the most of China's borrowing means recognizing the value of some areas of this engagement and ensuring that the MDBs are appropriately focused on these areas. In some forthcoming research, I look in detail at World Bank projects in China. A significant share of the bank's China portfolio is aimed at reducing the country's massive carbon emissions, which is essential if we are to reduce the pace of climate change and its harmful effects, detailed just last week in the government's report on climate change. We know well that the damaging effects from climate change are not contained within national borders, and positive action taken in one country ultimately benefits other countries. From an economist's perspective, this aspect of the MDBs' work in China is a classic global public good and something that ultimately benefits us, even as we sit here 7,000 miles away.

There are other areas of World Bank lending that aren't nearly as compelling, and by my estimates, one-third to nearly half of the bank's lending in China is not appropriately focused. The capital increase agreement negotiated by the US Treasury rightly seeks to reign in these areas of financing by laying out what sorts of activities are appropriate for the bank's relatively wealthier borrowers.

More importantly, the agreement also asks more of China and other relatively wealthier borrowers in the form of higher prices on their World Bank loans. Through higher loan charges, the bank will increase revenues, which eases the financing burden on shareholders, and will also create better incentives for the bank's borrowers. I think there is more scope over time to further differentiate the lending terms for China and other borrowers to a degree that their borrowing can genuinely be viewed as financially profitable for the institution.

Responding to China's Global Financing

Let me turn to what China is doing outside of the multilateral institutions and how the United States is responding. Over the course of a decade, China has become the leading bilateral source of development assistance globally, slightly surpassing the United States. Of course, the two countries look very different in the composition of their assistance. The United States mostly provides grant support in the health and humanitarian sectors, while China mostly provides loans to support infrastructure projects.

In some respects, China's lending is like that of the MDBs in that it is providing development country governments access to capital to invest in roads, bridges, and energy infrastructure, all of which are sorely needed to spur economic growth. But it's also increasingly clear that China's lending lacks important constraints, and the evidence suggests that Chinese development finance is pushing some countries into over-indebtedness with all the problems that come with unsustainable debt burdens.

In research earlier this year at the Center for Global Development, my colleagues and I detailed the debt problems facing China's Belt and Road initiative and pointed to the failures in China's approach that are pushing some countries into debt crises. Within the Belt and Road, this includes countries like Djibouti, which is host to ports and military bases for multiple countries, as well as China's neighbors Pakistan, Mongolia, and Laos.

While I am skeptical about overuse of the term "debt trap diplomacy" to characterize China's lending program, we don't have to have a clear understanding of China's motivations in every instance in order to recognize that policy failures on China's part are contributing to debt problems when they arise. As a result, a key priority for US policy should be to affect a change in behavior by bringing China into the norms and disciplines of other major creditor countries, something we describe in detail in our research paper.

But we can also respond to the problematic aspects of China's lending by offering developing countries better alternatives. That should start with strong support for the MDBs, which are ready made to lend at scale and with high standards.

But we can also do more bilaterally, and one response from the administration, spurred by leadership in this committee, holds promise. The expansion of OPIC's lending authority and other reforms contained in the BUILD Act have the potential to bring more US-led development finance to bear globally, expanding the mix of financing tools on offer in the US assistance portfolio. The new US Development Finance Corporation should better enable the United States to go beyond traditional assistance in the health and humanitarian sectors to provide larger scale financing in infrastructure and other growth-oriented sectors.

As much as I think the BUILD Act is a positive step forward, my optimism comes with some caveats. First, the US DFC should be additional and not a substitute for traditional assistance. US leadership through long-standing programs like PEPFAR is highly valued in developing countries and is doing vital worked measured in lives saved. And as I noted earlier, strong US contributions to multilateral funds like IDA are critical in maintaining our leadership in these institutions. It would be a fundamental mistake to allow the aid budget to be gutted on the heels of the BUILD Act.

When it comes to the new DFC itself, it is important to recognize its essential value, particularly vis-a-vis Chinese finance. Yes, more financing overall is a good thing. But it is in the standards attached to that financing that will distinguish the DFC. The legislation lays important markers on project effectiveness and social and environmental safeguards. But it will take diligence and hard work to make these things a reality and to sustain them over time.

Too often, the experience of other development finance institutions suggests, for example, that time and resource-intensive environmental impact assessments are viewed as red tape in the face of competitive pressures. Positioning the new DFC so prominently as a competitor to China only heightens my concern on this point. I encourage this committee in its oversight to adhere to a strong sense of what ought to distinguish US finance from the worst characteristics of Chinese finance—things like ensuring that local communities are consulted and fully compensated when they are negatively affected by a road project, or ensuring that a negative environmental impact assessment carries enough weight to alter or even halt a potential project.

Finally, I'll close by highlighting the risk of going too far when it comes to using development finance to compete with China. Yes, we should offer developing countries a "clear choice" by distinguishing our approach to assistance from the problematic features of Chinese finance. Here, we can and should do a better job with our developing country partners—both by clearly identifying problems such as non-competitive procurement and by supporting their efforts to be smarter borrowers when China is the creditor.

But there's a difference between offering choices and forcing countries to choose. It would be a costly mistake to seek to carve up the developing world in Cold War fashion between clients of the United States and clients of China. Chinese development finance is a reality, and even with its problematic features, it is undoubtedly delivering something of value to a wide range of developing countries. Where that is the case, we will not convince these countries otherwise.

Where Chinese finance is causing problems, the US objective should be to change Chinese behavior, working with key allies in the G7, India, and Australia, and through multilateral settings like the IMF and World Bank. Chinese officials are showing signs of feeling the pressure of a backlash on the debt issue. Now is the time to exploit that by seeking change: not by drawing battle lines in the developing world that are unlikely to hold, but by pressuring Chinese officials in settings that matter to them, settings like the G20, the IMF, and the World Bank.

Thank you.