S. HRG. 115–621

MULTILATERAL ECONOMIC INSTITUTIONS AND U.S. FOREIGN POLICY

HEARING

BEFORE THE

SUBCOMMITTEE ON MULTILATERAL INTERNATIONAL DEVELOPMENT, MULTILATERAL INSTITUTIONS AND INTERNATIONAL ECONOMIC, ENERGY, AND ENVIRONMENTAL POLICY

OF THE

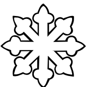
COMMITTEE ON FOREIGN RELATIONS UNITED STATES SENATE

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

NOVEMBER 27, 2018

Printed for the use of the Committee on Foreign Relations



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36–503 PDF WASHINGTON : 2019

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CONTENTS

	Page
Young, Hon. Todd, U.S. Senator from Indiana	1
Merkley, Hon. Jeff, U.S. Senator from Oregon	3
Malpass, Hon. David, Under Secretary, International Affairs, U.S. Department of the Treasury, Washington, DC	4
Prepared statement	52
Responses to additional questions submitted for the record by Senator Menendez	64
De Marcellus, Hon. Roland, acting deputy assistant secretary, International Finance and Development, Bureau of Economic and Business Affairs, U.S. Department of State, Washington, DC	6
Prepared statement	7
Lowery, Hon. Clay, visiting fellow, Center for Global Development, Arlington, VA	21
Prepared statement	22
Hillman, Jennifer, Professor, Georgetown Law Center, Washington, DC	25
Prepared statement	65
SAVING MULTILATERALISM—RENOVATING THE HOUSE OF GLOBAL ECONOMIC GOVERNANCE FOR THE 21ST CENTURY—*by Jennifer Hillman—The German Marshall Fund of the United States*—[included as a supplement to Ms. Hillman's prepared statement]	80
Lee, Thea, president, Economic Policy Institute, Washington, DC	27
Prepared statement	29
Morris, Scott, senior fellow and director, United States Development Policy Initiative, Center for Global Development, Bethesda, MD	32
Prepared statement	33
EXAMINING THE DEBT IMPLICATIONS OF THE BELT AND ROAD INITIATIVE FROM A POLICY PERSPECTIVE—*by John Hurley, Scott Morris, and Gailyn Portelance*—[entered into the hearing record by Senator Young]	143
Responses to additional questions submitted for the record by Senator Robert Menendez	182
EXAMINING WORLD BANK LENDING TO CHINA: GRADUATION OR MODULATION—*Scott Morris and Gailyn Portelance*—[included in the hearing record as part of Scott Morris's response to a question from Senator Menendez]]	183
Segal, Stephanie, senior fellow and deputy director, Simon Chair in Political Economy, Center for Strategic and International Studies, Washington, DC	37
Prepared statement	38

MULTILATERAL ECONOMIC INSTITUTIONS AND U.S. FOREIGN POLICY

TUESDAY, NOVEMBER 27, 2018

U.S. SENATE,
SUBCOMMITTEE ON MULTILATERAL INTERNATIONAL DEVELOPMENT, MULTILATERAL INSTITUTIONS, AND INTERNATIONAL ECONOMIC, ENERGY, AND ENVIRONMENTAL POLICY
COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:39 p.m. in Room SD–419, Dirksen Senate Office Building, Hon. Todd Young, chairman of the subcommittee, presiding.

Present: Senators Young [presiding] and Merkley.

OPENING STATEMENT OF HON. TODD YOUNG, U.S. SENATOR FROM INDIANA

Senator YOUNG. Good afternoon. This hearing of the Senate Foreign Relations Subcommittee on Multilateral International Development, Multilateral Institutions, and International Economic, Energy, and Environmental Policy will come to order.

Once again, I want to thank the ranking member, Senator Merkley. Today's hearing represents our subcommittee's eighth hearing during the 115th Congress. I am grateful for our continued partnership on this and many other issues.

The title for today's hearing is "Multilateral Economic Institutions and U.S. Foreign Policy."

We will divide today's hearing into two separate panels. Our first panel will consist of two administration witnesses: the Honorable David Malpass, Under Secretary for International Affairs at the U.S. Department of Treasury and the Honorable Roland de Marcellus, Acting Deputy Assistant Secretary for International Finance and Development at the U.S. Department of State. I want to welcome both of you.

Our second panel today will consist of five distinguished experts and former officials from previous administrations. I will introduce each of them following this panel.

Now, given this important topic and our excellent witnesses here today, I am, of course, eager to hear from each of you, but before we do, allow me to frame this conversation somewhat.

In July of 1944, delegates from 44 nations met in Bretton Woods, New Hampshire to establish new rules and institutions for the post-World War II international economic system. These nations, led by the United States and informed by lessons regarding the

causes of World War II, sought to create institutions that would catalyze economic growth, reduce poverty, expand trade, and promote financial stability. The primary result of these negotiations were the International Monetary Fund and the International Bank for Reconstruction and Development, which is now part of the World Bank group.

At risk of ruining the surprise, allow me to say the following up front. The U.S. is not and should not be neutral when it comes to the continued success of these institutions. The U.S. helped create these multilateral institutions for good reasons, and Americans have been among the leading beneficiaries.

While the IMF, World Bank, and regional development banks are not perfect and they require reform, on balance, they have promoted and sustained the open rules-based international economic order that has facilitated decades of extraordinary economic growth for both Americans and people around the world. They have helped lift millions out of poverty, doing good, creating international customers for American companies, and promoting peace, stability and prosperity. That is why I believe the U.S. should continue to support these institutions, pushing them to fulfill their important purposes and implement reforms where necessary.

If we fail to lead and remain engaged in these multinational fora, others nations will step forward and replace us, namely China. In a vacuum created by the absence of U.S. leadership, Beijing would twist these organizations to their purposes and state capitalist model. Absent U.S. leadership and engagement, China would expedite the creation of alternatives to the institutions that have done so much good and serve the interests of Americans and millions around the world. Less powerful and prosperous nations would have little choice but to reluctantly bandwagon with Beijing. That would represent a negative outcome for Americans and for pretty much everyone other than the Chinese Communist Party. A coercive international economic order dominated by China would look very different.

Now, to be clear, most developing countries, and particularly those in Asia, do not want to be forced to choose between the United States and China. Many countries have genuine development needs, and they will find one way or another to address those needs. However, developing countries do want choices. The U.S. should ensure developing countries have an alternative to the Chinese model, which often involves poor transparency, unsustainable debt, and the creation of dependence, which is frequently exploited later for China's strategic advantage.

We should use our voice and our votes in these international financial institutions to demand greater transparency from China and to ensure Beijing is not saddling developing countries with unsustainable debt burdens.

Simultaneously, we should lead with our strength, the private sector. We should ensure U.S. federal policies, laws, and institutions, as well as U.S. official development assistance, focus on catalyzing private investment, making clear that the United States want prosperous and independent trading partners, not dependent debtors to extort in order to gain access to a port.

I look forward to discussing with our witnesses how these international financial institutions have benefited Americans, how they are performing and what reforms may be necessary. I am interested in discussing how the U.S. is or should be using our voice and our vote in these international financial institutions to address the lack of transparency from China we have seen in the developing world and some of the resulting debt burdens inflicted on developing countries.

I would also like to hear from our witnesses on the upcoming G20 summit and what key U.S. objectives the administration is or should be pursuing there.

So with those thoughts in mind, I would now like to call on Ranking Member Merkley for his opening remarks. Senator Merkley?

STATEMENT OF HON. JEFF MERKLEY, U.S. SENATOR FROM OREGON

Senator MERKLEY. Thank you very much, Senator Young, in organizing this hearing and for your partnership over the last 2 years. I think this subcommittee has examined a number of important issues and done so with a real policy framework, intentional effort to get to the bottom of the story. And well done.

I expect we will hear from our State and Treasury Department witnesses about the value of U.S. contributions to the IMF and the World Bank, the value that they have in supporting a transparent development agenda that seeks to assist countries expand their economies. These efforts are particularly relevant in a world where so many countries seek financing from China, whose loans come with lax to nonexistent labor and environmental standards and whose repayment terms are clouded in mystery. These are important issues, and I look forward to hearing from our government witnesses the administration's current efforts in this area.

But China's opaque financing does not just affect the developing world. I hope to hear from our second panel about how Beijing's anticompetitive behavior has violated the commitments it made to us and to the world community when we supported its membership in the World Trade Organization, an other multilateral economic institution that affects U.S. foreign policy and workers here at home. Those violations include the theft of intellectual property, weak labor and environmental standards, and forcing U.S. and foreign companies to transfer technology.

The Chinese Government provides subsidized loans, export credits, loan forgiveness and more for state-owned enterprises. These firms use these unfair advantages to shrink market share for U.S. firms who do not receive the same benefits from Washington and are forced to lay off workers.

I want to note that when I was reading the materials for this hearing, it really emphasized the debt trap that China is using as an instrument of foreign policy. And it reminded me of a book I read in college called "The Debt Trap." But this book was about the IMF's policy 45 years ago and about how we had many loans that went to the elite in developing countries, how the elite banked those funds overseas, and how subsequent governments were left in these poor countries to repay the debt, leaving them in an ex-

traordinarily vulnerable situation in terms of policies that would benefit their citizens versus benefit foreign investors.

It has been many, many decades in which the IMF's practices are very different. But now we have China adopting a debt trap model, adopting a model in which they are setting up a system where they can exercise leverage in a fashion that is not beneficial to the development of the welfare of the citizens of many countries. And I think it merits this full investigation, and I certainly appreciate you scheduling this hearing.

Senator YOUNG. Well, again, I want to welcome our witnesses. Know that your full written statements will be included in the record. I thank you for the thoughtfulness of those statements.

I would ask each of you to summarize your written statement, however, within 5 minutes so that we can engage in a more extended question and answer period. So let us go in the order that I announced you. Under Secretary Malpass?

STATEMENT OF HON. DAVID MALPASS, UNDER SECRETARY, INTERNATIONAL AFFAIRS, UNITED STATES DEPARTMENT OF THE TREASURY, WASHINGTON, D.C.

Mr. MALPASS. Thank you very much, Senator Young, and thank you, Senator Merkley. Thanks for holding the hearing.

While there has been substantial economic progress in the United States, growth abroad has softened materially, causing challenges for international economic policy. Our goal is to achieve faster U.S. and global growth in ways that improve after-tax wages for American workers.

I would like to describe some of our major 2018 international policies in order to create the context for our work in the international financial institutions, the IFIs.

We have engaged repeatedly with China on our trade and investment concerns and the problems caused by their One Belt, One Road initiative. It often leaves countries with excessive debt and poor quality projects. If countries default on these debts, China often gains influence over the host governments and may take ownership of the underlying assets. We have built a common awareness of these concerns in the G7 and the G20. In lending, China often fails to adhere to international standards in areas such as anti-corruption, export credits, and finding coordinated and sustainable solutions to payment difficulties, such as those sought in the Paris Club.

In addition to that work on China, we built a common awareness, as I mentioned in the concerns, in the G7 and G20 that is important. Secretary Mnuchin has pushed forward an initiative on debt transparency that will increase public disclosure and broaden the existing definition of international debt beyond traditional bonds and loans. We will be working with the IMF and the World Bank in this initiative. It should reduce the frequency and severity of developing country crises and help push back on China's overlending.

With Congress' support, we have also enhanced America's national security through FIRRMA, which has strengthened and modernized the Committee on Foreign Investment in the United States, CFIUS. CFIUS launched an innovative pilot program on November

10th, which includes requiring declarations for certain foreign investments in U.S. businesses involved in critical technologies in 27 specific industries.

We have worked multilaterally to forge a new currency consensus in the G20 to recognize the growth and investment benefits of currency stability. The U.S.-Mexico-Canada agreement, to be signed later this week, includes the first currency chapter in a trade agreement. We also reached an understanding with South Korea on currency stability and transparency at the time of the update of KORUS.

Argentina's new IMF program includes a nominal monetary anchor and an important commitment to leaving currency intervention unsterilized. Those policies quickly stopped Argentina's mid-2018 currency crisis, and they are dramatically reducing the rate of inflation. By expressly limiting the growth of the monetary base, a policy that the United States strongly supported, the central bank was able to arrest the precipitous decline in the exchange rate.

Treasury also this year launched the America Crece initiative to promote growth in the western hemisphere. In 2018, we signed energy framework agreements with Panama and Chile. We expect to sign one with Jamaica tomorrow and hope to conclude one with Argentina in the near future.

We have refocused the Financial Stability Board on its systemic risk mandate, including the adoption of an activities-based approach on insurance activities and wind-down of work streams unrelated to stability issues and the evaluation of the effectiveness of existing policies before developing new policies. I served on the nominations committee for FSB leadership and was pleased with yesterday's announcement of Fed Vice Chairman Randy Quarles as the FSB's next chairman, the first American to serve in that role.

Looking into 2019, we will continue our work on debt transparency, the implementation of FIRRMA, the energy initiatives, and China's unfair trade practices and lack of reciprocity and market access. We maintain active economic dialogues with other countries to assess systemic vulnerabilities and to support democratic principles and institutions.

In Latin America notably in the western hemisphere, we have emphasized the risks and challenges posed by "The Troika of Tyranny," namely Venezuela, Cuba, and Nicaragua.

As Brexit approaches, Treasury is analyzing risks to the international financial system. We are working toward improved trade arrangements with the EU. The administration has notified Congress on October 16th of its intent to start trade negotiations with the UK, once it leaves the EU in March of 2019. And we continue to work to streamline the G20.

I am going to stop at this point and leave discussion of the IFIs to my State Department colleague, Secretary de Marcellus. Thank you.

[Mr. Malpass's prepared statement is located at the end of this transcript.]

Senator YOUNG. Thank you, Secretary Malpass.

Secretary de Marcellus?

STATEMENT OF HON. ROLAND DE MARCELLUS, ACTING DEPUTY ASSISTANT SECRETARY, INTERNATIONAL FINANCE AND DEVELOPMENT, BUREAU OF ECONOMIC AND BUSINESS AFFAIRS, UNITED STATES DEPARTMENT OF STATE, WASHINGTON, D.C.

Mr. DE MARCELLUS. Thank you very much. Chairman Young, Ranking Member Merkley, thank you so much for holding these hearings. It is certainly an honor to be here today and a particular honor to testify with Under Secretary Malpass.

Senator, as you noted in your opening statement, the United States was the leading force in establishing the World Bank and IMF. And though Treasury has the lead for the oversight of the IFIs, international financial institutions, the State Department has been working closely with Treasury from the very beginning to be sure that these institutions advance our interests. We created them and we remain in the IFIs to advance our national security interests, our foreign policy interests, and our economic interests, as well as promoting the wellbeing of people globally.

The question is sometimes asked, which is better? Multilateral assistance or bilateral assistance? To me it is like asking, when you build a house, which tool is better, the nail gun or the power drill? It really depends on the task at hand at that very moment. Now, we might use the nail gun or bilateral assistance more often, but we do not want be at the job site without the power drill.

Now, that said, the tools can always be improved and reformed. And Under Secretary Malpass' written statement goes into excellent detail on the reforms that we are looking for across the IFIs, and we are very supportive of those.

One advantage that the IFIs offer is the leveraging of resources since their resources so exceed our own because of the other donors, as well as the access to capital markets.

In addition, we can leverage the skills of the very talented staff at IFIs, provide advice to developing countries around the world on issues like procurement, fiscal policy, anti-corruption, or debt sustainability and many other issues.

I would like to just focus on three areas where the IFIs advance our interests. One, by providing stability in strategically important areas such as the Middle East. Two, by advancing our economic interests. And three, by offering a best practice alternative to the Chinese lending model.

In terms of the Middle East, when our vital ally, Jordan, was threatened with massive refugee flows from Syria, it threatened to destabilize the country. So we turned to the World Bank to help. The World Bank set up the Global Concessional Financing Facility, or GCFF, to help pool funds to assist countries facing refugee flows, initially Jordan. The United States put in, so far, $35 million to this fund. We were a founding donor. Other countries then followed our lead and put in, so far, another $244 million as of the middle of this year.

Now, what happened is the World Bank and the European Bank for Reconstruction and Development then extended loans—they were low interest, thanks to these contributions—to help the Syrian refugees and their Jordanian host communities with clean water, education, health, job opportunities.

So in sum, $35 million from us went to about $1.5 billion in low interest support for a key regional ally, Jordan.

Now, going to our economic interests, as you noted and the Under Secretary noted, the IMF and the banks have been working to advance prosperity around the world. So this creates better conditions for expanding the U.S. and global economy, thus giving us larger markets for export and support for American jobs. America's fastest growing export markets, now representing 40 percent of our exports, are in developing countries.

The IFIs also help by promoting in these countries a transparent business climate and helping to raise global procurement standards, fight corruption, and unleash private investment. This helps our companies compete better.

Third and lastly, the IFIs promote and provide transparent financing terms, offering, as you noted, borrowers a better alternative for their people to the opaque terms and financing offered by China in their lending practices. This has already led to unsustainable debt levels in several cases. The IMF is working alongside the World Bank, as the Under Secretary has noted, to bring transparency to countries external debts, helping to shed light on these and to counter these predatory lending practices.

But in addition, as Senator Merkley noted, development banks employ policies aligned with American laws and American values to safeguard the environment and people. Unlike lenders with little to no regard for these standards, the banks require borrowing governments to address environmental and social impacts associated with the projects. These requirements support sustainable development and lasting results.

So in closing, I would like to reemphasize the State Department's commitment to working with Treasury to ensure that the IFIs advance our national security, our foreign policy, and our economic interests globally. Over 7 decades, this has benefited exporters and taxpayers, promoting American prosperity and security.

We also appreciate Congress' interest, your engagement, and continued support on these issues.

So thank you again for holding this hearing, and I look forward to your questions. Thank you.

[Mr. de Marcellus's prepared statement follows:]

PREPARED STATEMENT OF HON. ROLAND DE MARCELLUS

Chairman Young, Ranking Member Merkley, and Members of the Subcommittee, it is my honor to appear before you today to discuss the important role that the International Financial Institutions (IFIs) play in advancing our national security, foreign policy, and economic interests globally. IFIs include the International Monetary Fund (IMF) and the Multilateral Development Banks (MDBs), which include the World Bank, Inter-American Development Bank, the European Bank for Reconstruction and Development, the African Development Bank, and the Asian Development Bank.

Enhancing U.S. Leadership

The United States was the leading force in establishing the World Bank and International Monetary Fund (IMF) in 1944. The Department of the Treasury has the lead for oversight of the IFIs, but the Department of State has been working closely with Treasury from the very beginning to advance our interests. Our objective was then and is now to strengthen the international economy for the benefit of the American people and U.S. interests globally.

I would like to describe briefly how these institutions work at the most general level. First, they pool contributions from countries around the world. The staff of the institution then works with recipient countries to develop projects and programs for the benefit of the recipients' economic development in the case of the Multilateral Development Banks, or financial stability in the case of the IMF. Those projects and programs then come to the board of the institution for a vote of approval. The United States has the largest vote at nearly all of the IFIs and considerable influence. The Treasury Department gives directions to our representatives at the institutions on how to vote in each case. They do so, however, in close coordination with other agencies, particularly the State Department.

Getting Bang for the Buck

We created the IFIs, and remain engaged in them, to advance our national security, foreign policy, and economic objectives as well as to promote the wellbeing of people throughout the world. The question is sometimes asked, which is better—bilateral assistance or multilateral assistance? It is like asking which tool is better for building a house—a nail gun or a power drill? It depends on the particular task at hand. In building the house, we might use the nail gun (or bilateral assistance) more often, but we certainly want the power drill at the job site as well.

As I alluded to earlier, the resources of the IFIs far exceed our own contributions because these institutions draw heavily from other donors and leverage resources from the international capital markets. For example, in the World Bank's nonconcessional lending arm, the International Bank for Reconstruction and Development (IBRD), every dollar invested from the United States is combined with about five additional dollars from other countries. These combined six dollars allow World Bank/IBRD to raise additional financing on international capital markets, amounting to up to 30 dollars it can then lend for development assistance. These loans are repaid to the IBRD—with interest—by the borrowing governments, which finances future IBRD loans. Our contributions, multiplied by the others, contribute to global economic growth and stability that directly benefit American workers and exporters. In addition, we are able to leverage the highly skilled staff at the IFIs, who provide expert advice to developing countries on issues ranging from anti-corruption and proper procurement practices to fiscal policy and debt sustainability, and countless other issues.

Enhancing American National Security

The IFIs can also advance our national security. Outward migration and destabilizing threats have frequently come from the world's fragile and conflict-affected countries. Support to these vulnerable countries is a key priority of the IFIs. For example, the World Bank administers multi-donor trust funds and convenes top financial and policy experts to develop strategies to promote growth and development in countries such as Afghanistan, Liberia, and South Sudan. These engagements decrease the cost of U.S. support and help to meet our policy objectives.

Another excellent example is Jordan, which has been deeply affected by the crisis in neighboring Syria. President Trump stated in his remarks on September 25 to the U.N. General Assembly: "As we see in Jordan, the most compassionate policy is to place refugees as close to their homes as possible to ease their eventual return to be part of the rebuilding process. This approach also stretches finite resources to help far more people, increasing the impact of every dollar spent."

It is in that spirit that we had worked with the World Bank to create the Global Concessional Financing Facility (GCFF), an innovative financing mechanism created to help countries—initially Jordan—cope with refugee crises. This is a perfect example of the leveraging that stretches our contributions further. The United States was a founding donor to the GCFF and has contributed a total of $35 million. Other countries quickly followed our lead and by mid-2018 had provided a total of approximately $244 million more. Those contributions combined with loans from the World Bank and the European Bank for Reconstruction and Development resulted in $1.45 billion of low-interest loans to Jordan explicitly to support the refugees and assist the Jordanian host communities. In sum, our $35 million contribution resulted in almost $1.5 billion provided to help Jordan support hundreds of thousands of Syrian refugees.

The IMF is another key partner in U.S. efforts to support macroeconomic stability and advance economic reforms in strategically important countries such as Ukraine, Iraq, and Egypt. The IMF's work has complemented and supported many of our foreign policy objectives. With its powerful voice on economic and financial governance issues globally, the IMF has provided impetus for governments to undertake necessary economic reforms aimed at boosting growth of real median incomes. A good current example is Argentina, where, with IMF support, the Macri Government is

making important economic reforms to put itself on sustainable financial footing. This will help the Argentine Government continue on a path towards sound economic management and restore growth, important for global economic stability.

Expanding Markets for U.S. Exports

Promoting prosperity around the world helps create better conditions for expanding the U.S. and global economy, creating and increasing markets for U.S. exporters and supporting American jobs. America's fastest growing export markets—now representing roughly 40 percent of U.S. exports—are developing countries. The IFIs help these countries to unleash their economic potential, which has helped to lift tens of millions of their citizens out of poverty. As their prosperity has increased, so has their purchasing power, expanding the number of reliable consumers around the world for U.S. products and services.

Improving Business Climate and Standards

The IFIs also help U.S. exporters by promoting a transparent business climate and helping to raise global procurement standards, combat corruption, and unleash private investment. For example, the World Bank's annual Doing Business report incentivizes countries to undertake reforms to make it easier to open and operate a business. This enables U.S. companies to better compete in the developing world. Thanks in part to U.S. leadership, the IFIs engage with developing countries to strengthen governance and legal frameworks, including respect for the rule of law and property rights. As another example, the World Bank has helped countries around the world establish functional and accountable customs procedures, providing U.S. exporters with faster, more predictable clearance of goods.

Specifically, the Multilateral Development Banks champion transparent and fair global standards for financing and procurement, with open, transparent bidding and terms. Public procurement accounts for 10 to 15 percent of the world economy. By improving procurement standards in developing economies, the MDBs help level the playing field for U.S. business to compete for public contracts globally. The Department of State has worked to expand opportunities for U.S. companies to participate in MDB projects. One initiative to increase such opportunities is the BIDS platform (which stands for Business Information Database System). BIDS (bids.state.gov) aggregates MDB project opportunities and helps link U.S. companies to relevant U.S. Government economic officers at overseas posts who can help them navigate the local market.

The transparent financing terms practiced by the MDBs offer governments a better alternative for their people than the opaque terms and financing proffered by some countries in bilateral lending that have helped lead to unsustainable sovereign debt in several cases. At the same time, our engagement at the IMF gives us the ability to press for stringent policy requirements for countries to qualify for IMF programs. For example, the IMF works alongside the World Bank to bring transparency to countries' external debts, helping to shed light on and counter predatory lending practices by other countries.

Protecting People and the Environment

The MDBs employ policies aligned with American laws and values to safeguard people and the environment. Unlike those willing to provide financing to governments with little to no regard for these standards, the MDBs require the borrowing governments to address environmental and social risks in order to receive support for investment projects. Examples of these requirements include conducting environmental and social impact assessments, consulting with affected communities about potential project impacts, and restoring the livelihoods of displaced people. These requirements not only support sustainable development, they provide additional opportunities for U.S. companies, which lead the world in practices that account for environmental and social impact.

Confronting Global Health Threats

The IFIs support U.S. global health security interests by helping address pandemic risks and diseases before they migrate to or affect the United States. For example, in response to the 20142015 Ebola outbreak in West Africa, the World Bank provided quick-disbursing funding for a rapid response to the disease outbreak. Helping control Ebola saves us money at home. The National Institutes of Health has estimated the cost of caring for Ebola at as much as $50,000 per patient per day. Treating just two Ebola cases in Nebraska in 2014 cost $1.16 million. MDBs also help to prevent disease outbreaks from becoming a pandemic by helping countries to strengthen their health systems, which also boosts the impact of our bilateral health assistance.

In closing, I would like to reiterate that the Department of State is committed to working with the Department of Treasury to ensure that the International Financial Institutions advance our national security, foreign policy, and economic interests globally. Our contributions to the IFIs leverage other countries' resources to deliver global economic growth and development. Over seven decades, this has directly benefitted U.S. exporters, workers, and taxpayers, promoting American prosperity and strength.

Senator YOUNG. Well, thank you both for that helpful summary. In fact, you have preempted some of my sort of foundational questions.

But I would like to begin with a bit of history here, as you did, Secretary de Marcellus, indicating in your prepared testimony that the World Bank and IMF were created through U.S. leadership in large measure back in 1944. And the United States was compelled because of that unique moment in history in which it found itself as we were nearing the end of a World War. We had suffered through a Great Depression.

Do the lessons or dangers that were felt in 1944 still have some relevance to today as we think about the appropriate role that the IMF and World Bank are playing? Are they serving different needs than were felt back in—you know, 60 years ago, 70 years ago?

Mr. DE MARCELLUS. Thank you very much. I would invite Secretary Malpass to amplify on this because he certainly has very good insights on this question.

I would say many of the issues remain the same at the macro level of building economic prosperity, to advance the global economy, and American interests.

However, the world has changed. And the focus at the time of creation was really on reconstructing Europe and our allies in Western Europe. Now it is really more on poor developing countries who need more work on governance and more foundational help, for instance, on health systems, the work that the World Bank does to prevent pandemic health threats from hitting U.S. shores in the country. It would not have applied so much in 1944 but is now part of their work.

And then, of course, we have something new in that China is an emerging donor but a large one, which is a new development we have not seen, at the same time and as has been noted, it is a significant factor in the international system. Therefore, the IMF, World Bank, and other development banks have a new role, as has been noted, to provide an alternative but also in helping countries, borrowers, understand what is really an offer from China, helping them understand and analyze the terms.

So there are many new ways and countless other ways that the development banks and IMF have adjusted to time over the 7 decades.

Senator YOUNG. Secretary Malpass, so in addition to stability with the example of the Middle East, more specifically the Jordan example, very powerful, global prosperity—40 percent of our export markets, as Secretary de Marcellus indicated, are located in developing countries. And then lastly, an alternative to the opaque Chinese model.

Are there other rationales for these institutions that we should be thinking about?

Mr. MALPASS. In the World Bank, we have advocated a shift, a graduation of countries from being borrowers to not borrowing, and that way leaving more resources for poorer countries.

So one of the things going on now is the conflict state problem or the fragile state problem where both the IMF and the multilateral development banks have some expertise in helping those situations. So one of the goals is to get the focus of the organizations toward those needier countries or weaker governments.

Senator YOUNG. Very good.

Secretary Malpass, how do you believe the IMF and World Bank are doing in fulfilling their missions? You have itemized a whole lot of reforms that the administration is already well on its way, fairly deeply involved in at the executive level. Maybe you could identify the leading couple of reforms that you believe need to occur, how the United States should be using its voice and its vote to advance those reforms, and then if you have an opportunity to reflect on how Congress might provide additional authorities or assistance on any of these fronts, please volunteer that to us.

Mr. MALPASS. Thank you, Senator. I will make three areas of comment.

One is how different the world financial environment is today from when the institutions were founded. So there's much more availability of private capital often, and countries have been able to build local currency financing structures, which simply did not exist really prior to 1990. And so that is a sea change, a seismic shift in the way the institutions operate.

So the reforms that we have encouraged in them are this graduation concept, so to stop lending to countries that do not really need the money, to have differential pricing in the loans so that better-off countries pay more in interest for the loans that they are doing, to have an increased focus on the quality of the loans and the transparency of those loans.

And then I would also say in the World Bank, a capital increase that has recently been agreed on by the member countries. There was a substantial focus on creating a sustainable lending concept. So that means that the World Bank would not suddenly lend a lot at the beginning of a capital cycle and then need more money as it goes along. So the hope is that this will create a sustainable platform where they will not have to keep having capital increases.

So from the standpoint then of the IMF, I will mention three reforms that we have been working on there.

One is with regard to fiscal policy, making it more growth oriented. In some decades, the tendency was to think of it as a repayment mechanism from countries that had gotten over-indebted. And so one of the shifts we are looking for is to have it be more integrally involved in creating a higher median income for the country that it is working in.

A second is the type of privatizations being done. Sometimes in the past there would be a tendency and emphasis on selling assets from the government for the highest price rather than thinking of it as the greatest benefit to the nation's growth. And you can often get more benefit by stopping a monopoly rather than selling a monopoly for the highest price to the high bidder.

And the third that I will mention is we are no longer on the gold standard. That was one of the formative purposes of the IMF. And so in that regard, IMF is still, under article 1, seeking stability of exchange rates rather than competitive devaluation. So I mentioned in my opening remarks that thrust of administration policy.

So as far as what Congress can do in this, I think holding this hearing is very good, and then being engaged in thinking about these policies. This is truly a seismic shift in global finance toward a global situation where capital is available where countries are implementing good policies. And so in that regard, Congress can both be aware, be knowledgeable, and be engaged in encouraging that effort. My goal—one of my goals—is to see quite a few more countries—let us say five or 10 more countries—growing really fast as we go into 2019 and 2020.

Senator YOUNG. Well, thank you, that is helpful.

This Senator, I know Senator Merkley, intends to stay engaged on these issues. And if there are some concrete things we can do to be of assistance to help you as you walk your way through these reforms, please let us know.

Mr. MALPASS. Senator, I am sorry. If I may interrupt. One thing I forgot to mention. You know, we are bound by a great number of mandates from Congress, legislative mandates. There are nearly 100. And while we share many of the goals of many of the mandates, the cost of managing those is actually substantial. We bear a lot at Treasury. The State Department bears a substantial cost to managing those mandates, which tend not to expire. So these may be things that made sense 20 years ago that do not need to be on the books now. So taking a look at that would help us a lot.

Senator YOUNG. Well, we will require your expertise and assistance and that of your team. But I would request that you identify those 100, 100-plus mandates, indicate how precisely they impede your ability to advance reforms and open markets, enhance stability, and present an alternative to China in the case of the World Bank. And let us know how we can be helpful.

Mr. MALPASS. Thank you.

Senator YOUNG. We would like to take a look at that and work together on a bipartisan basis.

But before I turn it over to Senator Merkley—and I will give you due time to ask all that is on your mind, Jeff—I just would like for my own benefit and for all of those who are watching—Secretary de Marcellus, you mentioned leveraging $35 million in the case of Jordan, 35 million U.S. dollars, as I understood it, into $1.5 billion through use of IFIs. Can you walk me through exactly how that works?

Mr. DE MARCELLUS. Thank you, Senator. I would be very happy to.

So Jordan, since it is a higher income country, does not qualify for low interest loans from the World Bank. Therefore, when they took on all of these refugees, we and they did not think it was fair for them to take market-based loans for people from another country. And it would be hard for them to sell to the Jordanian people that they were going to take market-based loans. They really needed lower interest loans.

So what we did was set up this fund where donors—so our $35 million plus the $244 million from others. We go and basically buy down the interest rate on these loans, turning what would be a normal loan for the World Bank into a discount, very low interest loan, which is more appropriate to the need and in recognition of Jordan's contributions to managing this horrible humanitarian situation.

So what it does is basically by paying off the interest, you are able to leverage much larger amounts. That is how you get from $35 million up to almost $300 million in total donors. Then you take the entire loan amount down to this rate. That is how you get to $1.5 billion.

Senator YOUNG. Thank you much.

Senator Merkley?

Senator MERKLEY. Thank you both very much.

So I wanted to start with a letter that a group of Senators sent on August 16th that asked this question about whether IMF funds are essentially being used to repay Chinese debt. And to give you an example of this, Pakistan is a good example of a country that has a significant amount of Chinese investment. I think the number I have is $62 billion. They owe a lot of money back to China, Chinese banks, and they are seeking an IMF bailout. I think it is a $12 billion bailout. And they have asked the U.S. to make sure that we do not block this.

Is that IMF money essentially going to help Pakistan repay Chinese banks? Why is that a good economic development strategy?

Mr. MALPASS. Senator, I do not think that would be a good development strategy. And so the IMF team just came back from Pakistan. I had people in Pakistan 2 weeks ago. One of the things we are pushing hard for is full transparency of the debt. You mentioned Chinese debt. But one of the challenges is they have not disclosed the terms of—in many cases, they have not disclosed the terms of that debt. That means the interest rate, the maturity, and when it would have to be repaid.

In general terms, we think that the maturity of the Chinese debt comes after the IMF would have been repaid. So from the standpoint of IMF money being used to pay Chinese money, I would say a challenge is to find a program that will cause substantial economic reform in Pakistan and that will allow it to be funded, that Pakistan be funded and have an ability to survive in financial terms going forward.

And I will take this moment to say with China in general, this problem is not unique to Pakistan. China is lending in many countries where the terms of the loans are simply not given, and that gives China a lot of leverage within its program. And it is something that we are pushing back on very hard in the Paris Club, in the OECD, in the IMF, the World Bank, at the G20 and in the G7.

Senator MERKLEY. So when you say that terms are not given, do you mean not given to the borrower or not given to the international community?

Mr. MALPASS. In some cases, both. So they are not made public. They are not available to the international community, but sometimes they are not even available to certain parts inside the government itself. And that is an issue because China may make a

loan, but not really want the terms of the loan to be disclosed even within the government that it is lending to.

Senator MERKLEY. So Senator Young and I both referred to this Chinese debt trap strategy, and I am just going to restate it simply and see if you all concur that this is their strategy or if we are perhaps mischaracterizing the situation.

But China often lends to developing countries that may have an interest in a particular—building a port, building a highway, building a prestige project of some sort that involves a significant amount of debt. They often use their own workers, that is, Chinese workers, to build the project. It is often very opaque in terms of the terms. It often involves a—these are not gifts, but these are Chinese loans. So, therefore, repayment is necessary. The government is often reluctant to disclose the terms without transparency. So perhaps the country is getting a very poor deal. And the result is now China has significant leverage to apply for other national interests that China has.

Is that a fair characterization of the Chinese debt trap model?

Mr. MALPASS. I share many of those concerns. Yes, sir.

So I will give you an example where China then does not work with the international community on some of these. There is a group called the International Working Group on Export Credits where there is an effort to have disclosure of the export credits that are going to countries, such as countries in Africa or to Pakistan. China simply has stood aside from that group. They attend meetings but then do not engage to describe which of their institutions are making those loans.

And a second is the Paris Club itself where China is now—for many countries in the world, China is the biggest creditor. And yet, it does not participate in the Paris Club, which is an organization of creditor countries that tries to have rationality within the restructuring process when a country basically cannot repay.

So I am describing constructive ways that China could be better involved and yet simply it has chosen not to be.

Senator MERKLEY. Please go ahead, yes.

Mr. DE MARCELLUS. If I could add to that. One of the most prominent examples of what you have described is in Sri Lanka, the Hambantota Port, where, after Sri Lanka could not pay the debts, China converted the port to their own ownership for a 99-year lease, as well as 15,000 acres of land.

But when that happened, that was noticed around the world. We hear about it all over the world. As you have seen, that became a campaign issue in many elections around the world where opposition groups are criticizing the volume of Chinese lending and the terms and all of the other drawbacks that you already elaborated.

So Malaysia, we saw Prime Minister Mahathir canceling billions of dollars of Chinese projects.

The Maldives, a new government ran against basically Chinese lending, and won. And they are now opening up the Chinese books. In fact, it was in the press this morning that they discovered that some of the Chinese projects ran massively up in cost overruns, like tripled the market price for a hospital.

In Africa, Sierra Leone, a new government criticized Chinese lending and then canceled an airport project—it was $300 million—on the rational basis that the existing airport was not fully utilized.

And Burma scaled back a port from $7.3 billion to $1.3 billion.

So we see this happening more and more. I think countries are beginning to notice the down side and they are getting more savvy. I do not want to overstate it that these governments will not go back to China for more loans, but we think they are getting more sophisticated when they do it.

But then going to your earlier statement where you held up the book, "The Debt Trap," when the IMF and the West over-lent in many cases and built up debt burdens in the developing world, we dealt with it. We owned up to it. We did debt forgiveness. So by the same token, if China makes the same types of mistakes we might have made 45 years ago, we would look to them to do some sort of forgiveness for these countries so they are not saddled with debt forever crippling them. So I think that is something that the entire world would like to see.

But thank you for raising that issue. It is certainly one of intense interest.

Senator MERKLEY. One of the reasons it was such a problem was corruption. So there would be an IMF loan to a government where the elite would essentially funnel off massive amounts of the loan, and the remaining amount of the money and its development project could not possibly generate enough economic development to pay the loan back. So it was a bad investment.

And then the terms of the IMF agreement were essentially that to pay back the loan, you had to engage in austerity. So you had an elite that now had been super enriched by this deal because of the corruption, and you had a population that was now suffering the austerity necessary to try to find some path to pay it back, which was not a good deal for the people of a country. And as you say, we wrestled with it. We have transparency around it. We had an academic debate. We had an institutional debate.

I am not sure that those mechanisms—in fact, I am quite sure those mechanisms are not present in the Chinese consideration of the impact of their debt trap. It seems to me this is a case where it is a deliberate strategy to create leverage rather than a strategy gone awry, if you will, which if it is a deliberate strategy, you do not necessarily have any plan or desire to remedy it.

As you point out, in Sri Lanka, for 99 years they have a massive port owned. I know I have heard from the national security side. Our concern is it might also become a military base outpost for China.

So I am wondering, as we push to kind of draw attention to this strategy, are there other things that we should consider doing? For example, should we push for a policy in the IMF and World Bank that no loan, no grant project will go to any country that does not have complete transparency for its international borrowing?

Mr. MALPASS. Senator, those are very good points.

So within the transparency initiative that I mentioned in my remarks, we are working in the IMF and the World Bank to encourage them to include terms in loans, so when they do make a loan to a country, say that the country is expected to make transparent

all of the lending that it gets. Otherwise, you would be the lender into a situation where someone else has better terms than you do.

And then within that framework, we are also trying to make sure that we are talking about debt in a broadly construed context because one of the things that happens, financial markets are very innovative. So as soon as you find one loophole that you are closing, then there is an ability to find another. And one of the things going on is the promise of collateral or of payments in kind in future years. So China will make a loan to a country in dollars or in real currency today and then commit that country, get someone in the country to commit to ship them oil for the next 15 years. Well, that takes money from the people of the country and puts it in the pockets of the elite in the near term.

So Secretary Mnuchin's initiative on that, which we discuss in the G20, the G7, and have made substantial progress on, is exactly in line with that. And I think Congress can be insistent—as countries kind of look for alternatives, they often come to Congress and say, can you not finance this, we are in trouble—saying, look, at a minimum there has got to be full transparency of whatever debt you are taking on.

Senator MERKLEY. Thank you.

Senator YOUNG. Mr. de Marcellus, in your prepared statement, you wrote about the transparent financing terms practiced by multilateral development banks. And you contrasted that with the opaque terms that some of the bilateral lending, particularly with China, we see around the world. And you indicated that has, in turn, led to sovereign debt, which creates global financial fragility and instability.

You have also referred to predatory lending practices by some countries, particularly China. You discussed actions in Sri Lanka in particular. Malaysia is another country.

The Vice President of the United States just recently said infrastructure loans to governments across the Indo-Pacific too often come with strings attached and lead to staggering debt.

IMF Managing Director Lagarde, with whom I met this morning, has also expressed concern regarding a problematic increase in debt, potentially limiting other spending as debt service rises and creating balance of payment challenges.

Mr. Under Secretary, how is the U.S. specifically using its voice, its votes, and leverage in international financial institutions to encourage more transparency from China in its projects in the developing world, as well as an end to the imposition of unsustainable debt arrangements on developing countries? And, Mr. Malpass, if you prefer to chime in, please feel at liberty.

Mr. DE MARCELLUS. I will start and he can amplify.

Senator YOUNG. If you would like to privately confer for a moment and then respond collectively, that is also okay. [Laughter.]

Mr. DE MARCELLUS. As the Vice President said, there are problems there. Some Chinese loans are linked to resource extraction. Some appear to jeopardize countries' sovereignty. Some burden countries with unsustainable debt. Some have adverse environmental impacts. Many are implemented by Chinese SOEs and Chinese labor. Most appear not to be commercially viable, and then almost none are transparent. So we have to address all of those.

On the transparency, as Under Secretary Malpass described, working through the G20 and within the IMF and World Bank, we are working on debt sustainability frameworks for low income countries. So when they go into a low income country, they have to have a full picture. And Managing Director Lagarde has recognized this, and it has been very clear on the need for transparency when the IFIs go in. When we Western donors or the IFIs lend, that is not linked to resource extraction. They are weighed against debt sustainability frameworks. The information is shared with IMF.

And getting to the point earlier about these non-commercially viable projects—and as Under Secretary Malpass stressed earlier, what is new in the world is the private sector. So the best option is the private sector building these projects, and when they do it, they are darned sure it is commercially viable so you do not get that problem.

Senator YOUNG. Just following up on that briefly, how can the U.S. better, more effectively catalyze private investment in the developing world?

Mr. DE MARCELLUS. I think Congress has helped us in a great degree with the BUILD Act and the new Development Finance Corporation. Thank you for action on that. It is going to be able to give us new tools to try to fill the gap. They cannot replace, it should not replace the private sector, but if there are gaps to get the private sector off the sidelines—and there are also—now I will defer to Under Secretary Malpass as well—framework details. But at the G20, we are working on trying to develop infrastructure as an asset class for institutional investors to again to get the very large institutional money off the sidelines to build this infrastructure.

And then within the Indo-Pacific strategy, within that region, Secretary Pompeo announced a series of initiatives in power and digital and just general infrastructure to try to work with our private sector and again have our whole government work with them to try to fill the gaps. If there is a regulation that has to be fixed, if there is some other element that needs to be addressed to help the private sector get engaged, just be there on the ground, through our embassies, the Commerce Department, Treasury, USAID.

Senator YOUNG. Sort of wraparound services, as it were.

Mr. DE MARCELLUS. Correct.

Senator YOUNG. Mr. Malpass?

Mr. MALPASS. I will add to those points. I wanted to give a concrete example.

So as a country gets over-indebted, it typically has gone to the Paris Club. As I mentioned earlier, China has not accepted the invitation to be in the Paris Club. So it is the biggest creditor.

And I will mention one specific country. Congo-Brazzaville has in recent years borrowed way too much money. Much of it was borrowed from China. The problem is that other countries cannot then lend or even make—the private sector certainly does not want to invest into Congo-Brazzaville while there is this overhang of Chinese debt. But China will not say how much it thinks it is owed

and the country itself also does not know the terms and is not able to say how much it is owed.

And further, China does not have a process to reschedule or to forgive that debt, as Secretary de Marcellus was saying. The developed countries have a technique for when a country really has failed, to forgive that debt and let the country start to rebuild. China has rejected that as a process.

Yes, sir, Senator?

Senator YOUNG. Well, so this is instructive.

In the second panel, Ms. Segal in her prepared testimony noted China's reluctance to participate in certain international arrangements, the Paris Club in particular. And on the Paris Club website, China is listed as an ad hoc participant, not a permanent member.

So for those who may not be familiar with it, what is the Paris Club? Why does it matter? And what explains Chinese reluctance to become an official member of the Paris Club?

Mr. MALPASS. Yes, sir.

I myself have not been to the Paris Club, though I know some about it from my previous stint at Treasury and now my current stint. It is under my purview. It is a group of creditors that meets in Paris—of official creditors. So that would be, for example, the export-import kinds of banks around the world, the military lending that goes on, and other forms of official credit.

So they sit down when a country has failed. It is almost like, in my very lay terms, a bankruptcy process where a country is unable to pay. Then the creditors get together and think about what to do. And oftentimes that means extending the terms of loans or actually organizing the forgiveness of debt.

So as an ad hoc member, China was invited, and this has been going on for several years. It predates the current administration. They sit in the same room with other creditors. They listen to the disclosure of data. It would almost be like you could go and sit in a bankruptcy proceeding and hear everybody else's debt but you do not tell the group what you are owed by that company. And so the country then works with the creditors. China hears the information.

So what has been done in recent meetings—they meet monthly. So in recent meetings, the rest of the world has asked China to step out of the room when certain debts are discussed because China, by not participating, needs to be excluded from the group. And we are now at the point where we, the U.S., have suggested to the other participants in the Paris Club that China not be invited to future meetings if it is not going to participate in a given discussion. So it is a disclosure issue where they could be playing a constructive role in the world. They are the biggest creditor in many countries, and they should be doing this but have declined.

Senator YOUNG. Just very briefly. This subcommittee hearing is on multilateral economic institutions and U.S. foreign policy once again. So many of the challenges and concerns that many of us vocalize with respect to China and its predatory economic practices are shared by our G7 partners, by G20 member countries. And I just would like your thoughts. You can give us a letter grade or your qualitative assessment of how the United States is doing on

a multilateral basis in working with other countries to address these concerns and these predatory practices.

Mr. MALPASS. You know, will give us a B-plus or an A-minus. And the reason for that, while there is a lot of criticism of the U.S. for trying to stop international activity, the reality is the Trump administration but the U.S. Government as a whole is a leader in almost all of the international organizations that are going on, leading in a direction of more freedom of higher per capita incomes, better economic growth.

And the way to do that does not mean that we want the organizations to spend more money. In fact, one of the things that I have tried to get us to do is have these multilateral bodies have a lot fewer meetings and less talk and more action within them. And we have been somewhat successful in the G20, in the OECD framework, and in other frameworks in scaling back their work streams. I mentioned the Financial Stability Board, FSB, early in my remarks.

Senator YOUNG. Thank you. I am going to give Senator Merkley—allow him to close out this panel. And thank you, gentlemen.

Senator MERKLEY. So I was reading that the World Bank has some $60 billion of projects in China. And I was thinking about that, as I have seen China evolve from my first trip there, an economy based on bicycles to another trip with a few more ring roads around Beijing and a system choked with cars to yet another trip where I witnessed massive new metro systems and a 200-mile per hour train system.

Should we still be sending development loans to China?

Mr. MALPASS. In my view, no. In the World Bank reforms that have been put on the table and the World Bank management has committed to this year, they will be winding down, graduating China from IBRD lending. That is the part of the World Bank that is currently still lending to China.

However, the Asian Development Bank still lends and plans to continue lending and could, I think, substantially scale back and discontinue that lending.

So I agree with the thrust of your point, Senator Merkley.

And not to defend, but I would say to Senator Young's very good question, how is the U.S. engaged in these, we can state reforms and really push hard for them, but in a lot of cases, we do not have control of the organizations and they do not want to go in the direction that we are indicating.

With regard to China, final point, the world community is pretty much in line now recognizing that China has been taking advantage of the system. So there is actually good support within the G7 and even in the G20 and bigger bodies that China has got to change and got to stop taking these loans—wind down its borrowing from the institutions.

Senator MERKLEY. And finally, last Friday, the Trump administration released its National Climate Assessment that got a lot of attention, despite being released the day after Thanksgiving, because it laid out the already massive damage that is happening in the U.S. due to climate chaos and how those impacts will accelerate over the years to come.

Should our international institutions of lending adopt a strategy of only financing or primarily financing renewable strategies, non-carbon-burning strategies, given the grave consequences we are facing from carbon pollution?

Mr. MALPASS. In most cases, the organizations try to have high quality projects that are transparent where there are environmental assessments as appropriate for the projects. The projects are aimed at helping the people of the country get forward in terms of the availability of energy, the availability of even heating in certain countries.

So I would say the policy structure—as I mentioned before, we have nearly 100 congressional mandates, many of which—maybe the majority—are aimed at environmental practices within the multilateral development banks. So I do not know that additional—so I do not think additional legislation is needed in this regard. I would say that projects are monitored, and there is a substantial amount of evaluation done of environmental impacts now. Thank you.

Senator MERKLEY. A lengthy answer avoiding the core point of the question, but thank you.

Mr. MALPASS. Thank you, sir.

Senator YOUNG. Well, I thank you gentlemen for your time, your testimony, and your service. Note that I plan to keep the hearing record open for 48 hours, and I would appreciate you both submitting timely responses to any questions that may have been submitted for the record in my absence when I had to step out for a couple minutes. Thanks again for being here today.

If your schedules permit you to stay for the second panel, I of course would welcome you to do so. However, I understand if your schedules require you to depart.

This concludes the first panel. We will now take a few moments to transition and permit panel number 2 witnesses to take their positions. [Pause.]

Senator YOUNG. Our second panel today consists of five former members of previous administrations and expert witnesses. And I thank all of you for being here today.

The Honorable Clay Lowery, a Visiting Fellow at the Center for Global Development, who has also served as Assistant Secretary for International Affairs at the Treasury Department from 2005 to 2009.

Mr. Scott Morris, Senior Fellow and Director of the U.S. Development Policy Program at the Center for Global Development. He also previously served as Deputy Assistant Secretary for Development Finance and Debt at the U.S. Treasury from 2009 through 2012.

Ms. Jennifer Hillman, Professor in Practice, Georgetown Law Center.

Ms. Thea Lee, President of the Economic Policy Institute.

And Ms. Stephanie Segal, Senior Fellow and Deputy Director of the Simon Chair in Political Economy at the Center for Strategic and International Studies.

I welcome each of you. Thank you again for being here. Your full written statements will be included in the record. I would ask each of you to summarize your written statement within 5 minutes so

we can engage in an extended Q&A and conclude the hearing around 4:30. So that is roughly 45 minutes from now.

Why do we not go in the order that I announced you. Once again, Mr. Lowery.

STATEMENT OF HON. CLAY LOWERY, VISITING FELLOW, CENTER FOR GLOBAL DEVELOPMENT, ARLINGTON, VIRGINIA

Mr. LOWERY. Chairman Young, Ranking Member Merkley, thank you for the opportunity to testify on multilateral economic institutions and U.S. foreign policy.

I am going to skip the portion that I had about the multilateral economic institutions. I think the government witnesses covered it very well about the reforms that are needed, as well as the importance to our national interests.

So when thinking about these institutions in terms of our foreign policy, the committee asked, in particular, about the U.S. relationship with China, as we heard in some of the debate earlier. So I begin with the Trump administration's national security strategy that refers to China as a strategic competitor.

Through its section 301 investigations and other actions, the administration has gone even further and accused China of being an unfair competitor. And this analysis to me seems fair and accurate.

But to compete, the U.S. should not just criticize. It needs to have an affirmative strategy. And this starts with emphasizing U.S. strengths and seizing opportunities to demonstrate better U.S. alternatives. And our strengths in my opinion start with, one, our model of the private sector, not government support leading the way; and two, our deep and longstanding relationships with allies around the world who share our values and our ideals, not just having transactional arrangements.

So while China may have spent a trillion dollars in its Belt and Road Initiative over the last 5 years, I think it is far more important that just in the Indo-Pacific region alone, the U.S. has over $1.4 trillion in trade annually and invested over $900 billion in the region as of 2017. These are U.S. strengths, and we should use official tools, whether bilateral or multilateral, to highlight and leverage such strengths.

This is why I think the Trump administration and Congress, particularly this committee, deserve praise for rethinking OPIC and strengthening it through the BUILD Act.

The closest multilateral model to this approach is the International Finance Corporation, which is the window at the World Bank that finances productive private enterprises in the least developed countries.

To work in riskier countries, the IFC is probably going to need to issue more capital. And so recently IFC shareholders, including the United States, reached agreement that will allow the IFC to increase significantly its investments in the poorest countries and the most fragile countries, while the U.S. will not have to provide any new money to this and still retain its veto power. This deal strikes me as a solid accomplishment by the Trump administration.

On the other hand, the Trump administration has taken a number of steps that undermine the strengths of the United States, and I will just name two.

First was walking away from the Trans-Pacific Partnership. There is no other way to put it. This was reckless and a gift to China. Instead of helping to establish higher standards and better market access for our private sector, we are stuck trying to cobble together bilateral deals that appear to rely on a model of managed trade.

Second, the administration has not taken advantage of building a coalition to confront China, but has instead threatened to impose tariffs on our closest allies on the laughable justification that importing automobiles threatens our national security. In other words, rather than making China the outlier because of its behavior, the administration's unpredictability and unreliability on trade could cost us allies that we need to address the real challenges posed by China.

So this leads me to my last point, which is what can Congress do.

To supplement the strong bipartisan work that Congress did on establishing the International Development Finance Corporation, Congress should also work with the administration on the multilateral economic institutions. Let us just take the World Bank as an example. I see three areas of action for Congress.

First, approve and fund the capital increase for the IBRD.

Second, authorize the capital increase for the IFC, which is not going to cost any money in our appropriations.

And third, work with the administration on the upcoming 2019 IDA replenishment.

And finally, while this hearing is not about international trade, this committee may want to consider asserting its role on U.S. trade policy, particularly as it concerns China. I would encourage the committee to press the administration to develop and share its end goal for the current trade war or at least a framework agreement that would address the legitimate concerns with China's trade practices.

Thank you. I am happy to field any questions.

[Mr. Lowery's prepared statement follows:]

PREPARED STATEMENT OF HON. CLAY LOWERY

Chairman Young, Ranking Member Merkley, and members of the subcommittee, thank you for the opportunity to testify on the Multilateral Economic Institutions and U.S. Foreign Policy.

My name is Clay Lowery and I am Managing Director of Rock Creek Global Advisors, a consulting firm that advises companies on international economic and financial policy matters. I also serve as a visiting fellow at the Center for Global Development and as a senior advisor to the Center for Strategic and International Studies.

From 2005 to 2009, I was the Assistant Secretary of International Affairs for the Treasury Department, which exercises U.S. executive oversight of our involvement in the International Monetary Fund and the Multilateral Development Banks (MDBs), and is a key player in making U.S. foreign policy.

My testimony today, however, reflects my own views.

In my testimony, I will discuss (i) U.S. interests in the multilateral economic institutions, (ii) how to think about this in terms of our "competition" with China, and (iii) some recommendations on the role Congress should play.

The U.S. Role in the Multilateral Economic Institutions

The United States and its allies established the IMF, the World Bank, and the GATT—the predecessor of the World Trade Organization—at the Bretton Woods conference of 1944. The idea at the time—one that is still true today—was that international cooperation on key economic, financial and trade issues and maintain-

ing an open, rules-based economic order are important for global stability and prosperity. Since then, the U.S. has also been a founding member, a substantial contributor, and a leader of the key regional development banks: the Asian, African, Inter-American, and European development banks.

While each of these institutions has different mandates, tools, financing mechanisms and/or member countries, they broadly have similar objectives: to promote economic and financial stability, increase economic growth in a sustainable manner, and strive to maintain an open, competitive and well-coordinated international economic order.

As a large shareholder in these multilateral institutions, the U.S. Government should constantly be looking for ways to improve them. However, it is worth noting that these institutions have wellserved U.S. national interests over the decades, including by:

- Promoting global financial stability, which is a core objective of the IMF for example, and is critical to U.S. economic growth, exports, and job creation.
- Financing infrastructure and human capital development to foster prosperity overall and to support the construction of the actual roads and ports that allow U.S. exporters to get their products and services to market.
- Assisting with the "soft infrastructure" of property rights, the rule of law, bureaucratic efficiency, and stronger environmental and social standards, which improve the business environment and levels the playing field for U.S. businesses and workers.
- Leveraging resources through other countries' contributions and through capital markets. President Trump often expresses his concern that other countries are not sharing the burden fairly in international institutions. In the case of the IMF and the MDBs, this criticism has no merit. For instance, every dollar that the U.S. puts into the International Development Association (IDA), which is the concessional loan- and grant-making "window" of the World Bank, leads to 16 dollars in contributions by others.

Maybe just as importantly, these institutions support U.S. foreign policy goals, and the U.S. calls upon them time and time again—whether it is to (i) finance infrastructure in frontline states such as Afghanistan, (ii) provide non-humanitarian financial support to rebuild countries that have been devastated by natural disasters, or (iii) boost economies that are the source of refugee flows to mitigate the problems of mass migrations.

These institutions have received continuous support from the Treasury and State Departments in both Republican and Democratic administrations. Perhaps as importantly, previous Secretaries of Defense and military leaders also have strongly supported them. They have recognized that the IMF and the MDBs are important tools to conduct strong foreign policy and to provide the conditions necessary to keep our troops out of harm's way. They have recognized that U.S. leadership of these institutions is vital not only to their effectiveness, but to U.S. national security interests.

How does this all relate to China?

The committee asked about these multilateral economic institutions and U.S. foreign policy, particularly as we think about U.S. relations with China. It should come as no surprise that, as China has risen to the near-top of the global economic and financial ladder, it has sought to shape the international economic order in ways that advance its own national interests. To do so, China is trying to alter the global rules and norms that it did not play a role in setting, change the governance structures in existing institutions to reflect its increasing strength, create alternative institutions that are more aligned with its economic model, and set standards in areas where standards are not yet defined.

The Trump administration's National Security Strategy referred to China as a strategic competitor. Through its Section 301 investigation and other actions, the administration has gone further and accused China of being an unfair competitor. This analysis seems fairly accurate to me, and the administration should be commended for being willing to take on China on a number of fronts.

I do not believe that the administration's approach on these issues has been flawless and I have a number of criticisms. For today's hearing, however, I will focus on the multilateral economic institutions, and how best to use them to promote the interests I discussed earlier.

First, the United States should have an affirmative strategy. Rather than simply complaining about China's attempts to alter the system, pointing out its flaws, or trying to mirror China's approach, the U.S. should highlight its own strengths and seize opportunities to demonstrate the better U.S. alternatives.

The U.S. strengths are abundant and well-recognized. Broadly speaking, we have a system that relies on strong rule of law, protection of property rights, and a very robust private sector. Our companies, farmers, and workers are internationally competitive, particularly in technology and high-value manufacturing, which are areas that leverage American ingenuity, innovation, and highly-developed capital markets. Just as importantly, we have deep and longstanding relationships with allies around the world who share our values and ideals.

In fact, I'd argue that often the people and governments of these countries want the U.S. to succeed, not because it will help President Trump or the U.S. gain more power, but because it also helps them. This is a significant difference from the model China seems to be promoting.

While China may have spent $1 trillion in its Belt and Road Initiative (BRI) over the last five years, I think it far more important that—just in the Indo-Pacific region—the U.S. has over $1.4 trillion in trade annually and invested over $900 billion in the region as of 2017. These are U.S. strengths and we should use official tools—whether bilateral or multilateral—to highlight and leverage such strengths.

This is why I think the Trump administration deserves praise for rethinking the Overseas Private Investment Corporation (OPIC) and working with Congress to strengthen it through the BUILD Act. If it works well, the new International Development Finance Corporation (IDFC) should catalyze U.S. private capital in ways that challenge China's development model and leverage U.S. strengths. I also applaud the administration for going further by working with Japan and Australia to leverage this model.

The closest multilateral model to this approach is the International Finance Corporation (IFC), which is the "window" at the World Bank that finances the establishment, improvement, and expansion of productive private enterprises in less developed countries. In order for the IFC to be more effective going forward, it needs to be in countries where private sector investors won't go—unless incentivized. That way, instead of countries having to turn to a state-led model with countries such as China providing the financing and expertise, the IFC can work with an emerging private sector to advance similar objectives and in ways that are more in line with U.S. values and interests.

To work in riskier countries, the IFC will need to issue more capital. Recently, IFC shareholders, including the U.S., reached agreement to increase the IFC's capital. As part of the agreement, (i) the IFC will increase significantly its investments in the poorest and most fragile countries, (ii) the U.S. will not have to provide any new money, and (iii) the U.S. will still retain enough voting shares to maintain its veto power over major decisions at the IFC. This strikes me as a solid accomplishment by the Trump administration.

On the other hand, the administration has taken a number of steps that undermine the strengths of the United States—particularly as concerns a "strategic competition" with China. First and foremost was walking away from the Trans-Pacific Partnership (TPP). There is no other way to put it: this was reckless and a gift to China. Instead of helping to establish higher standards and better market access, and working with allies and partners in the region to advance our commercial and strategic interests, the U.S. is stuck on the outside trying to cobble together bilateral deals that appear to rely on the model of managed trade. Perhaps just as importantly, by withdrawing from this significant initiative, we have undercut another one of our strengths, which is our allies' confidence in U.S. leadership.

Secondly, the administration has exacerbated this loss of confidence through its approach to addressing legitimate concerns with China's trade practices. Instead of working with our allies to build a coalition to confront China, the administration has been trying to justify imposing more and more tariffs, including on our closest allies, based on the laughable proposition that importing autos and auto parts threatens national security. Rather than making China the outlier because of its behavior, the administration's unpredictability and unreliability on trade could cost us allies that we need to address the real challenges posed by China.

Third, the administration seems overly focused on U.S. trade in goods, despite the fact that trade in services is a major American strength. While this approach may play well politically among some in the U.S., it fails to accurately assess U.S. competitive strengths and how best to leverage them to compete with China over the long term.

What Can Congress Do?

This leads me to my last point, which is: what can Congress do?

Congress, particularly this committee, deserves a lot of credit for its bipartisan leadership in modernizing and expanding our own development finance institution through the BUILD act. The new IDFC could demonstrate that there are preferable

alternatives to China's international economic development model, while also helping meet U.S. foreign policy goals and promoting development around the world.

To supplement these efforts, Congress should work with the administration on its multilateral economic institution strategy. Just in the World Bank, I see three areas of action for Congress:

1. Funding the capital increase for the IBRD. The administration has done a solid job of promoting reforms during the negotiation for the capital increase, including re-allocating resources away from China and other middle-income countries and to lesser-developed countries. Congress should authorize and appropriate the funds to continue to allow the U.S. to be the leading player in the World Bank.
2. Authorize the capital increase for the IFC. As noted above, this multilateral model aligns with U.S. strengths and requires only authorization, not appropriation. While some have questioned whether the agreement reached can be implemented in full, it is worth taking some risk when there are no more U.S. taxpayer resources at stake.
3. Work with the administration on the 2019 IDA replenishment. Next year, the administration will be negotiating the replenishment of IDA. This is an area where the U.S. can work with China as another donor. If there are IDA reforms that Congress believes should be introduced or expanded upon, then it should voice those to the administration as early in 2019 as possible.

These are just a few examples and do not include the regional development banks, which may also require oversight and reform. Just over the Thanksgiving weekend, for instance, former Secretary of State and Treasury George Schultz authored an op-ed suggesting changes at the IDB to allocate more resources to addressing economic challenges in Central American countries as a way to better approach the refugee problem. Serious ideas such as these should be examined and explored.

Finally, while this hearing is not about international trade, this committee may want to consider asserting its role on U.S. trade policy, particularly as it concerns China. The administration's approach of conflating national security with international economic policy, attacking our allies whose help we need to confront and negotiate with China, and imposing successive rounds of tariffs instead of negotiating new commitments, does not appear consistent with the principle of strong Congressional oversight on trade. I would encourage this committee to press the administration to develop and share its end-goal for the current trade war or a framework agreement that would address the legitimate concerns with China's trade practices.

Thank you and I'm happy to field any questions.

Senator YOUNG. Plenty to follow up on there. Thank you, Mr. Lowery.

I am going to go down the line with your indulgence. I had indicated I would go in the order in which I introduced you, but you are not seated in that order. So Ms. Hillman.

STATEMENT OF JENNIFER HILLMAN, PROFESSOR, GEORGETOWN LAW CENTER, WASHINGTON, D.C.

Ms. HILLMAN. Well, thank you very much. That makes it a lot easier on all of us.

Thank you, Chairman Young and Senator Merkley. I very much appreciate the opportunity to appear before you, particularly at this time when the international economic order that, as Chairman Young mentioned, the United States worked so hard to create and nurture is at such a critical inflection point I think with the United States in particular headed down a potentially dangerous, unilateral, and isolationist road.

The major problem I think with the approach that we are taking is that the problems that we are confronting, whether that is the struggle around the world for good jobs that pay a living wage, whether that is climate change, whether that is the widening of the wealth gap or the rise of extremism and threats to national security. These are not problems that can be isolated or solved by the

United States alone. These are increasingly complex problems that overlap with one another and that will require global solutions.

And yet, these problems are arising at a time when our international economic institutions are under siege. They are responding to a backlash from globalization. They are being attacked from outdated mandates that do not address the 21st century problems that they need to deal with. And they are being questioned in terms of their effectiveness, their relevance and their legitimacy.

I would say the crisis is the most acute at the World Trade Organization. And yet, the United States needs the United States more than ever if we are to take on China.

Why the crisis at the WTO? Well, there are a number of sources of frustration outlined in my written testimony. I will mention just two.

First, there is a lack of balance at the WTO between the weak negotiating arm of the WTO with members having reached only one agreement on trade facilitation since 1995 compared to the very strong—some would say even too strong—dispute settlement arm of the WTO, while the executive part of it is viewed as highly competent but lacking in the authority to drive any meaningful change.

And it is this lack of balance that appears to be the primary driver for the United States' decision to block any process to reappoint members of the WTO's appellate body. So we are now down to just the bare minimum of three members sitting on that appellate body, and any even discussion about how to put new members on the appellate body has been blocked by the United States.

Secondly I will mention a recently willingness, led by the United States, to impose tariffs that violate the WTO's basic rules, which leads many to question what is the point of having a rules-based organization if its major members regularly flout those rules.

So I believe it is critical that the WTO and its WTO dispute settlement system be fixed immediately as the United States needs to take the WTO path if it is going to fix the problems that we have with China. And in my view that is what ought to happen, is that we ought to be bringing a big and bold case based on a coalition of countries working together to take on China. Why?

First, it represents the best opportunity to bring enough leverage together by the trading interests of the coalition to put sufficient pressure on China to make it clear that fundamental reform is needed.

Second, a comprehensive WTO case would restore confidence in the WTO and the rules of the trading system.

Third, in the past, countries have been reluctant to take on China for fear of retaliation. But a broad coalition-based case would lessen the likelihood that China would or could effectively retaliate against all of the trading partners that would be in this coalition.

Fourth, the evidentiary burdens of bringing a case against China because of its lack of transparency are formidable, but a coalition case would allow you to pool all of the evidence that has been being collected against China from the United States, the European Union, Japan, Canada, and others.

And finally, WTO cases have already been tried but with limited success. The problem is that the challenges were narrow, limited

to a few Chinese measures or to a particular industry or set of producers. No panel has yet been requested to rule on the Chinese system as a whole, and that is what I would recommend, that there be a WTO case to hold China to the specific commitments that it made when it joined the WTO as well as a broad, overarching what is referred to as a non-violation case that would basically say, China, you promised when you became a member of the WTO that you would become a market-oriented economy and you have not done so. If anything, you have gone the other way. And you would bring a case at the WTO that says, A, you are violating that basic overarching notion of being a market economy, and B, you are violating—and I have laid out in my written testimony—12 very specific commitments that you made that you are now violating.

And my own view would be if you bring this kind of big, bold coalition case against China, that will be the best way to result in the big structural reforms that we really need to see within China and that we ought to use the multilateral institution of the WTO and use the leverage and the power that it creates with its binding dispute settlement mechanism to be the best tool that we can engage in to take on China.

[Ms. Hillman's prepared statement is located at the end of this transcript.]

Senator YOUNG. Thank you, Ms. Hillman.

Ms. Lee?

STATEMENT OF THEA LEE, PRESIDENT, ECONOMIC POLICY INSTITUTE, WASHINGTON, D.C.

Ms. LEE. Thank you, Chairman Young, Ranking Member Merkley, for the invitation to participate in today's important hearing.

Today's hearing provides an opportunity to review U.S. engagement with multilateral economic institutions and the importance of both using our influence in those institutions strategically and balancing international engagement with the use of appropriate unilateral tools and domestic policies.

I would argue that past U.S. trade policy has failed American workers, as well as many domestic producers, and has undermined democratic decision-making authority with respect to environmental and consumer protections.

Going forward, Congress and the executive branch should articulate and implement a new approach to global economic integration, one that prioritizes good jobs and strong communities and that supports domestic democratic decision-making, where possible. This strategy is most likely to succeed if implemented with the cooperation and support of key allies and the multilateral economic institutions, as I think both Mr. Lowery and Ms. Hillman discussed.

Enforceable multilateral rules are essential to a well functioning global system. But the WTO, the organization tasked with defining those rules has struggled in recent years to achieve consensus on new rules and to enforce existing rules.

For American workers, the WTO has often appeared to be an obstacle to a reformed trade policy.

First, WTO rules are lopsided towards corporate investors over those of workers—to its corporate interests over those of workers, consumers and the environment. Investors' rights are prominently protected by provisions on investment, financial flows, intellectual property rights, among others, while protections for workers' rights are almost completely absent. The WTO has failed to address systematic currency manipulation or misalignment, as well as the use of permissive tax laws to attract investment. I would argue that both of these are key areas where multilateral trade rules ought to be available and enforceable.

The U.S. Government has not used its considerable clout at the WTO to press for deep reforms along these lines. Even if it were to do so, it would only succeed if it were able to build a coalition with other industrialized countries and key developing and emerging nations. But perhaps the current moment of stalemate and rising tension could be an opportunity to build such a coalition.

Second, with respect to enforcement, the United States has not been able to manage its trade relationship with China effectively since China's accession to the WTO. The U.S. goods trade deficit with China hit $375 billion in 2017, up from $83 billion in 2001. The growth of the trade deficit with China during this period was responsible for the loss of 3.4 million U.S. jobs in all 50 States and in every congressional district. Nearly three-fourths of the jobs lost were in manufacturing.

And that is one of the reasons why getting trade policy right is so important. The jobs displaced by flawed trade policy are, for the most part, manufacturing jobs which provide excellent wages and benefits, especially compared with jobs in the service sector.

EPI research has shown that the wage-suppressing effects of our poor approach to globalization and trade have hit all workers without college degrees across the country, not just those in manufacturing who have lost jobs directly to import competition.

These widespread wage impacts are more in the aggregate than the more concentrated losses in directly trade-impacted sectors.

The key elements of needed trade policy reform include the following.

First of all, address currency misalignment. The U.S. must abandon our strong dollar dogma and target a currency that allows for a manageable and stable trade deficit.

We should also ensure that our tax and spending policies are in line with a sustainable value for the dollar. Last year's tax bill and spending policies contributed to a higher value dollar, which is one reason why our trade deficit is growing.

The WTO and the IMF have not provided any support or guidance for addressing currency misalignment despite the fact that each of those organizations in principle have some jurisdiction in that area. In the medium and long term, the U.S. Government should seek to strengthen and clarify currency tools at both the WTO and the IMF. Ultimately, the goal should be to bring countries to the table to negotiate a new Plaza Accord, as was last done in 1985. This is the single most effective way to rebalance global trade flows, and supportive action from the multilateral economic institutions could be crucial in incentivizing such a deal.

We should make access to the U.S. market contingent on respect and enforcement of internationally recognized core labor rights. The WTO, in particular, must recognize that violation of core workers' rights is as much an unfair trade policy as the violation of patents or copyrights.

And finally, we need to develop and commit to a concrete economic plan to help workers in America, focusing on skills, workforce development, job quality, infrastructure, clean energy transition, and expanding a strong social safety net. We need a tax system that supports this plan, but our current system rewards capital over labor and outsourcing over domestic production. It remains riddled with unproductive loopholes and especially after last year's changes, it failed to raise adequate revenue to fund needed investments. We must ensure that American workers and businesses have the tools and skills they need to compete successfully in a dynamic global economy.

Thank you for your attention. I look forward to your questions.

[The prepared statement of Ms. Lee follows:]

PREPARED STATEMENT OF THEA MEI LEE

Thank you, Chairman Young, Ranking Member Merkley, and members of the subcommittee, for the invitation to participate in today's important hearing. I am the president of the Economic Policy Institute—a nonprofit, nonpartisan think tank, which has analyzed the effects of economic policy on the lives of America's working families for over three decades.

Our country is at a critical moment with respect to international trade and investment policy. We need clarity regarding our strategic goals and priorities in the global economy. At the same time, we urgently need to align our trade policy with our domestic choices on tax policy, infrastructure, workforce development, regulation, and labor markets.

Today's hearing provides an opportunity to review U.S. engagement with multilateral economic institutions, and the importance of both using our influence in those institutions strategically and balancing international engagement with the use of appropriate unilateral tools and domestic policies.

Over the last several decades, the U.S. Government has consciously chosen to accelerate our integration into the global economy, with a particular set of priorities focused on accommodating the concerns of multinational corporations that invest and operate both in the United States and abroad. The vehicles for this accelerated integration include the negotiation of more than a dozen bilateral and regional trade agreements, a corporate-centered agenda at the World Trade Organization and the international financial institutions, and inconsistent and lackluster enforcement of U.S. trade laws.

At the same time, the U.S. Government has dramatically under-invested in crucial infrastructure, education, and skills training, while workplace protections and the social safety net have eroded, and the tax code has become more regressive. Our macroeconomic policy has tended to weight concerns about inflation more heavily than the goal of achieving and maintaining full employment. On net, these global and domestic choices have exacerbated growing inequality and wage stagnation, and contributed to the erosion of the middle class and the manufacturing sector. This has deepened geographical, as well as class and race, divisions in the United States.

Critique of current trade policy

Past U.S. trade policy has failed American workers—as well as many domestic producers—and has undermined democratic decision-making authority with respect to environmental and consumer protections. Going forward, Congress and the executive branch should articulate and implement a new approach to global economic integration—one that prioritizes good jobs and strong communities, and that supports domestic democratic decision-making where possible. This strategy is most likely to succeed if implemented with the cooperation and support of key allies and the multilateral economic institutions. Transparency and predictability are essential elements.

The World Trade Organization (WTO) is the global organization tasked with defining multilateral trade rules. The 168 members of the WTO constitute about 98 percent of the global economy. While enforceable multilateral rules are essential to a well-functioning global system, the WTO has struggled on several fronts in recent years. First, it has become increasingly difficult to achieve consensus on new rules, and key areas like currency misalignment, climate change abatement, and coordination of tax regimes are not even on the agenda. Second, enforcement of existing rules has been contentious, and the member states are currently locked in a disagreement over dispute settlement.

For American workers, the WTO has often appeared to be an obstacle to a reformed trade policy—both in terms of the inadequacy of the current rules and problems with enforcement.

First, WTO rules are lopsided towards corporate interests over those of workers, consumers, and the environment. Investors' rights are prominently protected by provisions on investment, financial flows, and intellectual property rights, among others, while protections for workers' rights are almost completely absent (with the exception of a minor clause on prison labor). The WTO's regulatory rules also tend to favor corporate interests in weaker regulation over stronger domestic protections for consumers or the environment. In addition, the WTO has failed to address systematic currency manipulation or misalignment, as well as the use of permissive tax laws to attract investment. I would argue both of these are key areas where multilateral trade rules ought to be available and enforceable.

The U.S. Government has not used its considerable clout at the WTO to press for deep reforms along these lines. Even if it were to do so, it would only succeed if it were able to build a coalition with other industrialized countries and key developing and emerging nations. Perhaps the current moment of stalemate and rising tension could be an opportunity to build such a coalition.

And second, with respect to enforcement, the United States has not been able to manage its trade relationship with China effectively since China's accession to the WTO in 2001. This is, in our view, the most pressing U.S. trade concern, along with other countries that run persistent current account surpluses. The United States ran a goods trade deficit with China of $375 billion in 2017—up from $83 billion in 2001. This is the largest single bilateral trade deficit between any two countries in the history of the world—and it continues to trend upwards, despite twenty U.S. challenges to China at the WTO, despite earnest annual bilateral talks and commitments, and despite all the "reform" commitments China made upon accession. Currency misalignment is at the center of our trade imbalance with China.

The growth of the U.S. trade deficit with China between 2001 and 2017 was responsible for the loss of 3.4 million U.S. jobs—in all 50 states and in every congressional district. Nearly three-fourths (74.4 percent) of the jobs lost were in manufacturing.[1]

And our trade problems with China are getting worse, not better. The U.S. trade deficit with China is up almost 10 percent through September of 2018 (year to date, over the same period last year).

The composition of imports from China is changing in fundamental ways, with significant, negative implications for certain kinds of high-skill, high-wage jobs once thought to be the hallmark of the U.S. economy. Since it entered the WTO in 2001, China has moved rapidly "upscale," from low-tech, low-skilled, labor-intensive industries such as apparel, footwear, and basic electronics to more capital- and skills-intensive industries such as computers, electrical machinery, and motor vehicle parts. China has developed a rapidly growing trade surplus in these specific industries, and in high-tech products in general.

The jobs displaced by flawed trade policies are often manufacturing jobs, which provide excellent wages and benefits, especially compared with jobs in the service sector, where employment has been growing. These manufacturing jobs are often unionized, and have generally provided higher than average wages, on-the-job training, and benefits like health care and retirement security.[2]

And EPI research has shown that the wage-suppressing effects of our poor approach to globalization and trade have hit all workers without college degrees across the country—of all races and ethnicities—not just those in manufacturing who have lost jobs directly to import competition. While trade-displaced workers face the larg-

[1] Robert E. Scott and Zane Mokhiber, "The China Toll Deepens," October 23, 2018.

[2] Robert E. Scott, "We Still Haven't Recovered Well-paying Construction and Manufacturing Jobs," Economic Policy Institute, August 16, 2017.

est individual losses, in the aggregate the wider effects of across-the-board downward pressure on wages are much more significant.[3]

What we should be doing on trade policy

We urgently need to work together to develop and implement a strategic trade policy that aligns with our values and goals, and that complements our domestic policy to create good, skilled jobs in manufacturing, in agriculture, and in the service sector.

The key elements of reform include the following:

Address currency misalignment. The United States must abandon our strong dollar dogma and target a currency that allows for a manageable and stable trade deficit. We absolutely can manage the value of the U.S. dollar, and we need to set it at a level that essentially balances trade. This will give U.S. manufacturing the breathing room it needs to gain back some of the few million jobs it has lost in recent decades. (More information can be found in a 2017 EPI report on the pervasive negative impact currency misalignment has had on American jobs and wages.)[4] Our multilateral economic institutions tasked with addressing currency—the WTO and the International Monetary Fund—have not provided any support or guidance for addressing currency misalignment. In the immediate term, we should test the multilateral institutions by taking necessary steps to manage the dollar, but in the medium and long term, the U.S. Government should seek to strengthen and clarify currency tools at both the WTO and the IMF. This multilateral action can send a strong message to those countries that run large, persistent trade surpluses and have undervalued currencies. Ultimately, the goal should be to bring countries to the table to negotiate a new "Plaza Accord," as was last done in 1985. This is the single most effective way to rebalance global trade flows,[5] and supportive action from the multilateral economic institutions could be crucial in incentivizing such a deal.

Moratorium on new trade agreements. There is no reason to devote policy resources to chasing a "better trade deal"—certainly not by negotiating agreements that incentivize outsourcing and boost the profits of the multinational corporations that actively subvert the bargaining power of American workers. Policymakers who want to work across international borders could instead focus on eliminating tax havens or harmonizing climate policies to ensure that countries do not free ride on others' efforts to mitigate greenhouse gas emissions. The most effective and appropriate way to address these concerns would be for the multilateral economic institutions to provide a forum, eventually moving toward consensus rules and enforcement capacity. (Recommendations in a 2017 report by EPI address how to reorient national policy toward measures that will benefit the United States and other countries.)[6]

Make access to the U.S. market contingent on respect and enforcement of internationally recognized core labor rights. These core labor standards include the right of freedom of association and the right to bargain collectively, as well as freedom from discrimination, forced labor, and child labor (as outlined by the International Labour Organization in the Declaration on Fundamental Principles and Rights at Work). Enforcing these core labor rights is win-win for workers in all countries.[7] While the U.S. has included labor rights provisions in our trade agreements for many years, these rights still suffer from unnecessary loopholes and ambiguity in definition, and they have not been effectively and consistently enforced. We need a new approach and commitment, and the WTO in particular must recognize that violation of internationally recognized workers' rights is as much an unfair trade policy as the violation of patents or copyrights.

And finally, but just as significantly, we need to develop and commit to a concrete economic plan to help workers in America—by focusing on skills and workforce development, job quality, infrastructure, the clean energy transition, and expanding a strong social safety net. The U.S. Government has its own responsibility to develop and implement a coherent long-term economic strategy with respect to both manufacturing and services, both trade-related and domestic. We have failed to in-

[3] Josh Bivens, Adding Insult to Injury: How Bad Policy Decisions Have Amplified Globalization's Costs for American Workers, Economic Policy Institute, July 11, 2017.

[4] Robert E. Scott, Growth in U.S.-China Trade Deficit between 2001 and 2015 Cost 3.4 Million Jobs: Here's How to Rebalance Trade and Rebuild American Manufacturing, Economic Policy Institute, January 31, 2017.

[5] Robert E. Scott, Re-Balancing U.S. Trade and Capital Accounts, Economic Policy Institute, Working Paper#286, 2009.

[6] Josh Bivens, Adding Insult to Injury: How Bad Policy Decisions Have Amplified Globalization's Costs for American Workers, Economic Policy Institute, July 11, 2017.

[7] Thomas I. Palley, "The Economic Case for Labor Standards: A Layman's Guide," Richmond Journal of Global Law & Business, vol. 2, issue 2, 2001.

vest adequately in infrastructure and skills for decades, and business has not filled the void. We have a tax system that rewards capital over labor, and outsourcing over domestic production. It remains riddled with unproductive loopholes, and—especially after last year's changes—it fails to raise adequate revenue to fund needed investments. We must use domestic tax, infrastructure, and workforce development policies to ensure that American workers and businesses have the tools and skills they need to compete successfully in a dynamic global economy.

Thank you for your attention, and I look forward to your questions.

Senator YOUNG. Thank you, Ms. Lee.

Mr. Morris?

STATEMENT OF SCOTT MORRIS, SENIOR FELLOW AND DIRECTOR, UNITED STATES DEVELOPMENT POLICY INITIATIVE, CENTER FOR GLOBAL DEVELOPMENT, BETHESDA, MARYLAND

Mr. MORRIS. Thank you, Mr. Chairman, Senator Merkley.

Let me start by saying I very much agree with the case that has been made, in particular, for the multilateral development banks. So I am not going to repeat in any detail what we have already heard.

I do want to say, though, on these institutions—I want to make the point that U.S. leadership depends on our willingness to provide financial support. So the administration's support for the capital increase of the World Bank is a positive move in my view, and while a capital increase does not benefit the poorest countries, it will support many countries in Asia, Africa, and Latin America where the U.S. has important interests and ties.

At the same time, the administration has scaled back support for the MDBs' efforts in the poorest countries. These cuts diminish U.S. standing and limit the MDBs' ability to engage where they are needed the most.

So while I believe the capital increase merits your support, it should not happen on the backs of other critical MDB commitments.

Senator Merkley, you raised the question of China's borrowing from the MDBs, and I do want to address that point. I should say, as we already heard from the administration, that this has been something that this administration and, frankly, the Obama administration was critical of.

That said, I think it is actually misguided to push too hard on this issue, particularly when there is a better alternative. Specifically the capital increase agreement itself requires China and other relatively wealthier borrowers to pay higher interest rates on their World Bank loans. Higher loan charges will increase bank revenues, easing the financing burden on shareholders and creating better incentives for the bank's borrowers.

But it is also important to recognize how World Bank lending to China can actually benefit us. In a forthcoming paper, I examine the bank's projects in China, a significant share of which is aimed at the critical task of reducing the country's massive carbon emissions. The damaging effects from climate change are not contained within our national borders, and positive action taken in one country ultimately benefits others, including our own.

Finally, let me turn to China's financing activities in other developing countries.

In some respects, China's lending is like that of the MDBs in providing capital to invest in transport and energy infrastructure, which is sorely needed to spur economic growth. But it is also increasingly clear, as we have heard, that China's lending is pushing some countries into over-indebtedness.

Earlier this year, my colleagues and I detailed the debt problems facing China's Belt and Road Initiative and pointed to failures in China's approach that are harming some countries. Within the Belt and Road, this includes countries like Djibouti, which hosts U.S. and Chinese military bases, as well as Pakistan, Mongolia, and Laos.

A key priority for U.S. policy should be to effect a change in behavior by bringing China into the norms and disciplines of other major creditor countries.

We can also respond by offering developing countries more options. That should start with strong support for the MDBs, which are readymade to lend at scale and with high standards. The recently enacted BUILD Act will also usefully bring more U.S.-led development finance to bear globally.

That said, the new Development Finance Corporation should be additional and not a substitute for traditional assistance. U.S. leadership through longstanding programs like PEPFAR is doing vital work measured in lives saved, and they deserve sustained support.

It is also important to recognize the essential value of this Development Finance Corporation. Yes, it will deliver more financing, but it is in the standards attached to that financing that will distinguish the institution.

The BUILD Act lays important markers on project effectiveness and social and environmental safeguards, things like ensuring that local communities are consulted and compensated if they are displaced by a road project. It will take diligence to make these things a reality and sustain them over time.

Let me close by highlighting the risk of going too far when it comes to competing with China. There is a difference between offering choices to developing countries and forcing them to choose. It would be a costly mistake to seek to carve up the developing world in Cold War fashion between clients of the U.S. and clients of China. Chinese finance is a reality, and where it is delivering something of value to developing countries, we will not convince them otherwise.

Chinese officials are sensitive to the backlash on the debt issue right now. And now is the time to exploit that by seeking a change in policy and practice, not by drawing battle lines in the developing world that are unlikely to hold, but by working with allies to pressure Chinese officials in settings that matter to them, settings like the World Bank, the IMF, and the G20.

Thank you.

[Mr. Morris's prepared statement follows:]

PREPARED STATEMENT OF SCOTT A. MORRIS

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 U.S. 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 U.S. 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 U.S. interests, the role that China is playing today in development finance, and the U.S. 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 U.S. 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 percent of the U.S. foreign assistance budget). In doing so, we directly leveraged over $120 billion in MDB on-the-ground assistance that year. That's three and half times as much as the U.S. 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 U.S. troops on the ground. This is why U.S. 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 U.S. 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 U.S. 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 U.S. 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 U.S. 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 U.S. 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 re-

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

mains 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 U.S. 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 U.S. 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 U.S. 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 U.S. 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 U.S.-led development finance to bear globally, expanding the mix of financing tools on offer in the U.S. assistance portfolio. The new U.S. 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 U.S. DFC should be additional and not a substitute for traditional assistance. U.S. 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 U.S. 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 U.S. 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 U.S. 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.

Senator YOUNG. Thank you, Mr. Morris.

Ms. Segal?

STATEMENT OF STEPHANIE SEGAL, SENIOR FELLOW AND DEPUTY DIRECTOR, SIMON CHAIR IN POLITICAL ECONOMY, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES, WASHINGTON, D.C.

Ms. SEGAL. Mr. Chairman, Mr. Ranking Member, thank you for the opportunity to contribute to today's discussion. I was asked to speak about the International Monetary Fund and also to address China's strategic approach to projecting economic power and influence globally.

The IMF was created to foster the stability of the international monetary system, and it does this by engaging in three principal activities. First, it monitors the economic developments of its members through IMF surveillance. Second, it provides loans to IMF members facing balance of payments needs. And third, it enhances the technical competence of IMF members through capacity development.

The global economy has changed considerably since the IMF's founding. Economic liberalization has extended beyond trade to now include financial and human capital flows. We are also witnessing the emergence of China as a global power and as a challenger to U.S. economic supremacy. This context makes the activities of the IMF, that is, surveillance, lending, and capacity building, more important than ever.

In terms of surveillance, the IMF's most recent evaluation of the Chinese economy took place in July, and thanks to efforts championed by the United States to promote transparency, the Fund's report on China can be accessed by anyone with an unrestricted Internet connection. Because of IMF surveillance, Chinese authorities and the rest of the world receive a technical assessment of China's economy from highly trained economists. Having a fact-based discussion on a common set of indicators, something that is required by the Fund's articles of agreement for all Fund members, is valuable in and of itself. That is the good news.

Where IMF lending is concerned, China and specifically its Belt and Road Initiative, or BRI, is playing a less constructive role. According to the U.S.-China Economic and Security Review Commission, the BRI is a well resourced, whole-of-government concept for regional and global connectivity. BRI financing comes from Chinese policy banks, state-owned commercial banks, the Silk Road Fund, as well as the Asian Infrastructure Investment Bank and the new Development Bank.

Some projects will deliver the benefits that recipient countries hope for. But reports from BRI countries suggest that the return on other projects will not live up to expectations. A recent report noted that Chinese lending to Pakistan, Angola, and Zambia have complicated the countries' prospects for an IMF program due largely to nonexistent information on the maturity, cost, and terms of Chinese loans. Missing terms or contingent liabilities left out of official statistics would compromise a key piece of IMF due diligence, that is, the debt sustainability analysis.

The IMF's Managing Director is correct to call for absolute transparency on the nature, size, and terms of debts in order to determine the debt sustainability of any country seeking IMF assistance.

Separate but related to comprehensive data reporting is China's reluctance to join the Paris Club. Given China's role as the largest single bilateral creditor to post-HIPC, low income countries, its failure to join with other creditor nations in seeking cooperative approaches to data collection and to debt relief undermines recipient countries, fellow creditors, and the integrity of the system.

The issue of data is where the Fund's work on capacity development is particularly relevant. The IMF should be ready to assist China in boosting its capacity to track credit and credit-like instruments and make this information public. Capacity development should also be prioritized for recipient countries so that they can assess financing terms and reduce any information asymmetries between borrowers and creditors. Expanding the envelope of data that member countries are obligated to provide in the context of IMF surveillance is also worth exploring.

So to close, IMF activities advance our national interest by boosting transparency, by promoting global financial stability, and by enhancing the technical capacity around the world. Maintaining U.S. support for the IMF through our policy engagement and in the context of periodic IMF resource reviews represents a responsible use of our own scarce national resources.

In addition to support for the IMF and the other IFIs, the United States can help countries that have limited options to finance needed investments. Passage of the BUILD Act, along with the recently announced Indo-Pacific Transparency Initiative, allows the United States to offer a positive agenda for infrastructure investment.

Again, I thank the subcommittee for the chance to offer my thoughts, and I look forward to any questions.

[Ms. Segal's prepared statement follows:]

PREPARED STATEMENT OF STEPHANIE SEGAL

Introduction

Mr. Chairman, Mr. Ranking Member, Members of the Subcommittee, thank you for the opportunity to contribute to today's discussion on Multilateral Economic Institutions and U.S. Foreign Policy. I appreciate the opportunity to discuss this topic, and I recognize the good work of the Subcommittee related to the strategic role of economics in foreign policy and national security.

I was asked to focus my testimony on the International Monetary Fund (IMF or Fund) and U.S. engagement with the institution. I will also address briefly China's economic rise, which has led to rapid changes in the international monetary system that the IMF oversees, as well as China's strategic and increasingly assertive approach to projecting its economic power and influence globally.

The International Monetary Fund

As members of the Committee know, the IMF and its sister institution, the World Bank—together the Bretton Woods Institutions—were created following World War II as part of an effort "to establish a framework for economic cooperation and development that would lead to a more stable and prosperous global economy."[1] To achieve this goal, the World Bank focuses on economic development and poverty reduction, while the IMF promotes international monetary cooperation to foster the stability of the international monetary system. The IMF engages in three principal activities to execute its mandate: First, it monitors the economies of its 189 members as well as the global economy under "Fund surveillance"; second, it provides temporary financial resources to IMF members facing balance of payments needs; and third, it enhances the technical competence of IMF members through capacity development. While not without room for improvement, these activities have ad-

[1] https://www.imf.org/en/About/Factsheets/Sheets/2016/07/27/15/31/IMF-World-Bank. Accessed November 23, 2018.

vanced U.S. interests by fostering greater transparency and accountability in the international system, and smoothing inevitable periods of adjustment.

Surveillance. The IMF's bilateral surveillance activities are based on Article IV of the IMF's Articles of Agreement which obliges the IMF to conduct "firm surveillance" over the exchange rate policies of its members in order to ensure the effective operation of the international monetary system. IMF members, in turn, are obligated to provide the IMF with the information necessary for such surveillance, as well as with any information deemed necessary for the effective discharge of the Fund's duties, which is called for separately under Article VIII, Section 5.

Bilateral surveillance takes the form of annual "Article IV" consultations, where an IMF country team spends time in-country, meeting with the monetary and fiscal authorities, political leadership, private sector participants, and civil society representatives among others to assess the country's economic and financial conditions. This annual review culminates in a detailed "Article IV" report which is presented to the country's authorities and IMF management, and then discussed by the IMF's Executive Board representing all 189 IMF member countries.

Thanks to the IMF's transparency policy, championed by the United States, publication of Article IV reports is now "voluntary but presumed", making the vast majority of such reports available to the wider public.

The IMF also conducts multilateral surveillance on regional and/or global economic and financial conditions. The IMF's twice-yearly World Economic Outlook (WEO), Global Financial Stability Report (GFSR), Fiscal Monitor and Regional Economic Outlooks (REOs), as well as the annual External Sector Report (ESR), are examples of IMF multilateral surveillance products which evaluate regional or global financial and economic conditions. The ESR, the newest of the multilateral reports and first piloted in 2012 with strong support from the United States, analyzes economic conditions in individual economies to assess if and how they contribute to global imbalances, as well as the role of policy in contributing to such imbalances.

Separate but related to IMF surveillance is the Fund's work to further the provision of economic and financial data to the public through various data standards. While voluntary, adherence to the IMF's enhanced General Data Dissemination Standard (e-GDDS); Special Data Dissemination Standard (SDDS); and SDDS Plus have filled data gaps, promoted greater data transparency, and provided market participants around the world with high quality data essential to capital market development. Taken together, nearly the entire IMF membership (185 of 189 member countries) subscribe to one of the three standards.

Lending. IMF lending is intended to "give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with (the) opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."[2] An IMF member therefore can smooth the adjustment to an economic shock by borrowing from the IMF in exchange for a set of conditions, generally ex ante commitments to policy reforms and quantified performance criteria for the duration of a lending program. Under a successful program, market confidence is restored, and the IMF is repaid as the economy adjusts and investors return to the country. In practice, few cases are so straight-forward, and yet the IMF has an excellent repayment history. During the Global Financial Crisis (GFC) in 2008-09, on through the ensuing euro area debt crisis, the IMF entered into programs and provided financial support to numerous countries, the vast majority of which have repaid their purchases to the Fund in full. A 2016 U.S. Treasury Report to Congress highlights that in the 24 cases of IMF exceptional access lending since 2008 there was only a single instance of a country not repaying in full and on time, and in that case (Greece in June 2015) the country quickly remedied the delay in its repayment to the IMF. The same report offered Treasury's assessment that IMF lending played an essential role in mitigating risks of spillover to the global economy.[3]

Of course, there are cases where Fund programs are unsuccessful, either because the program was not completed, or because even despite program completion, balance of payments vulnerabilities were not durably addressed, leading to follow-on programs. In these cases, while IMF program design should be examined, factors contributing to a program's success or failure generally go well beyond program design and concern the member's political will to implement sustainable macroeconomic policies as well as global conditions, among other factors.

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[2] Articles of Agreement of the International Monetary Fund, Article I(v): https://www.imf.org/external/pubs/ft/aa/index.htm. Accessed November 23, 2018.

[3] U.S. Department of the Treasury, U.S. Treasury Report to Congress on Ways to Improve the Effectiveness of the IMF and Mitigate Risks to U.S. Participation, June 2016.

Currently, the IMF has $81.5 billion (SDR 58.8 billion) in credit outstanding, consisting of borrowing from the IMF's General Resources Account (GRA) as well as its concessional borrowing window, the Poverty Reduction and Growth Trust. The largest outstanding exposures to members currently engaged in IMF programs are to Argentina, Ukraine and Egypt. All three programs received strong support from the United States when they were brought to the Board for approval. While the circumstances giving rise to financing needs differ dramatically in each case, the country's importance to the United States was clearly a factor in garnering U.S. support for IMF program engagement. In each case, any bilateral assistance provided by the United States is dwarfed in comparison to the resources provided by the IMF.

Capacity Development. Capacity development—covering technical assistance, training and other related activities in fiscal management, monetary policy, legal frameworks, and statistics—can be provided by the IMF at the request of a member, although there is no obligation for a member to accept such assistance. Like IMF surveillance and lending activities, capacity development is grounded in the IMF's Articles of Agreement, which provide the Fund with the ability to "perform financial and technical services.consistent with the purposes of the Fund." A review of the IMF's capacity development activities completed this month underscores the importance of capacity development activities to meeting the Fund's core mandate of fostering the stability of the international monetary system.[4] In particular, the review highlights the importance of integrating the Fund's capacity development and surveillance activities; as well as continuing to prioritize the provision of capacity development assistance to fragile states where needs are greatest.

An Evolving International System

The global economy and international monetary system have changed considerably since the IMF's founding in 1945. The global economy is much more integrated now than in the wake of the Second World War, and economic liberalization has extended beyond trade to include financial and human capital flows. Liberalization has been good for living standards in the United States and around the world, yet we are experiencing a backlash, ironically coming from the center of the international system. In addition, in less than a generation we have witnessed the emergence of China as a global power and challenger to U.S. economic supremacy, which has likely exacerbated the backlash against economic liberalization, in part because China's own impressive growth has exploited liberalization without offering the same opening to the rest of the world. Finally, the uncertainty around the impacts of technological change on productivity, economic growth and the distribution of economic gains means the global economy is headed into unchartered territory. Neither the backlash to globalization nor technological disruption are the focus of today's hearing, so I won't spend more time on these issues here except to offer that they underscore the Fund's importance; the principal activities of the IMF—surveillance, lending and capacity development—are more important now than ever.

China's Rise. In 1980, the U.S. economy was nearly ten times the size of China's, and per capita GDP in the United States was more than 40 times China's. By 2000, the difference narrowed only marginally in U.S. dollar terms; however, under purchasing power parity—which assesses economic size by equalizing price levels between countries—the difference narrowed to slightly less than three times, reflecting both a weak renminbi and China's low cost of living. By 2017, the U.S. economy, at just over $19 trillion, was little more than one-and-one-half times the size of China's. But under purchasing power parity, the Chinese economy had already overtaken the United States as the world's largest. One can debate the merits of U.S. dollar versus purchasing power parity measures, but the trend is clear. Given that China's GDP per capita is still just a fraction of U.S. GDP per capita, we should expect the rate of Chinese economic growth to continue to outpace the United States, even as the U.S. economy grows in absolute terms.

China's economy (in U.S. dollars), can be expected to overtake the United States within a generation. The fact that China's economy, fueled by 1.4 billion Chinese consumers, will overtake the United States, a country one-fourth its size by population, should not be seen as a threat so much as a high probability event. Furthermore, China's economic size tells us little about how its leaders will manage its many challenges, ranging from population aging to environmental degradation to financial sector vulnerabilities. But the size of China's economy, combined with the Government's ability and willingness to corral its resources to achieve strategic objectives, does merit our close attention.

[4] International Monetary Fund, 2018 Review of the Fund's Capacity Development Strategy—Overview Paper, November 2018.

IMF Surveillance and China. China's economic rise and its relevance to the IMF can be framed around the three principle activities of the IMF: surveillance, lending and capacity development. In terms of surveillance, China meets the obligations of Fund membership. Its most recent Article IV discussion was held in July; and thanks to previously mentioned efforts championed by the United States to promote transparency, China's Article IV report can be downloaded by anyone with an unrestricted internet connection. In the report and accompanying materials, we read staff's assessment that Chinese data quality is "barely adequate" for Fund surveillance; that IMF Executive Directors support increased exchange rate flexibility and further capital account liberalization; and that they want China to allow market forces to play a more decisive role in the economy. With regard to China's Belt and Road Initiative (BRI), Executive Directors encourage China to give due attention to debt sustainability in partner countries. At a minimum, Chinese authorities are hearing the technical assessment of IMF economists, including specific shortcomings (e.g., data quality) and areas of vulnerability (e.g., the financial sector). The IMF Executive Board—that is, the international community—is weighing-in with messages that will formally be transmitted back to Beijing. It is always a question whether a staff assessment or Board discussion will gain traction domestically, but the question is not unique to China. Having a fact-based discussion on a common set of indicators—something required by the Fund's Articles of Agreement—is valuable in and of itself.

China, BRI and IMF Lending. In contrast to IMF surveillance, China's BRI is playing a far less constructive role where IMF lending is concerned. The problem comes from loans China is making to some would-be borrowers of the IMF, with much of the potentially problematic lending happening under the auspices of the BRI, which the U.S.-China Economic and Security Review Commission describes as a "well-resourced, whole-of-government concept for regional and global connectivity."[5] This year's Article IV report for China describes the BRI as an initiative which could "bring both opportunities for greater connectivity and growth, but also risks (e.g. debt sustainability)"; and calls on China to develop "a clearer overarching framework governing BRI investment, better coordination and oversight, more focus on debt sustainability of the partner countries, and a transparent mechanism for dealing with project disputes, non- performance and debt service problems, as well as more open procurement and greater transparency over contracts."[6] Chinese authorities, however, believe these concerns are overstated, and they see project selection and governance as "decisions of market entities."

It is possible that a number of BRI projects will deliver the economic benefits recipient countries hope for. It is also possible, based on reports coming from a number of BRI countries, that the economic return on some of these projects will be negative. In these cases, far from adding to macroeconomic stability, these projects potentially mire the recipient countries in higher levels of debt. The sheer scope of the BRI is daunting. Data provided in the U.S.-China Economic and Security Review Commission 2018 report suggests BRI equity and debt funding could already top half a trillion dollars through end-2017, coming from a mix of Chinese policy banks, Chinese state-owned commercial banks, the Silk Road Fund, as well as the multilateral Asian Infrastructure Investment Bank (AIIB) and New Development Bank (NDB).

In a speech earlier this month at the APEC CEO Summit, Vice President Pence referred to "infrastructure loans to governments" with "opaque" terms, producing "poor quality" projects "with strings attached and lead(-ing) to staggering debt."[7] He cautioned countries against accepting foreign debt that could compromise their sovereignty, reflecting fears that at least some of the infrastructure projects built under the BRI are motivated by China's political or military ambitions rather than to benefit the local or regional economies. A recent report initially published in the Financial Times and later re-printed in Pakistan reported that Chinese lending to Pakistan, Angola and Zambia has complicated the countries' prospects for an IMF program due largely to "non-existent" information on the maturity, cost and terms of loans.[8] The missing terms, combined with concerns that contingent liabilities (e.g.,

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[5] U.S.-China Economic and Security Review Commission, 2018 Report to Congress, November 2018.

[6] International Monetary Fund, People's Republic of China: Staff Report for the 2018 Article IV Consultation, June 28, 2018.

[7] https://www.whitehouse.gov/briefings-statements/remarks-vice-president-pence-2018-apec-ceo-summit-port-moresby-papua-new-guinea/. Accessed November 20, 2018.

[8] https://www.thenews.com.pk/print/397725-imf-faces-china-debt-dilemma-as-low-income-nations-seek-help,November 25, 2018. Accessed November 25, 2018.

government guarantees) may not be captured in official government statistics means that a key component of IMF due diligence, the debt sustainability assessment or DSA, is compromised.

The IMF has policies and conventions, starting with its preferred creditor status, that protect the Fund's balance sheet, but comprehensive and reliable data must be the foundation for any assessment. IMF Managing Director Christine Lagarde is correct in demanding "absolute transparency" on the nature, size and terms of debts in order to determine the debt sustainability of any country seeking IMF financial assistance.[9]

Separate but related to the issue of comprehensive data reporting is China's reluctance to participate in certain international arrangements, and the Paris Club in particular. Given China's role as the largest single bilateral creditor to post-HIPC low income countries, its failure to join with other creditor nations in seeking cooperative approaches to data transparency and debt relief undermines recipient countries, fellow creditors, and the integrity of the system.[10]

Capacity Development: China and BRI Recipients. Data is where the last of the three principle functions of the IMF is particularly relevant. While the conventional wisdom suggests China is actively hiding the amount and terms of its financing, it is also possible that Chinese authorities, at least those in charge of managing the country's exposures to overseas projects, have been blindsided by the volume of Chinese credit abroad. Given reports of Chinese exposure to numerous vulnerable countries, there is likely growing concern in China regarding the prospects for repayment. The IMF should be ready to assist China is boosting its capacity to track external credit and credit-like instruments, including contingent liabilities, with an eye to making this information public. China's move earlier this year to create China International Development Cooperation Agency (CIDCA) to evaluate and administer China's foreign assistance program can be a good first step, but with its limited focus on official development assistance, it is insufficient to capture all categories of relevant debt and contingent liabilities. In order to be effective and credible, CIDCA would also need to be independent from the Government.

Expanding the envelope of data that member countries are obligated to provide to the IMF in the context of surveillance is also worth considering.

The IMF and World Bank, in their reporting to the G-20, have underscored "that the primary responsibility for transparent debt recording, monitoring and reporting lies with the borrower."[11] In this respect, IMF capacity development should be prioritized for recipient countries attempting to attract financing for infrastructure to provide these countries with the tools to assess financing terms. The increasing complexity of debt instruments makes this work even more critical to reduce information asymmetries between borrowing countries and their creditors. In addition to the IMF, the donor-supported Debt Management Facility housed at the World Bank works to strengthen low income countries' debt management capacity and merits support.

What Can the United States Do?

U.S. influence at the IMF remains strong, reflecting America's role in the IMF's creation as well as the still-predominant contribution of the United States to the global economy. The United States currently holds 16.52 percent of the Fund's total voting power, giving it an effective veto over any change to the Articles of Agreement.[12] The United States also benefits from U.S representation among senior management, not only at the IMF but also at the multilateral development banks. In addition, while the IMF's resident Board ensures that all members interact directly with IMF staff, management and other Board members, the IMF's location in Washington also benefits the United States. But sustaining U.S. influence is far from guaranteed. The United States should recognize how IMF activities advance our national interests, by boosting transparency and ensuring a common reference point for economic discussions among global participants. IMF lending benefits U.S. stra-

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[9] https://www.reuters.com/article/us-imf-worldbank-pakistan-talks/imf-to-seek-absolute-transparency-of-pakistans-debts-in-bailout-talks-idUSKCN1ML0W1, October 11, 2018. Accessed November 25, 2018.

[10] International Monetary Fund, Macroeconomic Developments and Prospects in Low-Income Developing Countries-2018, March 2018, Table 4. Total Public and Publicly Guaranteed Debt by Creditor, 2007-16.

[11] International Monetary Fund and World Bank Group, G20 Notes on Strengthening Public Debt Transparency, June 13, 2018.

[12] Any amendment to the IMF's Articles of Agreement requires the approval of three-fifths of the IMF's members representing 85 percent of the total voting power. The next largest shareholder, Japan, holds a 6.15 percent of total votes; while China, the third largest shareholder, holds 6.09 percent.

tegic priorities and promotes financial stability, even when individual IMF programs fall short of objectives. Maintaining U.S. support for the Fund, through serious political engagement and financial support in the context of periodic IMF quota reviews, constitute a responsible use of scarce national resources.

In addition to supporting the IMF and the other international financial institutions, the United States can assist countries that are otherwise left with limited options to finance needed investments. In his speech earlier this month at the APEC CEO Summit, Vice President Pence underscored a renewed commitment to development financing, and infrastructure in particular.[13] Recent actions, including passage of the BUILD Act to create a new foreign aid agency with authority to provide US$60 billion in funding for developing nations; along with a new Indo-Pacific Transparency Initiative, can equip the United States to offer a positive agenda for infrastructure investment, including private sector participation, while boosting transparency and combating corruption. Finally, allowing U.S. companies to compete overseas, including with the backing of a fully operational Export-Import Bank, can support a positive U.S. agenda overseas.

Again, I thank the Subcommittee for the opportunity to offer these thoughts, and I look forward to answering members' questions.

Senator YOUNG. I thank each of you for your summary testimony. There is a lot for us to deal with in a fairly short amount of time.

But why do I not begin with our first three panelists, Mr. Lowery, Ms. Hillman, Ms. Lee. Each of you spoke to, I believe, the need for a more coherent and comprehensive strategy with respect to some of these issues we are dealing with.

Mr. Lowery, you indicated that Congress needs to assert our role with respect to trade policy and perhaps pressure—you did not say this, but pressure this and future administrations to clarify our economic security strategy. I will give you an opportunity to respond.

Ms. Hillman, you focused quite a bit on the WTO in your summary comments, indicating that there is a need to fix the binding dispute settlement system, and you suggested this could best be done by assembling a coalition. I am not aware that that has been written into any particular strategy document, certainly not in any great detail by a previous administration or the current administration.

Ms. Lee, you indicated that the Congress, working with our executive branch, should articulate and prioritize a strategy—your words. Most likely that would affect the sort of positive change I think that we all want with respect to jobs and incomes and economic stability if that change were pursued multilaterally, something you supported.

So I think there is a means towards our getting there. In fact, I drafted legislation that I think would get us there. It is S. 2757, the National Economic Security Strategy Act of 2018. Senator Merkley was the original cosponsor lead on this. It would create a statutory requirement for the periodic production and submission to Congress of a national economic security strategy.

What do you think about this idea, Mr. Lowery? We actually have a written document that can be critiqued by the academic community that will signal to our friends and adversaries and partners alike exactly what our strategy is. We could seek buy-in as we do with the National Defense Strategy or a National Security Strategy from the legislative branch. So we are all working to-

[13] https://www.whitehouse.gov/briefings-statements/remarks-vice-president-pence-2018-apec-ceo-summit-port-moresby-papua-new-guinea/. Accessed November 20, 2018

gether for the betterment of the United States and all we represent. Is it a good idea to have a written strategy?

Mr. LOWERY. So I had the honor of serving on the National Security Council staff back in 2001 and 2002. And part of the staff's work was the National Security Strategy, which I do find to be a very helpful document. In fact, I used that in my testimony today from the Trump administration.

So I have read your legislation. I think it would be a very helpful thing. I mean, having international economics should be part of any strategy, whether it is the National Security Strategy or creating a national economic strategy to go into more detail, just like, for instance, on the National Security Strategy, there is a National Defense Strategy that relies on it to create more—to be more specific on how the Defense Department envisions this document.

So I think that this makes a lot of sense to me. It helps create priorities. It helps communicate what the administration is trying to do, whether it is this administration, the next administration, or following administrations.

Senator YOUNG. And, of course, much of the strategy would be classified in nature. There would be a classified annex. As with our National Security Strategy, the rest of it would be open source.

Ms. Hillman, thoughts.

Ms. HILLMAN. I think it would be serving a great need, which I see very clearly right now, by helping to draw a line between what is economic security and what is national security because clearly one of the real threats to the WTO is the fact that the United States has imposed these tariffs on steel and aluminum in the name of national security. And right now, those tariffs are being challenged at the WTO by many of our trading partners. And the response of the United States has been that somehow we are allowed to violate all of our commitments because the challenge is coming to say you cannot put tariffs on steel of 25 percent because we agreed. We bound our tariffs on steel at 0 percent duties. So by charging this 25 percent tariff, we are breaking that commitment. We are violating the WTO rules. We said clearly we would not impose tariffs other than equally on all of the members of the WTO, and yet we are putting the tariffs on some but not on others. So what the United States is intending to say in that litigation is, oh, no, we are allowed to do this because we say it is in the name of national security.

And the problem for the WTO is if they agree with the United States that you can do anything if you claim that it is in the name of national security, every other country can do this to every other product and say that they can put these restraints on if they simply say it is in the name of national security.

And if, on the other hand, the WTO says no, United States, you cannot do this in the name of national security, the concern is that the Trump administration will withdraw from the WTO on the theory of, you know, sort of who are you, WTO, to tell us what is in our national security.

So I think your legislation and your idea of helping to figure out where is that line between national security from a defense sort of security standpoint versus what is in our economic security would be immensely helpful.

I think also going forward, as we think about whether or not there is going to be future tariffs under this section 232, it would be very helpful if there could be some of that line-drawing.

And the last thing. I will only comment quickly. You asked about whether or not there is some kind of a strategy document that would speak to these China issues that I was talking about in terms of a WTO case. The U.S.-China Economic and Review Security Commission just recently, very recently, released its annual report to the Congress, and included in their section on trade and China is this idea of sort of bringing a sort of bigger, bolder coalition case to challenge these trade issues with respect to China.

Senator YOUNG. Excellent.

Ms. Lee?

Ms. LEE. Thank you. Thank you, Mr. Chairman.

I look forward to reviewing your document because it sounds like a very useful direction to go. And I do believe there is a value in articulating and putting on paper and bringing together all the different agencies to have a coherent strategy. I think that is often missing in terms of U.S. economic policy. And I think one issue is that we should recognize that there are connections between our economic security and foreign policy, and sometimes those are legitimate concerns that are not taken into account.

I think the other reason that it is useful is that, as we know—and I think we have had a lot of discussion today—other governments, particularly China, but others as well, have a very concerted economic strategy, a long-term economic strategy that they are playing off of. And if the United States is passive or not coordinated, I think that we will almost inevitably lose out.

Senator YOUNG. Thank you.

It is a bit ironic. I can go to the Internet and access China's strategy. I can. In a sense, I have more coherence, more clarity, a broader view about what their strategy is on a going forward basis than I do as a member of the Senate Foreign Relations Committee where my job is, in the main, oversight. And I find that not just ironic but troubling, and I think a number of my colleagues find it troubling as well.

I will ask one additional question and then kick it to Senator Merkley. It is a follow-up to you, Ms. Hillman, with respect to this idea of bringing one broad case at the WTO against China.

The grounds of the case would be, A, that China has just broadly violated the expectations of a market economy. That seems sort of a violation of the spirit of the WTO agreement and the expectations you have when invited into the WTO. But then there are 12 specific commitments that you indicate the charges should include as well that one commits to when you enter the WTO.

In your assessment, why has a case like this not been brought?

Ms. HILLMAN. I think it's an excellent question. I think there is a number of reasons why it has not been brought.

Part of it is trying to bring a case as a coalition is difficult because you have to get everybody on the same page in terms of thinking about what kind of claims do we want to bring.

As I mentioned, in the past, there has been really a reluctance because China retaliates and retaliates so quickly and immediately against countries that do take actions against China. And they re-

taliate very clearly in this trade sphere and even for fairly innocuous actions.

When the Nobel Peace Prize is given out to a Chinese dissident, what is the first thing China does? It bans the exports of salmon because they do not want to in any way reward countries where the Nobel Peace Prize is given.

When the Philippines challenges the development of the islands in the South China Sea at the International Court of Justice and wins the case, what is the first thing China does? Ban Philippine mangos from going from the Philippines into China as a way of retaliating.

So countries have been really reluctant to take on China in a major way for fear that they will be the subject of this retaliation. Again, hence the reason why my view is if you put together a large coalition of countries, it does create a bit of a shield against this ability for China to immediately retaliate.

The other part of it, again as I mentioned, is evidence. It is hard to get enough of this evidence, particularly because China is so nontransparent. You simply cannot get your hands on the kind of documents that you would normally need in order to prove these cases.

And I think the last thing that is really important is one of the major and I would say the most major claim against China relates to the issue of subsidies, that China creates massive over-capacity in steel, in aluminum, in chemicals, in all of these products on the backs of subsidies. And the concern there is whether or not the disciplines for how do we get at subsidies in the WTO are adequate.

Right now, when the WTO tries to take on subsidies, you go kind of two roads. One is you can show that the imports of subsidized products are coming into the U.S. market, in which case you can try to put a countervailing duty onto those goods to offset the amount of the subsidy. So 50 percent of the cost of production was by a subsidy. You put a 50 percent duty on. That may work to protect the U.S. economy, but it pushes that subsidized steel out into all of the rest of the world. So it did not solve the problem.

If, on the other hand, what you bring is an adverse effects case, the problem is that the remedy is prospective only and it only requires China to so-call remove the adverse effects of the subsidy. But if that steel plant is already up, built, and running, it does not do you very much good to say prospectively that you are supposed to get rid of the adverse effects of the subsidy.

So the other reason why cases have not been brought is because some of the rules in the WTO are probably not sufficient to really take on board the substance of the problem that we have with China.

Senator YOUNG. Okay. Thank you.

I do not believe I will get to all of the questions I wanted to ask of all the witnesses because I do want to give Senator Merkley a lot of time to ask whatever might be on his mind. Thank you.

Would you encourage us, Ms. Hillman, yes or no, to consider contacting the administration, encouraging them to assemble a coalition, gather evidence, and bring a case even in light of the infirmities with respect to some of the WTO provisions? Do you think it still merits——

Ms. HILLMAN. Absolutely, yes. If the case wins, you have a lot of leverage over China to really push for it. If it loses, it will make it very clear where are the holes in the WTO rules that need to be fixed. So either way, the answer is yes.

Senator YOUNG. Thank you.

Senator Merkley?

Senator MERKLEY. Thank you.

Mr. Morris, you noted that some of our loans to China are helping China reduce carbon pollution and that that is a positive thing. Do you share the viewpoint from the administration's report last Friday that carbon pollution is a significant world problem and we need to act quickly to address it, a point that was also made last month by the IPCC report that was described as a firm alarm going off saying, wake up, act fast on carbon?

Mr. MORRIS. Absolutely I do.

And I would make the additional point that in fact it is, if not the most important thing the MDBs themselves are doing today, among the most important. The capital increase at the World Bank—that agreement itself makes new commitments to climate finance that I think are part of what garner my support for that agreement. I think it is absolutely critical to their agendas going forward.

Senator MERKLEY. Ms. Segal, do you share that view?

Ms. SEGAL. I do, and I would also add the IMF focuses on macroeconomic issues as opposed to development issues. But the IMF has also thought about climate and climate change as a macro-economic issue. And we do see that there are real macro-economic impacts from climate change. So, yes, I do agree.

Senator MERKLEY. Ms. Lee?

Ms. LEE. Yes, absolutely.

And I also think that the WTO could play a more constructive role with respect to climate change to allow countries that go first and go faster to implement carbon reducing strategies are not put at a competitive disadvantage through trade, so allowing border adjustable methods to adjust at the border for the difference in prices between countries that are moving quickly and countries that are moving more slowly.

Senator MERKLEY. Ms. Hillman?

Ms. HILLMAN. Yes, I totally agree. And I would only add that I do think I would agree with Ms. Lee that there is more that the WTO can do to both reduce all tariffs on anything that would contribute in terms of renewable energy types of goods. There has been a longstanding fight over exactly what products should be on that list, and my own view is that fight needs to be over with today so that you can go to zero duties and zero restraints of any kind on the trade in renewable energy materials in order to, again, make that contribution.

I do think the WTO is also trying to work at disciplines on fossil fuel subsidies, which is the other way in which the trading system could contribute to helping.

But the answer is unequivocally yes.

Senator MERKLEY. And Mr. Lowery, I do not want to leave you out.

Mr. LOWERY. Thank you. I am not going to say yes or no only because I have not read the report, one. And secondly I clearly just do not have deep enough knowledge in this area. But I will say this. I usually would listen to a lot of scientists that seem to be coming to similar conclusions.

Senator MERKLEY. Thank you.

So, Mr. Morris, as you were noting about the loans to China and helping China reduce carbon pollution, I could not help but recall an article I had read about how China is the major financer of new coal plants around the world. So I asked my team to get me some facts here.

So China is the largest investor in overseas coal projects, having invested $15 billion in the last few years. And they have another $13 billion in proposed projects.

They are involved in planning 700 new coal plants at home and abroad.

And from a different source, a New York Times article, at the end of 2016, China was immersed in 240 overseas coal power projects. And I have run into a number of these in different parts of the world.

And the same articles note that just the building of these plants that are essentially on the drawing board completely overwhelms Paris. And Paris itself is not a significant ceiling in terms of—we will break the barriers that have been set by international scientists for 2 degrees under Paris.

So some of you have already mentioned strategies that we could use in the international multilateral institutions to help take this on. But I hear this fire alarm ringing, saying wake up world. It is very hard. It is very hard because we have deeply invested ownership of fossil fuel assets around the world, and the owners clearly want to work hard to keep extracting them and burning them. And so that is an enormous challenge.

But the international institutions that you all study or represent—share a little bit more about. And I think, Ms. Lee, you mentioned a specific idea that I did not completely capture, but maybe you would like to start by mentioning that idea. How can multilateral institutions really help us as a human civilization on this planet take on this enormous and immediate catastrophic challenge?

Ms. LEE. The idea I was talking about had to do with the competitive differences, when countries move at different speeds to reduce carbon emissions. So, for example, if, let us say, the United States were to put on a carbon tax and raise the price of producing certain manufactured goods and other countries might move more slowly—developing countries. And that is certainly the idea of the Paris Accord. If production were to move from the United States to those places that have not yet reduced carbon emissions, then you are actually increasing emissions globally because you are moving relatively clean production to a relatively dirty place.

And one way of deterring that is to allow a border adjustable tax that would adjust for the difference in carbon strategies and that would prevent the competitive gaming of that. And it would not penalize the countries that do the right thing and move more quickly. And I believe it is correct that wealthier countries, wealthy industrialized countries, should move more quickly than poorer countries, but what you do not want to do is end up with this terrible outcome where——

Senator MERKLEY. No. I take your point on border adjustment.

We recently had a report from Xcel Energy in Colorado that put out a request for proposals, and it came back at 2 cents per kilowatt hour for wind, 3 cents for solar, and both of those were below the cost of power from an already depreciated coal plant.

Are we at the point where the dropping costs of solar and wind are going to dramatically change the calculations? Because even folks who may not share a concern about the health of our planet may want to be on the smart end of the cheapest energy.

Ms. LEE. Yes, and I think that is a really positive development when renewable energy actually ends up being cheaper than the more expensive. That is a huge advantage.

But also I think it is true—this goes, I think, back to the economic strategy and the long-term planning—is that some countries like China and Germany might have subsidized wind or solar panel productions at an earlier stage when it was not so obvious that there was an economic advantage. And that is the kind of thing I would like also see the United States be thinking ahead so that we are not brining up the rear in that kind of a decision.

Senator MERKLEY. Yes, Scott?

Mr. MORRIS. Yes. I would just say, Senator Merkley, you raise a good point. I do not think it has received enough attention. In fact, there seems to be an effect. As China goes greener and cleaner at home, they are pushing out dirtier abroad.

I think the challenge here, which is consistent with the broader challenge we have talked about, is that we want to bring China into multilateral norms and disciplines. Well, in this area, we need to be sure that they exist. So that is things like standards for export credit agencies when it comes to energy finance, development finance abroad.

You know, this institution that we are standing up under the BUILD Act—it is going to be really important that it has standards in this area that gives us some standing to try to enforce the massive volume of financing that is coming out of China and supporting these kinds of projects.

Senator MERKLEY. Anyone else want to chip in on this? [No response.]

Senator MERKLEY. So I want to turn back, Ms. Hillman, to your concept about this strategy for a multilateral challenge. I think of the whole WTO process as clunky—that is maybe on the complimentary side—and deeply dysfunctional, a maybe more accurate way to describe it.

And also fundamentally we struck a deal. It was a geostrategic maneuver aimed significantly at separating China from Russia, keeping the communist bloc separated. And we said, you know what? We will give you access to our market. We will let you produce goods at different labor standards, different environmental standards, and different enforcement standards, and very low wages, which means you will be able to undercut our products. Will this not be a sweet deal for you?

And it was a sweet deal, and it remains a sweet deal. And essentially every manufacturer in America said, can we not make a lot more money going to the cheapest place in the world to make things and then sell it back into the American market? And we saw a massive loss of manufacturing.

Is it time to rethink this sweet deal for China? They have taken the proceeds from that. They are doing massive infrastructure at home, which I described earlier, that I have seen just within a few trips. They are buying up strategic resources around the world. This is all part of a Chinese national economic security strategy, their Belt and Road strategy. And my colleague here has said, well, America needs a strategy. And our strategy is kind of mired going back to our Cold War battle keeping Russia and China separated. And we pay a massive economic price for it. Is it time to rethink the whole thing?

Ms. HILLMAN. I think it very well may be time, and part of why I guess I am proposing this idea is as part of a rethink, if you will, or resetting the table vis-a-vis China. And the question is sort of under what auspices or under what table setting, if you will, do we have the best leverage with respect to China. Because I do think it is clear that many countries around the world share many of the United States' substantive concerns about China, all of the concerns that you have just articulated, again that China has gotten away with because it is not just the United States that is feeling the brunt of a lot of the Chinese exports and, again, the products that are made with the low labor and the poor environmental conditions that you are describing. Those are affecting countries elsewhere in the world. So we have many allies with us that would agree with everything that you have just said in terms of what do we need to do about China.

Where they disagree is over the United States' unilateral tactic in approaching it.

And I guess where I am disagreeing is I do not think we have enough leverage alone to create the kind of change that we are really talking about in China. So my own view is that the only way you are going to get at exactly the issues that you have described is to try to put together a coalition. And I do think it is a large coalition that agrees with you and agrees that China must be dealt with.

The question is then what do get at the end of the day, whether it is enough change, enough resetting of that relationship because I do not disagree with you that when China joined the WTO, the expectations were really quite different from what the reality has been. And over the first couple of years, it appeared that China was moving in the right direction, it was opening up its economy,

it was moving in a more market-oriented direction, it was starting to shut down some of the most environmentally damaging.

But about—I do not know—2004, 2005, there is no question China took a major 180 degree turn in the wrong direction from every aspect. It became more state-owned. It became more Communist Party controlled. It became more abusive on a whole series of labor and environmental rights.

So I do not disagree with you. I guess what I am trying to say is I think you are right that we need a very dramatic response to China. And my only point is I think it needs to be a multilateral response and not just a unilateral one.

Senator MERKLEY. That is a very appropriate response for a multilateral conversation.

And our time has expired. So I am going to turn this back to the chairman. Thank you all very much.

Senator YOUNG. Well, thank you, Senator Merkley.

And so many smart minds, so many topics we have covered and so many more questions I would like to ask, but we have run out of time.

Chairman's prerogative. A couple of administrative items. One, I would like to draw some attention to a report, of which Scott Morris was one of the co-authors, for those who have an interest in Examining the Debt Implications of the Belt and Road Initiative From a Policy Perspective, the title of the report, I would commend it to you. Among other things, the report indicates that the World Bank and other MDBs should work toward a more detailed agreement with the Chinese Government when it comes to lending standards that will apply to any BRI project no matter the lender. With unanimous consent, I would like to enter this report in the record.

Senator MERKLEY. Absolutely.

Senator YOUNG. And as the last order of business, Mr. Lowery, I will be submitting a question to you for the record because in your prepared testimony, you called walking away from the TPP, "reckless and a gift to China." I would be very interested in your thoughts about where we should go from here with respect to multilateral trade agreements.

Thanks again all for appearing today as witnesses, for your research, for your expertise.

For the information of this member and others, the record will remain open until the close of business on Thursday.

Yes?

Senator MERKLEY. Thank you. I would like to ask unanimous consent to submit to the record a table from the Information, Technology and Innovation Foundation. It is a summary of what was referred to as China's broken WTO commitments, a dozen commitments where they have failed to live up to their promises.

Senator YOUNG. Without objection, and just under the wire.

[The information referred to above follows:]

Chinese WTO Commitment	Has China Lived up to the Commitment?
Not requiring technology transfer as a condition of market access	No
Joining the Government Procurement Agreement (GPA)	No
SOEs making purchases based on commercial considerations	No
SOEs shrinking as a share of the economy	No
Foreign banks enjoying national treatment	No
Telecommunications market opening to foreign producers	No
Foreign film distribution being liberalized	No
Export subsidies being substantially reduced	No
Intellectual property theft and violations being significantly reduced	No
Abiding by Technical Barriers to Trade Agreement and not manipulating technology standards	No
Moving toward a "Washington Consensus" model of development	No

Table 1: Chinese Commitments Upon Entering the WTO and Outcomes Today

Senator YOUNG. So the record will remain open until Thursday, including for members who may not have been present to, to submit questions for the record.

Thank you again, and thank you, Senator Merkley, for our continued partnership.

This hearing is now adjourned.

[Whereupon, at 4:40 p.m., the hearing was adjourned.]

Additional Material Submitted for the Record

PREPARED STATEMENT OF HON. DAVID MALPASS

Thank you for holding this hearing and for inviting me to testify.

My testimony a year ago to Congress addressed the topic of achieving faster U.S. and global growth in ways that improve after-tax wages for American workers. While there has been substantial progress in the United States, growth abroad has softened materially, causing challenges for international economic policy. In this context, I would like to provide an update on some of the major policies we implemented over the past year, and describe our policy direction for 2019. I will also present a detailed explanation of our policies on the International Financial Institutions (IFIs).

Major Policy Developments in 2018

In 2018, we worked to orient better the G20, G7, International Monetary Fund (IMF) and multilateral development banks (MDBs) toward growth and accountability. With engagement by the World Bank, IMF, and other partners, Secretary Mnuchin has pushed forward an initiative on debt transparency that will, in the near term, significantly increase public disclosure and broaden the existing definition of international debt beyond traditional bonds and loans. This will reduce the frequency and severity of developing country crises and help push back on China's

over-lending to fragile developing nations, including those with weak governance. The World Bank and IMF have focused on more comprehensive and transparent reporting of public sector liabilities of borrowers to assist with our initiative.

We engaged repeatedly with China on our trade and investment concerns and the problems caused by their One Belt, One Road (OBOR) initiative, which often leaves countries with excessive debt and poor-quality projects. If countries default on these debts, China often gains influence over the host government and may take ownership of the underlying assets. We have built a common awareness of these concerns in the G7 and G20. In lending, China often fails to adhere to international standards in areas such as anti-corruption, export credits, and finding coordinated and sustainable solutions to payment difficulties, such as those sought in the Paris Club. With evidence mounting in Asia and Africa that OBOR has undermined domestic institutions and economic strength in borrowing countries, countries such as Malaysia are re-examining the costs and benefits of OBOR-related projects.

With Congress's bipartisan support, we have enhanced America's national security through the enactment and ongoing implementation of the Foreign Investment Risk Review Moderation Act of 2018 (FIRRMA), which has strengthened and modernized the Committee on Foreign Investment in the United States (CFIUS).

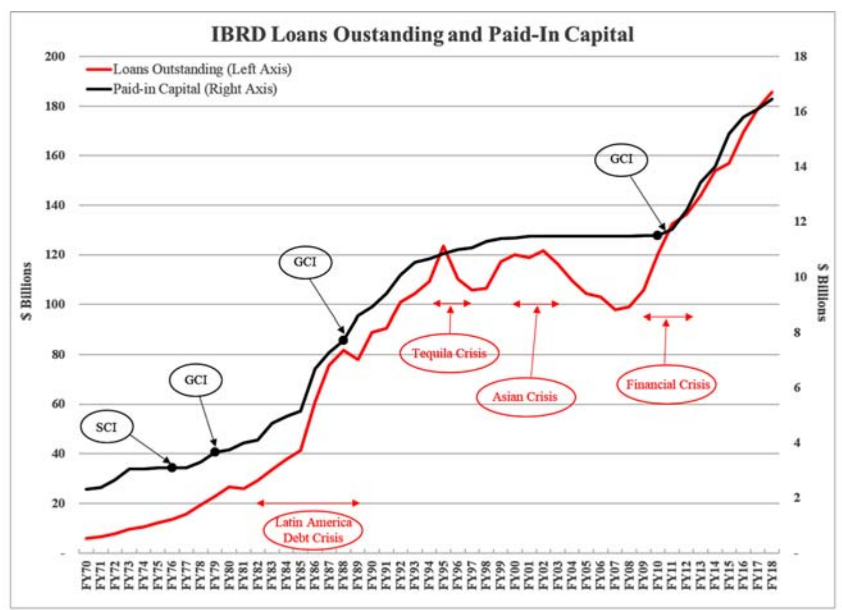
We have worked multilaterally to forge a new currency consensus in the G20 and International Monetary and Financial Committee recognizing the growth and investment benefits of currency stability. The administration recently concluded the U.S.-Mexico-Canada Agreement (USMCA), which included the first currency chapter in a trade agreement, consistent with congressional directives promulgated under Trade Promotion Authority. We also reached an understanding with South Korea on currency stability and transparency at the time of the update to the U.S.-Korea Free Trade Agreement (KORUS). Argentina's new IMF program includes a nominal monetary anchor and an important commitment to leaving currency intervention unsterilized, policies that quickly stopped Argentina's mid-2018 currency crisis and are dramatically reducing the rate of inflation.

Treasury also launched the America Crece (The Americas Grow) initiative to promote growth in the Western Hemisphere. One key element of this initiative is to deepen U.S. commercial ties with Latin America in energy and infrastructure. In 2018, we signed energy framework arrangements with Panama and Chile, plan to sign one with Jamaica tomorrow, and hope to soon conclude one with Argentina. Looking forward, we are working with Colombia and have identified other attractive partners. These energy framework arrangements seek to achieve a high degree of energy development, integration, faster economic growth, and security with our partners through heightened and impactful trade, investment, and finance transactions that rely primarily on private capital.

We have refocused the Financial Stability Board (FSB) on its systemic risk mandate, including the adoption of an activities-based approach for insurance activities, the wind-down of work streams unrelated to stability issues, and the evaluation of the effectiveness of existing policies before developing new policies. I served on the nominations committee for FSB leadership and was pleased with the recent announcement of Federal Reserve Vice Chair Randy Quarles as the FSB's next Chair, the first American to serve in this role.

We prepared and published a number of reports including: the MDB Evaluation Report, the Foreign Exchange Report, the report of the National Advisory Council on International Monetary and Financial Policies, the Export Credit Negotiations report, the Technical Assistance report, and the Exchange Stabilization Fund report.

My testimony before Congress last year discussed the role of multilateral development finance in global growth and prosperity. Since then, we have been successful in getting the World Bank to commit to meaningful reforms to achieve sustainability in its lending, enforce its graduation policy, implement differential pricing, and agree to other reforms that would enhance accountability. As discussed further below, a 2018 package for a World Bank capital increase focuses on these areas and includes a new financial discipline mechanism that constrains annual lending levels to stop the pattern of recurrent capital increases.



Policy Direction for 2019

Looking into 2019, we are again aiming our initiatives at improving the U.S. and global growth. We will follow through on the ongoing initiatives and push forward with new ones that will contribute to our economic and national security. As a key part of this effort, we maintain active economic and financial dialogues with like-minded countries around the world in order to exchange views on and assess systemic vulnerabilities and to support democratic principles and institutions.

Here in the Western Hemisphere, we have emphasized the risks and challenges posed by 'The Troika of Tyranny,' namely Venezuela, Cuba, and Nicaragua. This 'Troika' has actively subverted democratic institutions, looted its people's assets and engaged in economic malfeasance, which has resulted in one of the world's gravest migration crises, creating serious fiscal burdens and both security and public health risks for its neighbors in Colombia, Ecuador, Brazil, Peru, Panama, and Costa Rica. There are nearly 50,000 Venezuelans per day crossing into Colombia. Secretary Mnuchin has already held four meetings of finance ministers to review the crisis in Venezuela and the impact on its neighbors and support the broad coalition pressing for democratic change. In Nicaragua, we have built a strong consensus of donor countries to stop the multilateral development banks from lending to the Ortega regime, which perpetuates itself through the death, imprisonment, and exile of its many opponents.

A high priority in 2019 will be the continued implementation of FIRRMA. Pursuant to that legislation, CFIUS launched an innovative pilot program on November 10, which includes requiring declarations for certain foreign investments in U.S. businesses involved in critical technologies in 27 specific industries.

There will be substantial work to deepen our major initiative on debt transparency. And we will continue to challenge China's unfair trade practices and lack of reciprocity in trade, lending, and investment. We will continue our work in the G7, G20 and other forums to discuss the challenge to our market system from China's non-market policies. There is already widespread acknowledgement of the problems in many key countries, but more work needs to be done on strengthening the debt transparency and financial resiliency of market-oriented countries.

As Brexit approaches, Treasury is analyzing risks to the international financial system and working with the EU and the UK to ensure continued market access for U.S. firms, including financial services firms, and to avoid cliff-edge risks. We are working toward an improved trade arrangement with the EU and would like to pursue a bilateral trade agreement with the UK. The administration notified

Congress on October 16, 2018 of its intent to start trade negotiations with the UK once it leaves the EU in March 2019.

Supporting the administration's trade agenda remains another high priority in 2019. We will continue to increase reciprocity and market access, particularly for U.S. financial services firms. The financial services chapter of the USMCA will result in the elimination of a Canadian data localization rule that requires U.S. firms to store data in Canada. Other countries continue to erect similar barriers, and we are continuing to engage with finance ministries and central banks to achieve their regulatory objectives through other means while protecting U.S. firms from cumbersome foreign data localization requirements.

Treasury's Office of Technical Assistance (OTA) will continue its work to improve financial processes, including transparency, accountability, financial sector security and private sector-led growth. OTA works to improve budget and tax systems, while strengthening institutions charged with combating terrorist financing and financial crimes. For example, in Colombia, Indonesia and Uganda, Treasury's OTA helped governments strengthen public-private partnerships to finance infrastructure development in ways that mobilize private capital.

In Latin America, we will be building relationships with newly elected governments, including in Brazil and Mexico. We have engaged with Mexico on strengthening donor cooperation with the Northern Triangle, which is an area that the incoming Mexican Government has also stressed as a priority.

We continue to work to streamline the G20 and make it more effective. In 2019, Japan will chair the G20 while France will chair the G7. We will also start preparing for the United States to host the G7 in 2020.

Through Treasury's seats on the boards of the Overseas Private Investment Corporation (OPIC), the Millennium Challenge Corporation (MCC), and the U.S. International Development Finance Corporation (DFC) (the new organization to be established under the Better Utilization of Investments Leading to Development Act of 2018 that will encompass OPIC), Treasury seeks policies that provide strong financial coherence, further the national interest, and promote the effective use of taxpayer resources. Treasury is also leading U.S. efforts in the International Working Group on Export Credits, and working with the interagency on reforms in connection with the Export-Import Bank, to pursue relevant reforms.

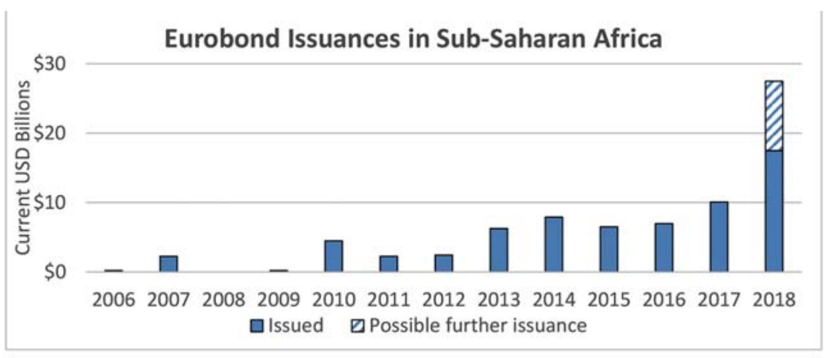
We have been in discussions on the World Bank's request for a capital increase. We are seeking to improve the quality of IMF programs through existing cases and upcoming conditionality reviews. We will be notifying Congress of negotiations related to the IMF's request for a quota increase under the 15th Quota Review (where we are in discussions to review the IMF's funding needs and the makeup of their resources) and have notified Congress of negotiations related to the International Development Association (IDA) and the African Development Bank (AfDB). These IFI topics are discussed in more detail below.

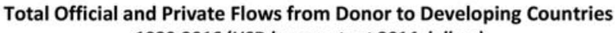
Seismic Shifts in Global Finance

My testimony a year ago discussed the seismic shifts that have occurred in the global financial landscape and that are challenging the relevance of the international financial institutions (IFIs). The structure of global interest rates has moved substantially lower after the inflation peaks of the late 1970s and early 1980s. Large inflows of private sector capital at increasingly affordable interest rates have materially added to growth and prosperity in many developing countries and dwarfed the resources of the IFIs. Similarly, emerging markets have gained far more access to external private capital, including directly from the capital markets as well as through global banks that borrow on the capital markets, resulting in private capital flows dwarfing official flows.

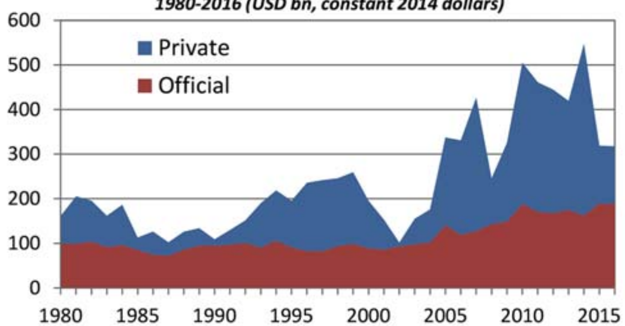
But these inflows have presented challenges, including renewed debt sustainability risks in more vulnerable countries with weaker institutions and macroeconomic policies. Consequently, the availability of increased financing must be accompanied by a dramatically increased level of debt transparency, the capacity to manage liabilities prudently, and the capability to deploy resources toward their most productive use.

Many emerging economies—particularly larger middle-income and upper middle-income economies—have gained access to longer maturity debt, increasingly in local currency. This has allowed these countries to build domestic yield curves, providing a solid foundation for ongoing market-sourced borrowing.



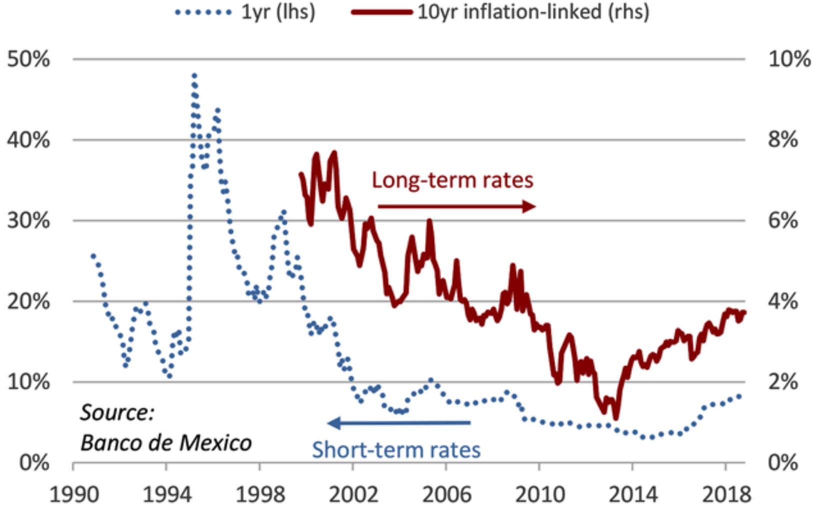


Note: Kenya ($2.5 billion), Ghana ($7.5 billion), and Tanzania ($0.7 billion) have discussed publicly plans for possible Eurobond issuances before the end of 2018.



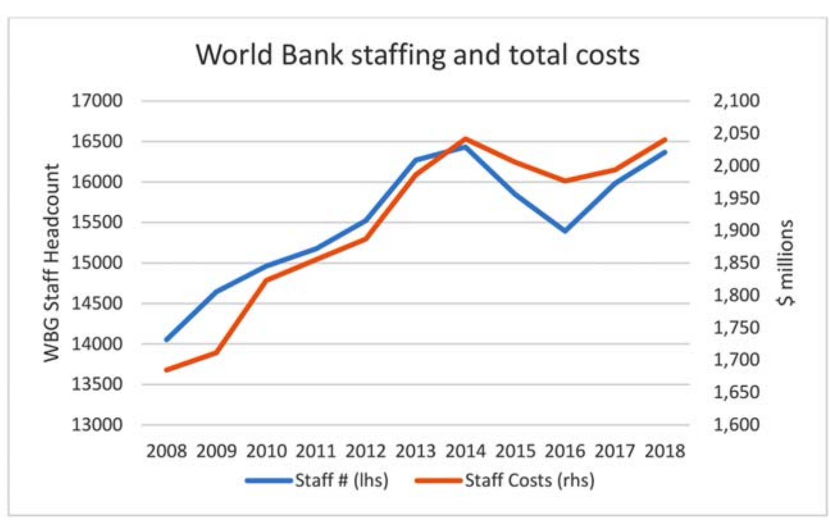
Note: Chart depicts flows from OECD Development Assistance Committee countries to developing countries in constant 2014 U.S. dollars.

Source: OECD



In addition to greater private capital flows, there is another important feature in the creditor landscape: developing economies are grappling with significant and growing inflows from non-traditional official creditors such as China. While Chinese financing may fill some gaps in financing for infrastructure investment in developing countries, there are often negative repercussions associated with Chinese lending. China's use of non-market export credits, opaque financing, and exclusive procurement practices often benefits the donor more than the recipient and undermines debt sustainability, domestic institutions, and environmental and social standards. China, for example, does not adhere to legally binding international standards to criminalize bribery of foreign public officials in international business transactions. Its financing also often includes conditions that do not show up on the Government balance sheet but burden borrowing countries with future liabilities such as commodity deliveries.

These major developments—the increase in developing country access to global capital markets and the surge in their official inflows from state-directed capital (mainly from China)—not only have profound consequences for developing countries, but also for the MDBs.



To deliver on their policy goals—positively shaping the conditions for growth and higher median incomes in developing countries—the MDBs need to focus more on the quality of their project loans rather than the quantity and on helping developing countries get their policy environment right for using private capital inflows effectively. The MDBs must ensure that they themselves do not displace private capital or lower their lending standards to compete with China's.

Role of MDBs

For the MDBs to effectively deliver on these goals, they must conduct sweeping reforms: Refocus assistance on poorer and more vulnerable countries. Strengthen institutions in those countries, and work with them to implement sound policies that attract private investment, deepen private markets, and accelerate economic growth. Potential reforms include limiting lending to defined needs and existing resources, introducing mechanisms to promote financial discipline including through budget

and salary constraints, differentiated loan pricing, graduation of borrowers, and sustainable lending practices.

We are working in the G-20 and G-7 to improve coordination among the IFIs. The G-20 has agreed on a set of principles whereby the IFIs will coordinate with each other, particularly regarding budget support lending. This helps ensure that the MDBs are not competing with the IMF to lend into difficult situations where the macroeconomic framework is inadequate. The MDBs are also striving to coordinate better at a strategic and operational level. One approach, coordinated country strategies, would help the MDBs and other donors avoid duplicating their efforts in a particular country and respond more effectively to the challenges it faces.

With regard to China's excessive lending, the MDBs (alongside the IMF) can be an effective tool in helping vulnerable countries better understand the risks and implications of such lending. The MDBs present a better source of development finance with higher environmental, social, procurement, and debt sustainability standards. They can also help countries constructively channel bilateral loans toward growth-positive projects that serve the borrower, not just the lender. Finally, the MDBs and IMF can help countries build capacity to negotiate transparent, non-corrupt terms for infrastructure projects with foreign financiers, taking into account the macroeconomic consequences of new non-concessional debt.

But it is worth noting that China has made substantial inroads into the MDBs despite its financing practices. In combination, China is absorbing decades of financial knowhow into its institutions in a few short years, a similar pattern to its absorption of manufacturing technology. We are working with allies and like-minded countries to guide the MDBs away from what could be viewed as endorsement of China's geopolitical ambitions.

World Bank Capital Increase

Regarding the World Bank's request for a capital increase, we secured commitments on most of the reforms discussed in my testimony before Congress a year ago. Though it will take time to implement, it is a solid reform package that better aligns the World Bank with U.S. national security, foreign policy, and economic priorities.

Treasury pushed hard for the adoption of a new mechanism to limit World Bank lending and ensure the durability of this capital increase. Based on this push, the International Bank for Reconstruction and Development (IBRD) will adopt a new financial sustainability framework that restricts annual lending commitments to those that can be sustained in real terms over the next 10 years through organic capital accumulation alone. The framework also includes a buffer to allow for a crisis response without the World Bank having to approach the United States and other shareholders for a capital increase. This new framework is aimed at achieving financial discipline and avoiding future capital increase requests. IBRD Governors will review the framework every five years, providing them an opportunity to push for any needed enhancements to ensure the IBRD continues operating within its existing financial resources.

As a direct result of the reform package, the IBRD committed to directing a bigger share of its lending to poorer countries, with the share of lending going to countries below the IBRD graduation income threshold increasing to 70 percent (from the current level of 60 percent); and to applying its graduation policy more rigorously, freeing up resources for countries that most need them. The reform package introduced differentiated loan pricing, making it the first MDB to adopt differentiated pricing for non-concessional sovereign lending. This will provide better-off, more creditworthy countries with an incentive to pursue market financing, rather than IBRD financing.

The World Bank will also constrain the growth of staff salaries, which are the biggest driver of increases in its administrative budget. Beginning with the World Bank's FY 2020 budget, the annual general salary adjustment for staff salaries will be capped. Management will also conduct a study of recruitment and retention, strengthen performance management, and undertake efforts to remove low performers. With these changes, staff compensation and World Bank administrative costs will grow at a slower rate than in past years.

The IBRD capital increase is packaged with an increase in the capitalization of the International Finance Corporation (IFC), the part of the World Bank Group that focuses on lending to and investing in the private sector in developing countries. We declined to participate in the IFC capital increase based on our assessment that the IFC did not need more capital to be impactful. Other countries wanted to expand the IFC on their own, and packaged their support for the IBRD reforms to an IFC expansion. Our voting power will be diluted to 16.4 percent from 21.0 percent, but we maintained our veto through a reduction in the IFC's veto threshold, which will

be adjusted from 20 percent to 15 percent. However, we succeeded in negotiating that shareholders will, in parallel, seek an amendment to the IFC Articles of Agreement to reduce the threshold that allows the United States to maintain our veto over any future IFC capital increases from 20 percent to 15 percent. We will also be seeking Congressional authorization to vote for such an amendment.

We will work with Congress regarding the subscription to the IBRD capital increase. Supporting the GCI would lock in the reforms, improve the effectiveness of World Bank programs, and complement U.S. assistance for strategically important partners. In short, the package will encourage countries to be more self-sufficient in financing their development, focus official development resources on needier countries with less access to other sources of finance, and create a more financially-disciplined World Bank whose lending growth is constrained and therefore more sustainable. The reform package will also advance other U.S. foreign policy objectives, including offering developing countries development finance based on transparency and high standards to counter Chinese over-lending.

IMF's Role in Growth

We are pursuing policies at the IMF to help make the institution both more effective and more focused on its core mission, including the purposes laid out in Article 1 of the IMF's Articles of Agreement, to promote high levels of employment and real income, promote exchange stability, maintain orderly exchange arrangements among members, and avoid competitive exchange depreciation.

We have pressed the IMF to prioritize this core mission in its analysis of exchange rates and global imbalances. As mentioned above, the IMF has, in its communiques starting in October 2017, highlighted that sound policies and strong fundamentals are essential to the stability of exchange rates, contributing to robust and sustainable growth and investment.

With strong U.S. support, the IMF approved in April 2018 a new enhanced framework for assessing corruption in its member countries. Under the new framework, IMF staff will assess the extent to which corruption is a macro-critical issue and propose policy recommendations to member countries. IMF lending programs may also include steps aimed at reducing endemic corruption.

As countries approach the IMF for support, the United States has stepped up its engagement in shaping program design. We prefer programs with design elements that prioritize the potential for broad-based growth (i.e., increases in real median income, not just GDP) and allow countries to pivot away from policies that have not worked. This involves three major changes to the IMF's current approach. First, fiscal policy changes need to be growth oriented. The projection of a reduction in the fiscal deficit cannot be an end in itself, because spending reductions often fail to materialize and recessions often derail deficit reduction based on tax increases. Second, IMF programs have often measured the success of a privatization in terms of the projected proceeds for the Government, which often means continued monopoly power. That is a mistake since de-monopolization of critical sectors generally has a more lasting growth impact. Third, monetary policies that provide sound money are at the core of a successful growth program.

The last point was recently illustrated by Argentina's first IMF program earlier this summer that neglected the exchange rate, which weakened precipitously. At the heart of the revised IMF program for Argentina is a commitment to a strong nominal anchor to recover confidence in the currency. By expressly limiting the growth of the monetary base, a policy that the United States strongly supported, the central bank was able to arrest the precipitous decline in the exchange rate, and the authorities there are on track to reduce interest rates and inflation very significantly (which had reached 6.5 percent per month in September and 5.4 percent in October), which will allow interest rates to support credit and growth. We support President Macri's vision for economic reforms, and believe that the monetary and structural reforms in the IMF program, if implemented, will place the Argentine economy on a path of sustainable growth.

IMF Quota Review

The IMF is undertaking its 15th General Review of Quotas, with the goal of completing the review no later than the Annual Meetings in October 2019. The review will both assess the adequacy of the IMF's resources and determine whether or not to adjust members' quotas and quota shares. The IMF has requested a buildup in its quota resources and claims that it needs to be the center of the global financial safety net. We will be seeking a constructive size for IMF resources that contributes fully to the stability of the international financial system, but recognizes that the IMF is just one part of the global financial system and its various support mechanisms.

CURRENT IMF RESOURCES

	SDR billions	USD billions
Quota	476	$661
Of which: U.S.	83	$115
NAB (40)	182	$253
Of which: U.S.	28	$39
Bilateral loans (40)	314	$436
Of which: U.S.	0	0
Total	972	$1,349
Of which: U.S.	111	$154

Pursuant to Section 41 of the Bretton Woods Agreement Act, we will shortly send a notification that IMF negotiations related to quota will begin in 2019 to provide you with formal advance notice of discussions. As the IMF conducts its quota review, we will work closely with it to improve the approach to conditionality in lending programs in order to make them more growth oriented. We will be heavily engaged in an upcoming review of IMF compensation and benefits with the goal of making IMF operations less costly and inefficient. And we will ensure that the IMF is sufficiently and efficiently resourced to carry out its mission and role. In this regard, we note that the IMF has ample resources to achieve its mission, countries have considerable alternative resources to draw upon in the event of a crisis, and the post-crisis financial reforms have helped strengthen the overall resiliency of the international monetary system.

MDB Authorization Topics and Specific MDB Objectives

We have notified Congress of the launch of negotiations on fund raising efforts by IDA and the AfDB.

The negotiations for the 19th replenishment of IDA (IDA-19) were launched on November 15, 2018 and will be carried out over the course of 2019. Under discussion is the donor funding for IDA's fiscal 2021–2023, running from July 2020–June 2023. Substantial changes were made to IDA's financial model and policy agenda before and during the current replenishment period.As a result, we expect IDA-19 to focus on taking stock of the IDA-18 reforms and IDA's ability to implement productive projects. We also have several reform priorities. First, we will work with other donors to ensure IDA-19 addresses rising debt levels among low-income countries.Second, we will seek to review and better target the support the World Bank provides for countries as they grow wealthier and transition from concessional financing under IDA to less-concessional financing through the IBRD. Third, we will seek to ensure that IDA retains a strong focus on fragile and conflict-affected countries, gender and development, and good governance, including in the area of debt management and transparency.

The Governors of the AfDB, over a U.S. objection, have decided to commence negotiations on the AfDB's capital needs in December 2018. Given Africa's enormous development challenges, we want a strong AfDB to serve the continent. However, new capital alone will not achieve a stronger institution. The AfDB needs to make greater progress on ongoing institutional reforms and agree on a set of further reforms that would accompany any new capital to ensure that it uses such funds more prudently and effectively. Among other items, we hope to see the AfDB fill critical vacancies in its accountability functions, better focus its lending on areas where it is most impactful, improve the readiness of projects before seeking board approval, strengthen project supervision and monitoring, and put in place a framework for financial discipline.

As with IDA, replenishment negotiations for the African Development Fund (AfDF), the AfDB's concessional arm, will occur in 2019. We intend to notify Congress of the launch of this negotiation in 2019. We are seeking many of the same improvements that are needed for the AfDB. In particular, given its relatively small scale, we want the AfDF to increase the selectivity of the areas it works in, with

an emphasis on regional transport and trade facilitation, electricity access, and water and sanitation. As a majority of AfDF recipient countries are now classified as fragile, heavily affected by conflict in neighboring countries, or otherwise at high risk of debt distress, we also expect the AfDF to maintain a strong emphasis on addressing fragility, conflict, and violence and helping countries improve their debt management.

We are strongly committed to enhancing growth and development within the U.S.-Mexico border region. We continue to support the North American Development Bank (NADB). The administration has requested in our FY 2019 budget that Congress authorize the United States to subscribe to $10 million of paid-in shares at the NADB. We and our Mexican partners in the NADB think that the NADB can do even more to improve the wellbeing of people in communities along the border. To that end, we included the NADB in our America Crece initiative and are exploring ways to boost the NADB's capabilities. The goal is to improve infrastructure along both sides of the border and create economic opportunities that increase median real incomes. We are also assessing whether the NADB has the right strategic and financial tools. We look forward to continuing these discussions once President-elect Lopez Obrador takes office and working with his administration and Congress to realize these goals.

The European Bank for Reconstruction and Development (EBRD) and the Asian Development Bank (AsDB) are both currently well capitalized. Our paramount objective at both institutions is to ensure they remain focused on project quality rather than using their existing capital to grow more quickly without due regard for development outcomes. At the EBRD, this is all the more important given that most of its traditional countries of operation in Central and Eastern Europe have gained ample access to capital markets since the EBRD was created in 1991. We want the EBRD to focus on priority countries with less access to capital—such as Egypt, Jordan, and countries in Central Asia and the Balkans—while resisting calls to expand its existing geographic footprint. At the AsDB, our principal objectives are to develop a path to graduation, reduce its engagement in upper middle income countries such as China, and introduce higher loan prices for countries with more access to private capital. We also seek to introduce an enhanced financial sustainability mechanism to ensure that we do not encounter future unplanned requests for shareholder capital.

Mandates Can Complicate the Goal of High-quality MDB Programs

Treasury is proud to have the statutory lead in representing the executive branch in the IFIs. This is a serious task and we execute it faithfully. That said, we coordinate closely with interagency colleagues, and we benefit from the input provided by other parts of the Government so that we can present a whole-of-government approach. For example, our State Department colleagues actively keep us abreast of key foreign policy priorities in countries where the IFIs are active; the Commerce Department informs American companies about procurement opportunities that come about as a result of MDB projects; and USAID provides technical advice regarding the soundness of individual projects and linkages to our bilateral assistance. As we consider individual projects at the MDBs, we systematically solicit input from any agency that is interested, and we seek to synthesize information so it can be provided as useful feedback to the MDBs.

The U.S. Government seeks high quality MDB projects that not only address the important development needs of recipient countries but that are also well—designed, technically sound, growth-enhancing, and based on strong consultation with the recipient government, affected communities, civil society, and other donor partners. We want to see strong monitoring of MDB projects, robust evaluations of completed projects, and thorough results measurement frameworks baked into every project so we can systematically track whether projects are performing well or not.

We continue to press the MDBs to achieve high standards regarding transparency, procurement, and environmental and social safeguards, with the goal of having our funds used correctly, fairly, and transparently. These high standards set the MDB projects apart from projects financed by other lenders who may provide funding, but without transparency and other protections.

The MDBs have substantially improved their projects over the years, often with significant help from Congress, including leaders on this Committee. And while we work to avoid situations in which people are hurt or abused in a project funded through the MDBs, there are instances when something goes wrong with an MDB project. Hence, we are advocating for robust independent mechanisms that improve MDB accountability and enable relief and redress.

Treasury follows numerous congressional mandates by using its voice and vote in international organizations. However, implementing the plethora of mandates is ex-

pensive, consumes significant staff time, and often ends up reducing the U.S. ability to influence policy in the direction Congress desires. Treasury is implementing a large number of legislatively required mandates in the IFIs. At last count, there are well over 100 congressional policy and directed vote mandates on the books. In addition, while mandates are added year by year, few are ever removed. We diligently follow these mandates from Congress. But as we seek to improve and reform the MDBs, we also invite Congress' attention to streamlining the number of legislative directives. Mandates require considerable time and resources to implement, and can detract from other important tasks related to loan quality. They can occasionally inadvertently undermine

U.S. leadership in the MDBs, as other member countries pay less attention to the U.S. position because our votes and positions on a given loan are pre-determined. Many mandates and reporting requirements are simply outdated. As we seek to reform the MDBs, we look forward to having a dialogue with members about how we can ensure voting mandates and reporting requirements have the impact that Congress intends but do not impede U.S. efforts to advance our broader strategic objectives in the MDBs. We appreciate the dialogue that we have had with the committee, not only on legislative mandates, but also on U.S. engagement at the MDBs as a whole. We look forward to continuing this dialogue today and into next year.

Debt Transparency Initiative

Treasury has encouraged an initiative at the IMF and World Bank to develop, and disseminate to the public, information on international borrowing. One of the principal thrusts of the initiative is to modernize official debt data in line with market developments over the last 20 years. Government debt obligations are no longer limited to traditional loans and bonds. New liabilities ranging from derivative operations to pre-paid forward sales of commodities impose the same calls on government budgets. If the burden on taxpayers is the same, the disclosure, accounting and fiscal treatment must be the same. Investors will then have more and better data to make decisions, allowing markets to function more smoothly and crises to be less frequent and less severe.

Over the next two years, this new standard of debt disclosure should be defined and endorsed by the official sector. In the case of the IMF, this practice is consistent with Section 42 of the Bretton Woods Act, which specifically directs the Secretary of the Treasury to support procedures to collect, and disseminate publicly, information on international borrowing.

The IFIs—including the IMF and World Bank—have a key role to play in enhancing debt transparency in, and supporting sustainable borrowing and lending practices by, their member countries. Developing countries need investment to grow, including in infrastructure. But lending to low-income countries (LICs) that is non-concessional, non-transparent, and funneled into poor quality projects will raise debt burdens without boosting productivity and growth. This, in turn, results in countries diverting scarce budget resources to service high levels of debt and poses a threat to countries' growth prospects and overall economic stability and development.

On the borrower side, the IMF and World Bank are making efforts to obtain a comprehensive picture of members' debt positions in both IMF bilateral surveillance and as part of their lending programs, with the goal of improving debt sustainability. In particular, we are working with both institutions to improve the public disclosure of a broad range of sovereign debt statistics, including publicly guaranteed contingent liabilities and forward sales of commodities, by member countries to reduce debt surprises. This will improve policy making and reduce the frequency and severity of financial crises. We also strongly support the IMF and World Bank's efforts to build borrower countries' capacity in public debt management and disclosure.

On the creditor side, the IMF and World Bank also have roles to play, in particular with emerging, non-traditional creditors such as China. The IMF and World Bank are engaging in more structured outreach to non-Paris Club and multilateral creditors, including preparing and providing workshops on debt sustainability analyses, lending frameworks, and external coordination in debt resolution. At the same time, they are planning reviews of their respective debt limit policies to strengthen data provisions and simplify conditionality. All of these steps reflect our shared priorities with the IFIs in promoting debt transparency, debt sustainability, and responsible burden sharing in debt resolution, which in turn will help reduce opportunities for corruption.

In conclusion, while U.S. growth has accelerated, growth in many other countries has slowed. This gives rise to new challenges in international economic policy that we are working to meet through new initiatives. I appreciate the opportunity to

present this Committee with a description of our major activities in 2018 and policy direction for 2019 and beyond, and I invite your views and questions.

RESPONSES TO ADDITIONAL QUESTIONS FOR THE RECORD SUBMITTED TO HON. DAVID MALPASS BY SENATOR ROBERT MENENDEZ

Debt Transparency

> In your testimony you state "Secretary Mnuchin pushed forward an initiative on debt transparency that will, in the near term, significantly increase public disclosure and broaden the existing definition of international debt beyond traditional bonds and loans."

Question 1. Can you provide a preliminary overview of the initiative?

Answer. The purpose of the initiative is to improve the quality, consistency, and transparency of sovereign debt data, including the reporting of debt equivalent instruments (e.g., forward sales of commodities, asset repurchase agreements) and contingent liabilities (e.g., obligations of state-owned enterprises, guarantees). To do so, the Treasury Department is working closely with our international counterparts as well as the International Monetary Fund (IMF) and the World Bank to promote the development and adoption of stronger international standards of data collection and disclosure. The Department anticipates that enhanced transparency of sovereign debt statistics will promote better policy decisions and reduce the frequency and severity of financial crises.

Question 2. Will you commit to consulting with Congress on issues that would entail any new authorities or oversight obligations?

Answer. Yes. The Treasury Department looks forward to working with Congress on this initiative.

Question 3. Will you commit to scheduling staff-level briefings on your ongoing efforts to combat Chinese debt-trap diplomacy?

Answer. Yes. The Office of Legislative Affairs will contact committee staff to schedule these briefings.

Multilateral Development Banks

> Regarding your testimony on Multilateral Development Banks (MDBs),

Question 4. Will you commit to engagement with this committee on the "sweeping reforms" envisioned by the administration to make MDBs more effective?

Answer. Yes. The Treasury Department looks forward to working with Congress to make MDBs more effective.

Question 5. Do you anticipate any new authorities will be required to achieve those reforms? If so, can you commit to timely consultations with the Committee?

Answer. Yes. For example, continued congressional support for contributions to the MDBs' concessional window replenishments advances our ability to promote additional reforms for the benefit of the world's poorest countries and ensure effective use of U.S. contributions. Treasury is committed to timely consultations, and we look forward to working with you.

International Monetary Fund Quota Review

> In your testimony you state "the IMF has ample resources to achieve its mission, countries have considerable alternative resources to draw upon in the event of a crisis, and the post-crisis financial reforms have helped strengthen the overall resiliency of the international monetary system."

Question 6. Please provide the data and calculations that you have used to conclude that the IMF has sufficient resources to meet expected contingencies.

Answer. There are many ways to estimate future demand for IMF resources, including by looking at the size of members' economies and their trade and capital flows, estimates of demand based on historical IMF programs, and data from past global crises. In addition, demand for IMF resources also relates to the availability of other sources of support, such as regional financial arrangements. Moreover, it is not feasible to assume that the IMF resources will cover every tail risk scenario. Therefore, Treasury constructed several crisis scenarios. These include a mild crisis scenario in which a set of emerging markets face financial difficulties and request assistance of about 3.5 percent of their Gross Domestic Product (GDP), with resulting demand for IMF resources of about $300 billion; a moderate crisis scenario in which the same set of emerging markets requests assistance at 6 percent of GDP, with resulting demand of about $500 billion; and a severe shock scenario in which

the set of emerging markets require assistance at amounts of 9 percent of GDP, with demand of about $700 billion.

Given underlying IMF financial commitments of almost $200 billion, under these scenarios, the IMF's medium-term overall lending needs range from about $500 to about $900 billion. Current IMF resources are sufficient to cover most crisis scenarios. In addition, the IMF can mobilize additional resources in the event of a severe global crisis.

PREPARED STATEMENT OF JENNIFER HILLMAN

A. INTRODUCTION

Virtually every major international gathering of world leaders recently has ended in failure—or at least failure to reach enough agreement to issue a concluding statement or communique.[1] These failures come at a time when many have been looking for signs that world leaders would come together to address the most pressing problems facing the world—including climate change, the breakdown in the rules of the international trading system, the need everywhere for good jobs that pay a living wage, and rapidly growing income inequality.

The failure of these meetings to produce formal agreements—or even specific paths to reaching agreements in the future—despite the high stakes has left many questioning the ability of the world's leaders to meet global challenges, shining a spotlight on the institutions and fora that were established for the purpose of achieving multilateral solutions-particularly the World Trade Organization (WTO), the World Bank, the International Monetary Fund (IMF), and the United Nations. The failure to reach agreements can best be seen as part of a long-term trend toward increased complexity in the world that makes it nearly impossible to reach traditional multilateral binding accords, combined with a waning of faith on the part of many countries in multilateralism and multilateral institutions.[2]

A number of clear trends emerge from the failures to reach accords at virtually all recent international gatherings:

1.) Government policies and international arrangements for collective decision-making have not kept pace with changes in the world, especially the high degree of international economic integration and interdependence.

Much of the increasing complexity in the international economic order stems from the explosive growth in the number and size of multinational corporations and financial institutions, many of which now dwarf the economic size of most of the nations in the world.[3] Added to the complexity is the increase in the speed at which goods, money and technology move around the globe in our digital age.

2.) Learning to operate in this vastly more complex world will require more multilateralism, not less.

As countries emerged from the era of colonialization and began opening their markets, the number of players on the global stage increased, making reaching consensus among a much larger group of disparate interests more difficult. But because the most significant problems facing the world cross many international boundaries,

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[1] 1 See, for example, Summit of Asia-Pacific Economic Cooperation in Papua New Guinea, November 18, 2018 (failure of an agreed-upon communique among the 21 nations of APEC blamed on US-China trade tensions and the growing competition for influence among the South Pacific countries); G-20 Finance Ministers, Buenos Aires, March 20, 2018 (no agreement on usual communique of shared principles on major economic policies due to trade issues); G-7 meeting, Quebec, Canada, June 8-9, 2018 (President Trump rejected a previously agreed-upon communique and disparaged Canadian Prime Minister Trudeau); G-20 leaders meetings in Hamburg, July 2017 (final text was held up by objections to the U.S. decision to withdraw from the Paris Agreement on climate change, despite agreement on most aspects of the final statement); WTO 11th Ministerial Meeting, Buenos Aires, Argentina, November 2017 (ended with no concluding statement and no new agreements). The NATO Summit (Brussels, July 11-12, 2018) did produce a communique, but also disputes over President Trump's demand that spending increases occur faster than previously agreed timeframes.

[2] 2 Concerns over the functioning of the international economic institutions and analyses about how to improve them have existed for decades. A number of these ideas were summarized, along with the suggestion that the G-20 be used as a fora in which renovation of the WTO, IMF and World Bank could be coordinated, in *Saving Multilateralism: Renovating the House of Global Economic Govemance for the 21st Century.* Jennifer Hillman, "German Marshall Fund of the US," attached as Appendix A.

[3] For example, Apple Inc. recently crossed the $1 trillion market capitalization figure, which makes it larger than the GDP of 183 out of the 199 countries for which the World Bank has GDP data.

solving them will require that countries come together to find regional, plurilateral, or global solutions.

3.) It is essential that the international economic institutions be updated and improved, not destroyed or left to wither.

Because it is clear that reaching major new binding accords or creating new international institutions is quite difficult, the best and most achievable solution is to renovate our existing institutions. Each needs to modernize and improve their governance structures to ensure that work can get done despite the increases in complexities and to update their mandates to ensure their ability to address the problems of the 21st century, many of which are quite different from those that existed in the 1940s when these institutions were created.

Given that the crisis is most acute at the WTO, this testimony will focus on what must be done to renovate the World Trade Organization and why doing so is critical, both for the trading system and for the continued existence of a rules-based international economic order. The need for the WTO and its dispute settlement system to remain viable is particularly critical if we are to address the challenges presented by the explosive growth of China and its transformation into the largest exporter of goods in the world.[4]

B. The Crisis at the WTO

The WTO was created in 1995 as a successor to the General Agreement on Tariffs and Trade (GATT) at the height of support for multilateralism and multilateral institutions. In recent years, many have expressed frustration with the WTO. The concerns include:

1.) A lack of balance—the negotiating arm of the WTO is weak and WTO members have reached only one new agreement-on trade facilitation-since 1995, while the dispute settlement arm has been (at least until the blockage at the Appellate Body in 2017) considered very strong-some say too strong, while the executive arm is viewed as highly competent but lacking in authority to drive change.[5]

2.) A limited mandate that does not readily allow the WTO to take on the "trade and . . ." issues connected to trade's impact on the environment, labor, the uneven distribution of the benefits of trade, currency manipulation, competition policy, or corruption around trade, or to ensure that the trading system rules contribute to the Sustainable Development Goals agreed to by the world's leaders in 2015. The WTO negotiating agenda has not been focused on the 21st century trade issues of digital trade, investment policy, food security, global health services, technology, on environmental goods and services.

3.) A bifurcation of members into "developed" versus "developing" country camps, with no in between for the emerging economies such as India, Russia, Brazil, or South Africa and no easy way to address the rise of China-now the largest merchandise exporter and second largest merchandise importer in the world.

4.) A recent willingness, led by the United States, to impose tariffs that violate the WTO's basic rules, leading many to question the point of having a rules-based organization if its major members openly flout those rules.

5.) A lack of enforcement of the transparency and notification requirements of the WTO, with most countries hopelessly behind on making required disclosures of their policies and practices, particularly with respect to the granting of subsidies.

6.) A limited ability to respond to the explosive growth of regional, bilateral and preferential trade agreements, with over 400 agreements establishing trade relationships and rules outside of the fonnal ambit of the WTO.

7.) concerns over the functioning of the dispute settlement system, particularly its Appellate Body, which have grown so extreme in the United States that the U.S. has blocked any process for the appointment of new Appellate Body members to fill the vacancies created by the expiration of members' terms, potentially leaving the Appellate Body with too few members to hear appeals.

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[4] In 2017, China's merchandise exports exceeded $2.3 trillion, far outstripping all other countries in the world, as the United States merchandise exports were close to $1.6 trillion, followed by Germany at just over $1.4 trillion, with all other countries' merchandise exports far below $1 trillion. WTO Trade Statistical Review 2018.

[5] USTR Robert Lighthizer commented on the relative strength of dispute settlement compared to negotiation in his remarks at the WTO's most recent Ministerial Conference (MC-11) in Buenos Aires: "[M]any are concerned that the WTO is losing its essential focus on negotiation and becoming a litigation-centered organization. Too often members seem to believe they can gain concessions through lawsuits that they could never get at the negotiating table."

Possible Fixes?

Given the failure to reach many new agreements or even to agree on a ministerial declaration at its latest Ministerial Conference—the WTO's MC-11, held in Buenos Aires, Argentina in December 2017—it is clear that the creation of a new and different international trade organization is a virtual impossibility.[6] Therefore, it is imperative that the WTO be renovated to make it a more efficient and effective organization-one that is capable of reaching new agreements and establishing new rules on the pressing trade issues of today and one that finds ways to respond to the concerns noted above.[7]

The specifics of how to do so are beyond the scope of this testimony, but should retlect the work that has been done over many years and with increasing intensity in the past year. Most recently, Canada hosted twelve WTO members at the Ottawa Ministerial on WTO Reform, focusing on changes that would: I) improve the efficiency and effectiveness of the WTO monitoring function, 2) safeguard the WTO dispute settlement system, and 3) modernize the trade negotiating agenda.[8] Neither the United States nor China were included in the Ottawa meeting, but both were informed of the outcome and much further discussion has flowed from the meeting.

For its part, the European Union put forward a series of proposals to reform the WTO and to break the logjam regarding the appointment of new members to the WTO's Appellate Body.[9] These proposals come at the behest of the European Council, which mandated a pursuit of WTO modernization that would: 1) make the WTO more relevant and adaptive to a changing world, and 2) strengthen the WTO's effectiveness. They involve reform ideas around broadening the negotiating agenda of the WTO to permit it to rebalance the system and level the playing field; establishing new rules to address barriers to services and investment, including with respect to forced technology transfers; increasing compliance with the transparency and notification requirements of the WTO; and shoring up the WTO's dispute settlement system, including by resolving the current blockage in appointments to the Appellate Body.

The United States, in its 2018 President's Trade Policy Agenda,[10] expressed concerns that the WTO dispute settlement system had appropriated to itself powers that the WTO Members never intended to give it; and lamented its inability to reach new agreements, its allowance for members to "self-declare" themselves to be "developing" countries and thereby take advantage of certain additional flexibilities (special and differential treatment) granted to developing countries, and its lack of management of the rise of China. Recently, the United States, along with Argentina, Costa Rica, the EU and Japan recently submitted a proposal to the WTO to address "the chronic low level of compliance with existing notification requirements" by in-

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[6] EU Trade Commissioner Cecilia Malmstrom noted at the close of the meeting: "All WTO Members have to face a simple fact: we failed to achieve all our objectives, and did not achieve any multilateral outcome. The sad reality is that we did not even agree to stop subsidizing illegal fishing." As the Reuters report on the Ministerial Conference (MC-11) noted: "The World Trade Organization failed to reach any new agreements on Wednesday, ending a three-day ministerial conference in discord in the face of stinging U.S. criticism of the group and vetoes from other countries."

[7] A number of major studies have been done suggesting ways to improve the functioning of the WTO, including "The Future of the WTO: Addressing Institutional Challenges in the New Millennium: Report of the Consultation Board to the Director-General Supachia Pantichpakdi" (2004) ("the Sutherland Report"); "The Multilateral Trade Regime: Which Way Forward?" (2007), The Warwick Commission Report, and most recently, the report of the high-level board of experts convened by the Berertelsmann Stiftung foundation, "Revitailzing Multilateral Governance at the World Trade Organization," 2018.

[8] Included in the Ottawa gathering were trade ministers from Australia, Brazil, Chile, the European Union, Japan, Kenya, Korea, Mexico, New Zealand, Norway, Singapore and Switzerland. In advance of the gathering, Canada circulated a paper outlining the discussion proposals to all members of the WTO. JOB/GC/201.

[9] Even more recently, the EU revised its specific proposals for changes at the Appellate Body (AB) into two formal submissions to the WTO, one that was introduced along with China, Canada, India, Norway, New Zealand, Switzerland, Australia, Korea, Iceland, Singapore and Mexico (WT/CG/W/72) that addresses five specific concerns relating to the Appellate Body (1. AB members remaining on after their term expires to finish appeals, 2. Reports taking longer than 90 days, 3. Municipal law as a matter of fact rather than law, 4. Unnecessary findings, and 5. The role of precedent) and a second document introduced along with China and India (WT/GC/W/753) that proposes that AB members serve one longer term, that the AB be expanded from 7 to 9 members serving on a full-time basis, with members remaining in place until their replacement has been appointed. Both proposals were submitted on November 26, 2018 for discussion at the meeting of the WTO's General Council scheduled for December 12-13, 2018.

[10] https://ustr.gov/about-usfpolicy-offices/press-office/reports-and-publications!2018/20l8-trade-policy-agenda-and-2017

troducing administrative sanctions for countries that fall behind with their reporting obligations.[11]

The Government of France, on the heels of hosting the 100th anniversary of Armistice Day and its follow-on Paris Peace Forum,[12] hosted a conference, A WTO Fit for the 21st Century, on November 16, 2018 to gather representatives from government, the WTO, academia and more to discuss and debate specific ideas on modernizing and improving the WTO.

Numerous non-governmental players-from think tanks to academics to trade practitioners--have also put forward ideas and proposals-increasingly under the banner of "the trading system is in crisis." Prominent among them is the Bertelsmann Stiftung report of its high-level board of experts, Revitalizing Multilateral Governance at the World Trade Organization."[13] That board recommended: 1) new policy dialogues to address trade policies and on the functioning of WTO bodies, 2) use of plurilateral negotiations among the "coalitions of the willing" rather than all members of the WTO; 3) an enhanced role for the WTO Secretariat to provide input and support to the policy debates at the WTO; and 4) an ongoing review of the institutional performance of the WTO.

Among the cross-cutting ideas in many of these proposals are the following:

1. The need for better enforcement of the transparency and notification requirements of the WTO;
2. Support for new negotiation dynamics through increased used of negotiations in groups smaller than all of the WTO membership to allow agreements to be reached more quickly;
3. A reconsideration of the role of the WTO Secretariat to permit it to recommend solutions and drive toward negotiated outcomes;
4. An urgent need to resolve the blockage of appointments to the WTO Appellate Body;
5. A need to expand the negotiating mandate of the WTO to include the 21st century trade issues, the many issues that fall into the "trade and . . ." set of issues, and the Sustainable Development Goals.

C. The United States Needs the WTO to Effectively Address Its Concerns with China

For the United States, the need for a well-functioning WTO is critical, as the United States needs the WTO if it is to effectively address its difficulties with China.

Concerns in the United States and around the world with China's practices and policies have been growing with each passing year. These concerns were recently succinctly summarized in the statement made by U.S. Ambassador to the WTO Dennis Shea in a May 8, 2018 statement to the WTO General Council:

> China ... is consistently acting in ways that undermine the global system of open and fair trade. Market access barriers too numerous to mention; forced technology transfers; intellectual property theft on an unprecedented scale; indigenous innovation policies and the Made in China 2025 program; discriminatory use of technical standards; massive government subsidies that have led to chronic overcapacity in key industrial sectors; and a highly restrictive foreign investment regime.[14]

The concerns are further laid out in two recent documents:

(1) the Section 301 Report, issued by USTR on March 2, 2018,[15] which raises four core concerns:

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[11] WTO JOB/GC/204 and JOB/CTG/14, November 1, 2018.

[12] The Paris Peace Forum, led by France's President Emmanuel Macron, is designed to be an annual gathering "based on a simple idea: international cooperation is key to tackling global challenges and ensuring durable peace. To support collective action, it gathers all actors of global governance under one roof for three days-states, international organizations, local governments, NGOs and foundations, companies, experts, journalists, trade unions, religious groups and citizens. Through original formats of debates and the presentation of solutions, it demonstrates there is still a momentum for multilateralism and a better organization of the planet, both among states from North and South and civil society actors." https://parispeaceforum.org/

[13] https://www.wto.org/english/news_e/news18_e/bertelsmann_rpt_e.pdf.

[14] Statement as delivered by Ambassador Dennis Shea, Deputy U.S. Trade Representative and U.S. Permanent Representative to the WTO, WTO General Council, Geneva, May 8, 2018.

[15] Findings of the Investigation Into China's Acts, Policies, And Practices Related lo Technology Transfer, Intellectual Property, And Innovation Under Section 301 of the Trade Act Of 1974, Office of the United States Trade Representative, March 22, 2018,

First, China uses foreign ownership restrictions, such as joint venture requirements and foreign equity limitations, and various administrative review and licensing processes, to require or pressure technology transfer from foreign companies.

Second, China's regime of technology regulations forces U.S. companies seeking to license technologies to Chinese entities to do so on non-market-based terms that favor Chinese recipients and that violates China's national treatment requirements to treat foreign investors no less favorably than it treats domestic investors.

Third, China directs and unfairly facilitates the systematic investment in, and acquisition of, foreign companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property and generate the transfer of technology to Chinese companies. The role of the state in directing and supporting this outbound investment strategy is pervasive, and evident at multiple levels of government—central, regional, and local.

Fourth, China conducts and supports unauthorized intrusions into, and theft from, the computer networks of foreign companies to access their sensitive commercial information and trade secrets.

This initial Section 301 report was recently (November 20, 2018) updated with additional evidence and new data, with the conclusion that "China fundamentally has not altered its acts, policies, and practices related to technology transfer, intellectual property, and innovation, and indeed appears to have taken further unreasonable actions in recent months." [16]

(2) the 2017 Report to Congress on China's WTO compliance, issued by USTR January 2018, which is the sixteenth such report and examines nine categories of WTO commitments undertaken by China (trading rights, import regulation, export regulation, internal policies affecting trade, investment, agriculture, intellectual property right, services and legal framework), with this year's report concluding that "the United States erred in supporting China's entry into the WTO on terms that have proven to be ineffective in securing China's embrace of an open, market-oriented trade regime." [17]

Both Reports raise the obvious question of what is the most effective way to address this myriad of interwoven and overlapping concerns. For me, the best approach would be a big, bold, comprehensive case at the WTO tiled by a broad coalition of countries that share the United States' substantive concerns about China-even if they strongly oppose the Trump Administration's unilateral tactics or the sequencing of actions that began with putting tariffs on steel and aluminum imports from those same countries that the United States needs to be working with on such an action at the WTO.

D. A Big, Bold WTO Case is the Best Way To Address the Deep, Systemic China Problems. Why?

First, a broad and deep WTO case represents the best opportunity to bring together enough of the trading interests in the world to put sufficient pressure on China to make it clear that fundamental reform is required if China is to remain a member in good standing in the WTO. The U.S. needs to use the power of collective action to impress upon both China and the WTO how significant the concerns really are. The United States simply cannot bring about the kind of change that is needed using a go-it-alone strategy. A coalition case also has the potential to shield its members from direct and immediate retaliation by China.

Second, a comprehensive WTO case would restore confidence in the WTO and its ability to address fundamental flaws in the rules of the trading system. As U.S. Ambassador Dennis Shea put it, "If the WTO wishes to remain relevant, it must—with urgency—confront the havoc created by China's state capitalism." [18] If the WTO can be seen to be able to apply or, where necessary, amend its rules to take on the challenges presented by China's "socialist market economy" framework, then faith in the institution and its rules-based system can be enhanced, for the good of the United States and the world.

Third, the work to put together a coalition, to research and agree upon the Chinese measures to be challenged and the claims to be made, and to litigate in a coordinated way at the WTO would make it less likely that the United States would accept a limited agreement connected to the U.S.-China bilateral trade deficit. Cer-

[16] USTR Update Concerning China's Acts, Policies and Practices Relating to Technology Transfer, Intellectual Property and Innovation, November 20, 2018,

[17] 2017 Report to Congress on China's WTO Compliance, Office of the United States Trade Representative, January 2018,

[18] Statement as delivered by Ambassador Dennis Shea, Deputy U.S. Trade Representative and U.S. pennanent Representative to the WTO, WTO General Council, Geneva, May 8, 2018.

tainly the United States' partners in such a coalition would raise strong objection to the U.S. accepting an agreement under which China simply agreed to shift its purchases of soybeans from Brazil to the U.S. or its sourcing of energy products from Russia and Central Asia to the United States. Given that the American people are already paying a high price as a result of the imposition of Section 301 tariffs on China and the corresponding retaliatory tariffs imposed by China on U.S. exports, it is essential that the United States emerge from the process with measures to address the many real problems with China rather than simply addressing the bilateral goods trade deficit.[19] A coalition may be the best way to avoid a narrow, deficit-focused bilateral deal.

The idea of bringing a broad, coalition-based case against China—both for specific violations and for its nullification and impairment of legitimate expectations that the United States and the other members of the WTO had at the time China joined the WTO—was recently endorsed in a recommendation to the Congress contained in the U.S.-China Economic and Security Review Commission's November 2018 Report to Congress.[20] The Commission specifically recommended that Congress examine whether USTR "should bring, in coordination with U.S. allies and partners, a "non-violation nullification or impairment" case—alongside violations of specific commitments—against China at the World Trade Organization under Article 23(b) of the General Agreement on Tariffs and Trade.[21]

E. The Time is Ripe for a WTO Case Now

The suggestion to bring a bold WTO case against China now certainly begs the question: if such a case is so clearly warranted and the problems have persisted for so long, why hasn't it been brought before now?

Among the reasons may be the following:

First, many countries (and the companies within those countries) have been reluctant to take on China for fear of retaliation by China, in ways both obvious and hidden.[22] Countries fear that China will impose trade remedies or other measures on their exports or deny needed permits to their companies or file WTO challenges, all in direct response to claims of unfair trade practices, forced technology transfers or intellectual property theft. While not a perfect shield, bringing a broad, coalition-based case would lessen the likelihood that China would or could effectively retaliate against all of the coalition partners, much less the many industries and companies that would be standing behind the case.

Second, bringing a collective case, with multiple complainants, is never easy, as it requires tremendous coordination of both the legal tasks of drafting and pleading and of the substantive arguments to be made, which may favor one country more than others or raise concerns for some but not all of the coalition. Only a handful of the 547 WTO complaints brought to date have been brought by a coalition of countries, but for this case to be most effective, a coalition is needed. And many of the potential coalition partners have been working with the U.S. in other fora, including the OECD, the G-7, and the Global Forum on Steel Excess Capacity. The need to pool together both the evidence and the political power of as large a coalition as can be mustered will be important to achieving sustained pressure at the highest levels on China.

[19] In Beijing on May 3-4, at its first high-level meeting with China following the release of the Section 301 Report, the United States presented it draft framework (attached herewith as Appendix B) for balancing the trade relationship with China, noting that "there is an immediate need for the United States and China to reduce the U.S. trade deficit with China," and listing as the first of eight issues the request for a commitment by China to reduce the US-China trade deficit by $200 billion.

[20] https://www.uscc.gov/sites/default/files/annual—reports/2018%20Annual%20Report%20to%20Congress.pdf.

[21] Commission Recommendation 2, page 21, Executive Summary and Recommendations, 2018 Report to Congress of the U.S.-China Economic and Security Review Commission.

[22] As stated in the Section 301 Report (at pg. 9): U.S. companies "fear that they will face retaliation or the loss of business opportunities if they come forward to complain about China's unfair trade practices . . . "Multiple submissions noted the great reluctance of U.S. companies to share information on China's technology transfer regime, given the importance of the China market to their businesses and the fact that Chinese Government officials are 'not shy about retaliating against critics.' For example, a representative of the Commission on the Theft of American Intellectual Property testified at the hearing: 'American companies are intimidated and reticent over the issue, especially in China. There they risk punishment by a powerful and opaque Chinese regulatory system.' In addition, according to the U.S. China Business Council, their member companies do not presently have 'reliable channel[s] to report abuses and to appeal adverse decisions . . . without fear of retaliation.'"

Third, many countries in the past have been reluctant to bring WTO disputes unless they were virtually assured of a victory. No one wanted to lose, given the diplomatic and political fallout that can occur from one country accusing another foreign sovereign of being a rules scofflaw. But in light of the depth and breadth of the concerns about China, now is the time to throw caution to the wind and bring a big case that challenges a number of both specific measures and systemic matters, assuming there is sound evidence to ensure that each claim has been brought in the good faith required by the WTO's Dispute Settlement Understanding (DSU).[23] Moreover, a number of the most likely applicable provisions have not yet been tested, against China or any other country. In the past when tried for the first time, WTO rules have usually been found to work.

Fourth, bringing cases against China has often presented very difficult evidentiary hurdles, as much of the information and evidence needed to support a claim, particularly a claim based on unwritten rules or practices, can be quite difficult to obtain. As noted above, one of the ongoing complaints of the United States and others is the lack of transparency in China, particularly around the issue of granting licenses or permits. As stated in the Section 301 Report: "The fact that China systematically implements its technology transfer regime in informal and indirect ways makes it 'just as effective [as written requirements], but almost impossible to prosecute.' . . . Nevertheless . . . confidential industry surveys, where companies may report their experiences anonymously, make clear that they are receiving such pressure. The lack of transparency in the regulatory environment, the complex relationship between the State and the private sector, and concerns about retaliation have enabled China's technology transfer regime to persist for more than a decade." 1A[24]

However, it is clear that over the course of the last decade or more, through the work of the U.S.-China Economic and Review Security Commission, USTR and other U.S. Government agencies, along with numerous business and industry groups, a substantial amount of evidence has been collected here in the United States. The combination of the comprehensive and well-documented Section 301 Report, the annual USTR report to Congress on China's WTO compliance and the annual reports to the Congress from the U.S.-China Economic and Review Security Commission already contain substantial evidence to support the potential claims noted above. Add to that the work done in the EU, Japan, Canada and others, and at the OECD along with other multilateral institutions, and it becomes clear that there should be more than sufficient evidence to demonstrate that China's economy is operating in ways that undermine the WTO's rules-based, market-based system. Indeed, one of the many benefits of bringing a case as a coalition is that each member of the coalition can contribute the evidence that they have collected and the experience of their companies.

Fifth, some would argue that WTO cases have already been tried, with some success and some failure. It is true that China has been challenged in 40 disputes brought to the WTO's dispute settlement system, with 22 of those cases arising from complaints filed by the United States, eight coming from the EU, four from Mexico, three from Canada, with Japan and Guatemala also bringing claims against China.[25] And a number of them (at least 15) have found against China. While the actual extent of Chinese compliance with WTO rulings can be questioned, in a number of cases, China has removed or amended its offending measures and in five others, China has reached a settlement agreement with the complaining party. The problem with many of these cases is that the challenges were relatively narrow, limited to a few Chinese measures, or to a particular industry or set of producers. While some of the more recent cases, including in particular the case on subsidies for aluminum and the Section 301-related case on IPR violations, have attempted to bring a specific case to showcase the underlying and more systemic problems, no panel has yet been requested in those cases and it remains to be seen whether a single case can provoke a more systemic response from China.

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[23] Article 10 of the DSU provides: "It is understood that requests for conciliation and the use of the dispute settlement procedures should not be intended or considered as contentious acts and that, if a dispute arises, all Members will engage in these procedures in good faith in an effort to resolve the dispute."

[24] Findings of the Investigation Into China's Acts, Policies, And Practices Related to Technology Transfer. Intellectual Property, And Innovation Under Section 301 of the Trade Act Of 1974, Office of the United States Trade Representative, March 22, 2018, at pg. 22.

[25] See the attached Appendix C for a list of the cases brought against China and their outcomes. Note that for eight of the cases, no panel has been requested, for two of the cases the panel is working on the case, and for two others, the DSB has agreed to establish the panel but the actual panelists to hear the case have not yet been appointed.

As a result, some have come to believe that the WTO, as the 20 17 USTR report to Congress states, "is not effective in addressing a trade regime that broadly conflicts with the fundamental underpinning of the WTO system."[26] I disagree. I do not believe that the kind of broad case, with claims across sectors and across legal regimes, has been tried. No one, for example, has challenged the Chinese system of intellectual property rights or technology transfers as a whole. The WTO, therefore, has not been given the opportunity to show what can be done to save its core provisions. Yet it is just such a systemic case that could provide the basis and the incentive to craft a legal remedy that could be beneficial to all sides.

The essential thrust of any WTO case should be to hold China to the specific commitments it made when it joined the WTO in 200 I and to the overarching understanding embodied in the Marrakesh Declaration that WTO members participate "based upon open, market-oriented policies."[27] The specific commitments China made are found in the texts of the WTO Agreements, China's Protocol of Accession to the WTO, certain designated paragraphs of the accompanying Working Party Report, and China's schedules of commitments.[28] The schedules cover tariffs and non-tariff measures applicable to agricultural trade and industrial goods (commitments under the General Agreement on Tariffs and Trade, or GATT) and services (commitments under the General Agreement on Trade in Services, or GATS). The Accession Protocol and Working Party Report thereto also set out promises on how China intends to fulfill its WTO obligations.

Every WTO case must be based on government measures (i.e., Jaws, regulations, rulings or practices), whether written or not, that violate one or more specific commitments or that "nullify or impair" a benefit provided to members of the WT0.[29] It is this combination of both actual violations and the non-violation impairment of benefits that should be the focus of the case at the WTO.

Among the things that could be included in such a big, bold case are the following, understanding that this is not an exhaustive list:

1. Technology Transfer

One of the key findings of the Section 301 Report is that the Chinese government uses both foreign ownership restrictions and administrative licensing and approvals processes to force technology transfer in exchange for either the investment approval itself or for the numerous administrative approvals needed to establish or operate a business in China.

However, China clearly committed (in one of the legally binding paragraphs of its Working Party report) that it would not condition investments on the transfer of technology:

> The allocation, permission or rights for importation and investment would not be conditional upon performance requirements set by national or sub-national authorities, or subject to secondary conditions covering, for example, the conduct of research, the provision of offsets or other forms of industrial compensation including specified types or volumes of business opportunities, the use of local inputs *or the transfer of technology.* (Emphasis added).[30]

While the Section 301 Report clearly notes the difficulty in proving the technology transfer mandates, given that many of them are unwritten, and that others are done in the course of a negotiation between two ostensibly private parties (even though the Chinese entity may be either state-owned or have Communist Party members on its board), recent decisions of the WTO Appellate Body have made it

[26] 2017 USTR Report to Congress on China's WTO Compliance at 5.F. The WTO Case Against China

[27] Marrakesh Declaration of 15 April 1994, Preamble.

[28] See Report of the Working Party to the Accession of China to the WTO, WT/ACC/CHN/49, 1 October 2001. Para 342 sets forth the specific paragraphs of the Working Party Report that are considered to be incorporated into the Protocol of Accession itself. These paragraphs are therefore considered to be equally legally binding on China as the provisions in its Protocol or the text of the WTO Agreements.

[29] The WTO Appellate Body, in EC-Asbestos described nullification and impairment: "Article XXIII: l(a) sets forth a cause of action for a claim that a Member has failed to carry out one or more of its obligations under the GATT 1994. A claim under Article XXIII: I (a), therefore, ties when a Member is alleged to have acted inconsistently with a provision of the GATT 1994. Article XXIII:l(b) sets forth a separate cause of action for a claim that, through the application of a measure, a Member has 'nullified or impaired' 'benefits' accruing to another Member, 'whether or not that measure conflicts with the provisions' of the GATT 1994. Thus, it is not necessary, under Article XXIII:l(b), to establish that the measure involved is inconsistent with, or violates, a provision of the GA TT 1994. Cases under Article XXIII: l(b) are, for this reason, sometimes described as 'non-violation' cases." Appellate Body Report, EC -Asbestos, para. 185.

[30] Paragraph 203, Working Party Report. See also Section 7.3 of China's Protocol of Accession.

clear that unwritten measures can be challenged.[31] Given the clear commitment made by China and the WTO's Agreement on Trade Related Investments' (TRIMs) prohibition on treating foreign investment less favorably than Chinese investment, China's practices resulting in the forced or coerced transfer of technology should be challenged.

2. Discriminatorv Licensing Restrictions

The second key finding of the Section 301 Report is that China's regime of technology regulations does not allow U.S. (or other foreign) firms to license their technology (or choose not to license it) under the conditions and terms that they would like or that would prevail in a market economy. The Chinese regulations, among other things, discriminate against foreign technology, putting foreign technology importers at a disadvantage relative to Chinese companies and imposing additional restrictions on the use and enjoyment of technology and intellectual property rights simply because the technology is of foreign origin. This violates China's commitment to provide national treatment.

Unlike the concerns for the unwritten and under-the-table nature of the forced technology transfer practices, these measures are formal laws and regulations that are well-known to the United States and others. Indeed, Japan, the U.S. and the EU have been raising concerns about these rules in the TRIPS Council and other WTO forums. Some of these same laws and regulations are the source of the United States' and the EU's May 2018 requests for consultations with China.

China's commitments here are clear: China ensured national and MFN treatment to foreign right-holders regarding all intellectual property rights across the board in compliance with the TRIPS Agreement[32] In enacting laws and imposing regulations which discriminate against foreign holders of intellectual property rights and which restrict foreign right holders' ability to protect certain intellectual property rights, China has broken those commitments and violated its WTO obligations.

3. Outbound Investment and Made in China 2025

The third major finding of the Section 301 Report is that China has engaged in a wide-ranging, well-funded effort to direct and support the systematic investment in, and acquisition of, U.S. companies and assets to obtain cutting-edge technology, in service of China's industrial policy. The report also notes that the role of the state in directing and supporting this outbound investment strategy is pervasive, and evident at multiple levels of government—central, regional, and local. The government has devoted massive amounts of financing to encourage and facilitate outbound investment in areas it deems strategic. In support of this goal, China has enlisted a broad range of actors to support this effort, including SOEs, state-backed funds, government policy banks, and private companies.

Concerns about these policies were heightened by the release by China's State Council in 2015 of its Made in China 2025 initiative, a .. comprehensive blueprint aimed at transforming China into an advanced manufacturing leader [through] preferential access to capital to domestic companies in order to promote their indigenous research and development capabilities, support their ability to acquire technology from abroad, and enhance their overall competitiveness."[33]

Because much of the outward investment regimes and the Made in China 2025 plan are formal laws, regulations or programs of the Chinese government, basic documentation for a WTO claim is relatively straightforward. However, the WTO rules have much less say over outward investment, making the nature of a WTO claim in this area more complicated. Nonetheless, there are some commitments that could form the basis for a violation claim, including a lack of reciprocity. For example, China stated that its IPR Jaws will provide that "any foreigner would be treated . . . on the basis of the principle of reciprocity."[34] Yet as the Section 3 0 I Report amply documents, the Chinese adm in istrati ve approval regime imposes substantially more restrictive requirements than that of the United States. U.S. firms face numerous barriers, such as sectoral restrictions, joint venture requirements, equity caps, and technology transfer requirements when they seek access to the Chinese

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[31] See, for example, Appellate Body Reports, Argentina—Measures Affecting the Importation of Goods, WT/DS438/AB/R / WT/DS444/AB/R / WT/DS445/AB/R, adopted 26 January 2015.

[32] Paragraph 256, Working Party Report, one of the legally binding paragraphs of China's Working Party Report.

[33] U.S. Chamber of Commerce, "Made in China 2025: Global Ambitions Built on Local Protections."

[34] Paragraph 256 of China's Working Party Report (one of the paragraphs that is legally binding).

market. Chinese firms do not face anything remotely approaching these types of restrictions when investing in the United States.

In addition, China's outward investment regime and programs like Made in China 2025 could be challenged under the WTO's GA TT Article XXlll "non-violation" given the non-market nature of China's outward investment scheme. As the Section 301 Report notes: "Market-based considerations . . . do not appear to be the primary driver of much of China's outbound investment and acquisition activity in areas targeted by its industrial policies. Instead, China directs and supports its firms to seek technologies that enhance China's development goals in each strategic sector."[35] Yet China, in joining the WTO, was becoming part of an organization calling for the "participation of . . . economies in the world trading system, based upon open, market-oriented policies and the commitments set out in the Uruguay Round Agreements and Decisions."[36]

4. Theft of Trade Secrets and Other Intelelectual Property

The fourth area identified by the Section 301 Report are cyber intrusions into U.S. commercial networks targeting confidential business information held by U.S. firms, conducted and supported by the government of China. These cyber intrusions have allowed the Chinese government to gain unauthorized access to a wide range of commercially-valuable business information, including trade secrets, technical data, negotiating positions, and sensitive and proprietary internal communications.

The Section 301 Report and the numerous documents and studies it references, along with the Department of Justice indictment of Chinese government hackers for cyber intrusions and economic espionage,[37] leave little doubt that China has engaged in serial theft of U.S. intelelectual property rights, trade secrets in particular.

The clear claim under the WTO is a violation of the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). TRIPS covers the broad array of intellectual property rights (i.e., patents, copyrights, trademarks, trade secrets, industrial designs, geographical indications, integrated circuits) and provides both minimum standards of protection and a broad-based requirement for enforcement. For example, Article 39 of the TRIPS Agreement provides that people and companies "shall have the possibility of preventing infonnation lawfully within their control from being disclosed to, acquired by, or used by others without their consent . . . " while TRIPs Article 41 imposes an affinnative obligation on all WTO Members: "Members shall ensure that enforcement procedures . . . are available under their law so as to pennit effective action against any act of infringement of intellectual property rights covered by this Agreement, including expeditious remedies to prevent infringements and remedies which constitute a deterrent to further infringements." Engaging in and permitting the theft, whether through cyber intrusions or not, is a violation of the basic requirement that China's laws and its efforts to enforce intellectual property rights "must have real force in the real world of commerce."[38]

5. Investment Restrictions

As noted above, Chinese government officials at times use China's current foreign investment approval process to restrict or unreasonably delay market entry for foreign companies, to require foreign companies to take on a Chinese partner, or to extract valuable, deal-specific commercial concessions as a price for market entry.[39] Foreign companies are often told that they will have to transfer technology, conduct research and development in China or satisfy performance requirements relating to exportation or the use of local content if they want their investments approved.[40]

In addition, in the name of security, a number of additional restrictions have been placed on foreign investment. The National Security law includes a more restrictive national security review process and other significant restrictions on foreign invest-

[35] Findings of the Investigation Into China's Acts, Policies, And Practices Related to Technology Transfer, Intellectual Property, And Innovation Under Section 301 of the Trade Act Of 1974, Office of the United States Trade Representative, March 22, 2018, pg. 148.

[36] Marrakesh Declaration of 15 April 1994.

[37] U.S. v. Wang Dong et al., (W. D. Pa., May I, 2014).

[38] James Bacchus, "How the World Trade Organization Can Curb China's Intellectual Property Transgressions," CATO, March 22, 2018.

[39] 2017 Report to Congress on China's WTO Compliance, USTR, January 2018, pp. 83-95.

[40] For example, in October 2012, MOF, MIIT and MOST issued two new measures establishing a fiscal support fund for manufacturers of New Energy Vehicles (NEVs) and NEV batteries. As foreign automobile manufacturers are required to form 50-percent joint ventures with Chinese partners, these requirements could effectively require them to transfer core NEV technology to their Chinese joint-venture partners in order to receive the available government funding.

ment, such as restrictions on the purchase, sale and use of foreign ICT products and services, cross-border data flow restrictions and data localization requirements."[41]

The *Catalogue Guiding Foreign Investmellf in Industry (Foreign Investment Catalogue),* imposes significant restrictions in key services sectors, extractive industries, agriculture and certain manuefacturing industries.

A number of the provisions in these laws and catalogues violate the commitment China made in its Protocol of Accession: "China shall ensure that . . . the right of importation or investment by national and sub-national authorities, is not conditioned on: whether competing domestic suppliers of such products exist; or performance requirements of any kind, such as local content, offsets, the transfer of technology, export performance or the conduct of research and development in China."[42] These also violate China's basic commitment to national treatment, requiring that China treat foreign companies no less favorably than it treats Chinese companies.[43]

6. Lack of An Independent Judiciary

The WTO rules require all members to ensure the conformity of its laws, regulations and administrative procedures with the requiren1ents of the WTO Agreement. Among those requirements is the maintenance of judicial, arbitral or administrative tribunals or procedures for the review and correction of administrative actions relating to trade matters, where the tribunals responsible for such reviews are: a) impartial, b) independent of administrative agencies subject to such review, and c) have no substantial interest in the outcome of the matter under review."[44]

When China joined the WTO, it expressly committed to .. establish or designate, and maintain tribunals, contact points and procedures for the prompt review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings of general application referred to in Article X: 1 of the GATT 1994, Article VI of the GATS and the relevant provisions of the TRIPS Agreement. Such tribunals shall be impartial and independent of the agency entrusted with administrative enforcement and shall not haye any substantial interest in the outcome of the matter."[45]

Yet China's National People's Congress and local peoples' congresses, as controlled by the Chinese Communist Party, maintain the power to dictate the outcomes of proceedings of all agencies entrusted with administrative enforcement of WTO-related rules, of the tribunals that review the decisions of administrative agencies, and all other judicial organs engaged in further reviews of actions and decisions by trade-related agencies and reviewing tribunals, such as China's Supreme People's Court.[46] Because this means that China's legal system allows the Chinese Communist Party to secure discrete administrative, legal and economic outcomes related to China's WTO obligations, China has violated its commitment to establish and maintain an independent judiciary and to provide for uniform, independent judicial review of administrative actions relating to WTO obligations and commitments.

7. Subsidies

Many regard the WTO's difficulty in regulating subsidies as among its greatest weaknesses, particularly when it comes to the size and the nature of the subsidies being provided in China. For example, subsidization and the resultant overcapacity have been problems in China, particularly with State-Owned-Enterprises (SOEs) which are provided with a variety of free or below-cost resources (such as land and raw materials), raising questions as to whether inputs provided by such SOEs to downstream manufacturers should be treated as government subsidies. The provisions of the WTO's Agreement on Subsidies and Countervailing Measures (ASCM) makes proving the existence of such subsidies difficult. Specifically, the agreement defines a subsidy as a "financial contribution by a government or any public

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[41] The recently enacted *Cybersecurity Law* adds additional restrictions to those in the National Security law.

[42] China's Protocol of Accession to the WTO, Section 7.3

[43] China's basic national treatment commitment is underscored in Paragraph 18 of the Working Party Report (one of the legally binding paragraphs): "The representative of China further confirmed that China would provide the same treatment to Chinese enterprises, including foreign-funded enterprises, and foreign enterprises and individuals in China."

[44] Article X.3(b) of the GATT.

[45] China's Protocol of Accession to the WTO, 2(D) Judicial Review.

[46] "China's top judge has fired a warning shot at judicial refonners by formally acknowledging that China's court system is not independent of the Communist Party and rejecting attempts to make it so." Financial Times, July 20, 2018.

body."[47] The WTO Appellate Body has interpreted "public body" to mean government or governmental entities that exercise governmental functions[48] —i.e., that the entity must possess, exercise, or be vested with "governmental authority" and be performing a "governmental function." This interpretation effectively takes Chinese SOEs out of the definition of subsidy and renders the WTO framework ineffective in addressing these cases.

Second, demonstrating the existence of a subsidy also requires showing that a benefit was provided to the subsidy recipient, with "benefit" being defined as making the recipient better off than they would have been absent the subsidy. Such a demonstration requires a comparison to a market benchmark to determine whether the terms of a loan or the price of a government purchase were more favorable than market-based terms. Because of the nature of China's economy, benchmarks are often hard to prove.

Moreover, remedies available under the WTO subsidy rules are perceived to be inadequate in addressing concerns about China. The ASCM does not provide an outright ban on subsidies but rather allows countries to take one of two actions when faced with subsidized goods: 1) countervailing duty actions if the subsidized goods are coming into their markets and causing injury to their domestic producers, with the amount of the duty equal to the portion of the cost of production that has been covered by the subsidy, or 2) adverse effects cases at the WTO, if the damage from trade in the subsidized product is causing hann in third-country markets.[49] The problem with countervailing duties is that they may simply push the subsidized goods into other markets, thus suppressing prices. The problem with adverse effects cases is that remedies in the WTO are prospective only so the requirement to "remove the adverse effects of the subsidy" often does little to dismantle the capacity that China has built to produce those goods in the first place.

In recent years, it appears that China has begun to tie subsidies to lists of qualified manufacturers located in China. For example, the central government and certain local governments provide subsidies in connection with the purchase ofNEYs, but they only make these subsidies available when certain Chinese-made NEVs, not imported NEVs, are purchased. China appears to pursue similar policies involving NEV batteries, leading to lost sales by U.S.-based manufacturers.[50]

China made two basic commitments with respect to subsidies when it joined the WTO: I) to notify the WTO of all the subsidies it granted or maintained, and 2) to eliminate all export contingent and import substitution subsidies. It also made general national treatment commitments not to discriminate against foreigners. It appears that China is violating all three commitments. The hope in bringing a broad challenge would be to force a long-overdue discussion about what the WTO can do to change its approach to disciplining subsidies, along with achieving a fonnal finding that China is in breach and must bring its measures into compliance.

8. Export Restraints

In some situations, China has used its border taxes to encourage the export of certain finished products over other finished products within a particular sector. For example, in the past, China has targeted value-added steel products, particularly wire products and steel pipe and tube products, causing a surge in exports of these products, many of which ended up in the U.S. market. Furthermore, despite its commitments to the contrary, China has taken no steps to abandon its use of trade-distortive VAT export rebates. Export taxes on any products other than those specified in Annex 6 to China's Protocol of Accession are prohibited and ripe for challenge.[51]

9. Standards

China seems to be actively pursuing the development of unique requirements, despite the existence of well-established international standards, as a means for protecting domestic companies from competing foreign standards and technologies. Indeed, China has already adopted unique standards for digital televisions, and it is

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[47] See Article I of the SCM Agreement. Assuming that a measure is a subsidy within the meaning of the SCM Agreement, it nevertheless is not subject to the SCM Agreement unless it has been specifically provided to an enterprise or industry or group of enterprises or industries.

[48] See *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products From China,* WT/DS379/AB/R.

[49] Part V, Agreement on Subsidies and Countervailing Measures.

[50] 2017 Report to Congress on China's WTO Compliance, USTR, January 2018; pg.90.

[51] "China shall eliminate all taxes and charges applied to exports unless specifically provided for in Annex 6 of this Protocol or applied in conformity with the provisions of Article VIII of the GATT 1994." Section 11.3, China's Protocol of Accession to the WTO.

trying to develop unique standards and technical regulations in a number of other sectors, including, for example, autos, telecommunications equipment, Internet protocols, wireless local area networks, radio frequency identification tag technology, audio and video coding and fertilizer as well as software encryption ‘and mobile phone batteries. This strategy has the potential to create significant barriers to entry into China's market, as the cost of compliance will be high for foreign companies, while China will also be placing its own companies at a disadvantage in its export markets, where international standards prevail. There are also concerns that integrating its domestic standards requirements into its certification or accreditation schemes would make them de facto mandatory.[52]

China's standards are subject to the WTO requirements on standards, both those contained in the Agreement on Sanitary and Phytosanitary Standards (SPS Agreement) (relating to food, animal and plant standards) and the Agreement on Technical Barriers to Trade (TBT). Both Agreements contain basic national treatment requirements, preferences for the harmonization of standards with those set by recognized international standards organizations and a basic requirement that standards not be more trade restrictive than necessary to fulfill a legitimate objective. To the extent that China's standards can be shown to have effectively created unnecessary obstacles to trade or to have unreasonably departed from international standards, they can be challenged at the WTO.

10. Services

China's commitments with respect to services are those found in its GATS (General Agreement on Trade in Services) schedules and in more recent commitments China has made to improve on those initial commitments. The problem is that in a number of sectors, China has not followed through previously agreed upon changes. For example:

Insurance: [53] While China allows wholly foreign-owned subsidiaries in the non-life (i.e., property and casualty) insurance sector, the market share of foreign-invested companies in this sector is only about two percent. Some U.S. insurance companies established in China sometimes encounter difficulties in getting the Chinese regulatory authorities to issue timely approvals of their requests to open up new internal branches to expand their operations. In November 2017, China announced that it would be easing certain of its foreign equity restrictions in the insurance services sector, but to date it has not done so.

Securities and management services: [54] China only permits foreign companies to establish as Chinese-foreign joint ventures, with foreign equity capped at 49 percent. In November 2017, China announced that it would be easing certain of its foreign equity restrictions in the securities and asset management services sectors, but to date it has not done so.

Legal services:[55] China has issued measures intended to implement the legal services commitments that it made upon joining the WTO. However, these measures restrict the types of legal services that can be provided by foreign law finns, including through a prohibition on foreign law finns hiring lawyers qualified to practice Chinese law, and impose lengthy delays for the establishment of new offices.

The WTO case should work to hold China to all of the commitments it has made to open up its services sector.

11. Agriculture

U.S. exporters continued to be confronted with non-transparent application of sanitary and phytosanitary (SPS) measures, many of which have appeared to lack scientific bases and have impeded market access for many U.S. agricultural products. China's seemingly unnecessary and arbitrary inspection-related import requirements also continued to impose burdens and regulatory uncertainty on U.S. agricultural producers exporting to China, as did the registration and certification requirements that China imposes, or proposes to impose, on U.S. food manufacturers.[56]

Any SPS measures adopted without a sound scientific basis or without a risk assessment or without being based on certain international standards are clearly subject to challenge at the WTO, with past cases indicating a high likelihood that any such measures would be struck down. The inspection-related requirements may also violate the WTO's Agreement on Pre-shipment Inspection, which contains both nondiscrimination and transparency requirements.

[52] 2017 Report to Congress on China's WTO Compliance, USTR, January 2018, pp. 60-61.
[53] 2017 Report to Congress on China's WTO Compliance, USTR, January 2018, p. 125
[54] 2017 Report to Congress on China's WTO Compliance, USTR, January 2018, p. 20.
[55] 2017 Report to Congress on China's WTO Compliance, USTR, January 2018, p. 129.
[56] 2017 Report to Congress on China's WTO Compliance, USTR, January 2018, p. 96.

Transparency[57]

The issue of transparency and access to China's laws, regulations and rules was of key concern to WTO members when China joined in 2001. China's Protocol of Accession and five paragraphs of its Working Party clearly commit China to making all laws, regulations and other measures pertaining to trade readily available and, upon request, available prior to their implementation or enforcement, along with making them available in one or more of the official languages of the WTO (English, French and Spanish). As the following examples show, China has not lived up to these commitments and can be challenged on these (and other) transparency failures at the WTO:

Publication of laws: While trade-related administrative regulations and departmental rules are more commonly (but still not regularly) published in the journal, it is less common for other measures such as opinions, circulars, orders, directives and notices to be published, even though they are in fact all binding legal measures. In addition, China does not normally publish in the journal certain types of trade-related measures, such as subsidy measures, nor does it nonnally publish sub-central government trade-related measures in the journal.

Notice and comment procedures: At the May 2011 S&ED meeting, China committed to issue a measure implementing the requirement to publish all proposed trade and economic related administrative regulations and departmental rules on the website of the State Council's Legislative Affairs Office (SCLAO) for a public comment period of not less than 30 days. In April 2012, the SCLAO issued two measures that appear to address this requirement. Since then, despite continuing U.S. engagement, little noticeable improvement in the publication of departmental rules for public comment appears to have taken place, even though China confirmed that those two SCLAO measures are binding on central government ministries.

13. Non-violation

Last, but certainly not least, a broad and deep case at the WTO should include a non-violation claim under Article XXIII of the GATT, focused on the myriad ways in which China's economy fails to meet the Marrakesh Declaration that the WTO was designed as a world trading system "based upon open, market-oriented policies." The non-violation clause of Article XXIII represents a real-world attempt to solve the broader problem of contractual incompleteness. It provides a legal cause of action against measures that do not violate the treaty but that nevertheless upset the reasonable expectations of the parties and can be aimed at policies that might otherwise be beyond the reach of the GATT/WTO agreements.[58] Non-violation claims have been rare.[59] WTO members generally agree that "the non-violation nullification or impairment remedy should be approached with caution and treated as an exceptional concept. The reason for this caution is straightforward. Members negotiate the rules that they agree to follow and only exceptionally would expect to be challenged for actions not in contravention of those rules." [60]

However, the wide-spread concerns with China's economy and the difficulties it has raised for WTO members suggests that this is indeed the time for an exceptional approach. As made clear in Harvard Law Professor Mark Wu's "China Inc." analysis, China's economy is structured differently from any other major economy and is different in ways that were not anticipated by WTO negotiators.[61] It is the complex web of overlapping networks and relationships, both formal and informal,

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[57] 2017 Report 10 Congress on China's WTO Compliance, USTR, January 2018, p. 137 to 141.

[58] Article XXIII provides:

Nullification or Impairment

1. If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of:

(a) the failure of another contracting party to carry out its obligations under this Agreement, or

(b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or

(c) the existence of any other situation, the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it.

[59] "Although the non-violation remedy is an important and accepted tool of WTO/GATT dispute settlement and has been 'on the books' for almost 50 years, we note that there have only been eight cases in which panels or working parties have substantively considered Article XX111: l(b) claims." Panel Report, *Japan-Film,* para. 10.36.

[60] Panel Report, *Japan-Film,* para. 10.36.

[61] Mark Wu, "The 'China, Inc.' Challenge to Global Trade Governance," Harvard International Law Journal, Vol. 57, Spring 2016, pp. 261-324.

between the state, the Communist Party, SOEs, private enterprises, financial institutions, investors and others with Chinese government oversight over state assets (SASAC), financial sector organization (Central Huijin Investment Ltd.), heavy state planning, placement of Communist party officials in key positions, specific forms of corporate networks and state-private sector linkages that make China's economy so unique and so hard for the trading rules to deal with.[62]

It is exactly for this type of situation that the non-violation nullification and impairment clause was drafted. The United States and all other WTO members had legitimate expectations that China would increasingly behave as a market economy—that it would achieve a discernable separation between its government and its private sector, that private property rights and an understanding of who controls and makes decisions in major enterprises would be clear, that subsidies would be curtailed, that theft of IP rights would be punished and diminished in amount, that S0Es would make purchases based on commercial considerations, that the Communist Party would not, by fiat, occupy critical seats within major "private" enterprises, and that standards and reguelations would be published for all to see. It is this collective failure by China, in addition to the specific violations of individual provisions noted above, that should form the core of a big, bold WTO case.

G. Objectives of Such a WTO Case

Most WTO disputes have as their goal a ruling by the Dispute Settlement Body that the measures complained about violate one or more provisions of the WTO Agreements, after which the responding party brings its measures into compliance, often by removing or amending the offending measures. Here, while one of the goals would indeed be to seek certain specific rulings of that type, the goals would be much broader—

1. to seek a common understanding of where the current set of rules are failing and need to be changed (with disciplines on subsidies at the top of that list);
2. to begin the process of scoping out exactly what those rule changes would look like to accommodate the views of the broader WTO membership;
3. to seek recognition from China of where and to what degree its economic structure can or cannot fit within a fair, transparent and market-based trading system; and
4. to give China the opportunity to make a choice that is its sovereign right to make-whether it wants to change its system to one that does fit within the parameters of the WTO or not.

As former USTR official Harry Broadman put it, "There's no right or wrong here. If China's choice results in conduct that does not square with the rules of the WTO . . . so be it. Beijing should then exit the WTO gracefully or be shown the door."[63] The hope would be that both China and the coalition of parties to the dispute would appreciate that the trading system is better off with China as part of it, that the WTO rules are in some places and in some ways part of the problem and need to be changed, but that tinkering at the margins will not suffice.

H. Conclusion

The concerns with China are global concerns. The tools used to address the concerns and the solution sought should be global as well. And that means using the WTO. And it means fixing the WTO, particularly its dispute settlement system, to ensure that the WTO is ready and able to take on the challenge that China presents to the world trading system.

[62] Mark Wu at 284.

[63] Harry G. Broadman, "The Coalition-Based Trade Strategy Trump Should Pursue Toward China," Forbes, April 9, 2018.

Saving Multilateralism—Renovating the House of Global Economic Governance for the 21st Century

by Jennifer Hillman—The German Marshall Fund of the United States[1]

[INCLUDED AS A SUPPLEMENT TO MS. HILLMAN'S PREPARED STATEMENT]

SAVING MULTILATERALISM

RENOVATING THE HOUSE OF GLOBAL ECONOMIC GOVERNANCE FOR THE 21ST CENTURY

JENNIFER HILLMAN
THE GERMAN MARSHALL FUND OF THE UNITED STATES

G|M|F The German Marshall Fund of the United States
STRENGTHENING TRANSATLANTIC COOPERATION

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Saving Multilateralism

Renovating the house of global economic governance for the 21st century

Brussels Forum Paper Series

March 2010

Jennifer Hillman*
The German Marshall Fund of the United States

Introduction: Coping with Complexity 3
Solid Foundations: The Architecture of Global Economic Governance 6
The Great Recession and the Steering Committee of the World Economy 10
The IMF, World Bank, and WTO: From Crisis to Reform 15
Guardian of Global Finance: The International Monetary Fund 17
From Reconstruction to Development: The World Bank 20
Negotiating the Rules: The World Trade Organization 24
Renovating the House of Global Economic Governance for the 21st Century 27
The Harbinger of Global Governance: Political Leadership and the G20 28
Reaffirming Multilateralism in a World of Regionalism 30
Transatlantic Multilateralism for the 21st Century 33
Conclusion 37
Bibliography 38

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1 Introduction: Coping with Complexity

Last December, the eyes of all those with a stake in international affairs turned to Europe. First they looked to Geneva, for signs that the long-running Doha Round of multilateral trade negotiations at the World Trade Organization (WTO) would get back on track after years of stalemate. Then observers turned to Copenhagen, hoping to see a binding and comprehensive agreement reflecting a commitment on the part of the world's governments to address the pressing global challenge of climate change. They were to be sorely disappointed. Inscribed on the faces of those struggling to reach agreements was a deep frustration with multilateral processes that were proving incapable of delivery. Instead of agreement, the images playing out on television screens and in newspapers around the world were of fractiousness and division, due in part to the large number of participants and contentiousness of the issues faced; of anger, on the part of all those who felt marginalized by the process; and of concern, from those looking for signs that the world still has the capacity to reach accords when it really matters.

The failure of these meetings to produce formal agreements—or even specific paths to reaching agreements in the future—despite the high stakes and the political capital that had been invested in advance left many questioning the ability of the world's leaders to meet global challenges, shedding a spotlight on the institutions and fora that were established for the purpose of achieving multilateral solutions to the most pressing collective problems of the 21st century.

Why did these meetings fail? Many had assumed that the most significant economic crisis since the Great Depression and the overwhelming scientific and circumstantial evidence of damaging changes to our climate would compel world leaders to set aside their differences and reach meaningful agreements. But it did not happen. It is not that the problems are not big enough or urgent enough. The failure to reach agreements can best be seen as part of a long-term trend toward increased complexity in the world that makes it nearly impossible to reach traditional multilateral binding accords, combined with a waning of faith on the part of many countries in multilateralism and multilateral institutions.

The long-term trend toward increasing complexity combined with a waning faith in multilateralism and multilateral institutions makes it nearly impossible to reach traditional binding multilateral accords.

This increased complexity stems from a number of seismic shifts in international relations—and especially in international *economic* relations—some of which have been unfolding over the course of decades while others are of more recent origin. Government policies and international arrangements for collective decision-making have not kept pace with changes in the world, especially the high degree of international economic integration and interdependence. With decolonization came increases in the number of countries who are players on the world stage as well as a rebalancing of global economic power that has continued with the rise of the BRICs (Brazil, Russia, India, and China) and the other emerging market economies. The collapse of the Soviet bloc, accompanied by market reforms in China and India in the 1980s and 1990s accelerated the rapid integration of the global economy. Where previously only about half the world's population—the Oraganisation for Economic Co-operation and Development (OECD) countries, plus parts of Latin America and Asia—were engaged in global economic activity, suddenly people everywhere were brought together in a single world economy based on capitalism and markets.

At the macro-level, this led to shifting trade flows and patterns of foreign direct investment, a rise in the number and size of multinational companies and financial institutions, and surging global demand. It also meant a corresponding increase in the speed with which goods, money, and technology traverse the globe. At the micro-level, the "great doubling" of the

The inability to create new institutions or reach agreements means greater reliance on—and greater need for renovation of—the existing international economic institutions, the IMF, the World Bank, and the WTO.

global workforce has had a direct effect on wages, income levels, and employment in the advanced industrial countries, in some instances prompting fears of economic insecurity and a public backlash against "globalization."[1]

Taken together, all these factors have stretched the capacity of the current institutions of multilateral governance to a breaking point, leading to fragmentation and the emergence of deep divisions among groups of countries at different stages of economic development. Throw in the increases in the complexity of the issues themselves and the degree to which these issues overlap and affect one another and the problems of the 21st century begin to look too complex to handle.

This paper argues that learning to operate in this vastly more complex world will require more multilateralism, not less. It means greater reliance than ever on those economic institutions and fora that have already learned to function in a global fashion—particularly the World Bank, the International Monetary Fund (IMF), and the WTO. It contends that creating new international institutions or binding accords is nearly impossible in today's world, and examines where the existing institutions stand today and the changes that will be necessary if they are to form the core of an effective global economic architecture for the 21st century.

Secondly, the paper explores the problems created by the lack of faith in multilateralism, particularly on the part of many developing and emerging market countries, who either don't want to rely on the multilateral institutions designed in a bygone era when the transatlantic powers dominated the world or who find that their economic needs can be more easily addressed through bilateral or regional agreements rather than working through the often more cumbersome processes at the multilateral level. Despite a new multilateralist president in the United States, the momentum in the world of global governance today is in the wrong direction, to be found in the hundreds of regional, sub-regional, and bilateral agreements that have come into force in the last several decades. With each such agreement comes a lessening of the energy, time, and resources left for multilateralism and multilateral institutions—along with the hard fact that the toughest global problems thus remain on the table, unsolved and insoluble through such regional arrangements.

Third, the paper contends that, in the absence of any prospect of building a new global economic architecture, the existing institutions of multilateral economic governance must be "renovated." Their governance structures need to be changed to reflect the dramatic shifts in the distribution of economic weight among countries, their mandates revised in order to ensure that they cover a wider range of issues but with better coherence among them, and they must be adapted in the face of proliferating regionalism, with a shift toward accommodating and incorporating regional accords within multilateral frameworks.

This paper also contends that while these changes are both daunting and essential if the institutions are to have the efficiency, effectiveness, and legitimacy they require, they are in fact well within the grasp of the current world system. We are not, in other words, in "a 1944 moment"—the constitution-making epoch when the United Nations, along with the World Bank, the IMF, and the predecessors to the WTO were created largely out of whole cloth. Nor do we need to be in such a moment in order to achieve a global economic architecture capable of meeting the needs of the 21st century. The current crisis, the coming together of world leaders through the elevation of the G20, and a common understanding of the

[1] Richard B. Freeman, *America Works: Critical Thoughts on the Exceptional U.S. Labor Market* (Russell Sage Foundation, 2007).

failings of the current international economic institutions ought to be enough to compel these much-needed renovations of the system.

Finally, although leadership will be needed from countries all around the world, the paper concludes by suggesting the role that Europe and the United States must play if they are to help save what together they started 65 years ago—the institutions of a multilateral economic order created to bring about global peace and prosperity for all, with a commitment to think and act globally when addressing the most pressing economic problems of the day.

2 Solid Foundations: The Architecture of Global Economic Governance

The UN bore responsibility for issues of diplomacy, security, and war; the World Bank for international development and the reduction of poverty; the International Monetary Fund for financial stability and economic cooperation; and the GATT, precursor to the World Trade Organization, for trade liberalization and institutional stability in the world trading system.

In 1944, in the woods of New Hampshire, with the end of World War II already in sight, an extraordinary set of gatherings occurred, bringing together an array of government officials whose vision for a better future was shaped by the hard lessons of the 1930s. Rejecting the catastrophic "beggar-thy-neighbor" policies of the major economic powers that had hastened the slide into worldwide depression and war, these public servants dedicated themselves instead to the creation of a rules-based international economic order that would serve as the basis for peace and prosperity. Over the course of the Bretton Woods Conference, the subsequent Dumbarton Oaks and San Francisco meetings, and the months that followed, they conceived of and created the charters for four major international institutions—the United Nations (UN), the International Bank for Reconstruction and Development (World Bank), the International Monetary Fund, and the International Trade Organization (ITO).[2]

At their inception, each of the major international institutions played specified roles. The UN bore responsibility for issues of diplomacy, security, and war; the World Bank for international development and the reduction of poverty; the International Monetary Fund for financial stability and economic cooperation; and the GATT, precursor to the World Trade Organization, for trade liberalization and institutional stability in the world trading system.

These institutions, while far from perfect, have done much to accomplish their most fundamental goals. In light of the tremendous pressure from around the world to protect domestic markets and jobs, the GATT/WTO and its rules and disciplines have kept an outbreak of Depression-era protectionism at bay for half a century, and eight rounds of multilateral trade negotiations have resulted in widespread liberalization of trade—at least in industrial products among industrial countries. The UN, while not achieving the ultimate goal of bringing an end to all wars, has done much to contain crises, settle regional conflicts, man peacekeeping missions, eradicate diseases, and work out agreements on everything from human rights conventions to the use of the seabed and of outer space. Similarly, the World Bank, while not eliminating poverty, has seen the portion of the world's population living in poverty decline from 40 percent 20 years ago to 21 percent today, along with providing loans and development assistance in more than 126 countries and participating in initiatives on everything from combating HIV/AIDS to biodiversity to education and debt relief for the poorest countries. The Bank is rightfully commended for its ability to raise and channel resources for development, for its highly-trained staff, and for its depth of knowledge about development strategies and approaches across country boundaries.[3] The IMF, while it has evolved considerably from its initial days of monitoring adherence to the par value system of fixed exchange rates, has made important changes to its key instruments—surveillance, lending, and technical assistance—allowing it to contain a number of financial crises, continue concessional lending where necessary, and join the fight against extreme poverty.[4]

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[2] The UN, IBRD (World Bank) and IMF all came into being with little delay. However, attempts to launch the ITO with a broad mandate had to be abandoned in 1951 when the Truman Administration announced that it would not seek ratification of the Havana Charter due to lack of support in the U.S. Congress. Instead, in 1947 a smaller group of countries negotiated the General Agreement on Tariffs and Trade (GATT), which was transformed in 1995 into the World Trade Organization (WTO).

[3] "Repowering the World Bank for the 21st Century." *Report of the High-Level Commission on Modernization of World Bank Group Governance* (the "Zedillo Commission Report"), Oct. 2009, p. 9.

[4] Rodrigo de Rato, former managing director of the IMF took the view before the 2008-2009 financial crisis that fundamental reform to the IMF was not needed, arguing that the IMF had evolved over its 60 years through amendments to its key instruments while remaining true to its purposes of fostering international economic cooperation, promoting rising prosperity and safeguarding global financial stability. Rodrigo de Rato, "Is the IMF's Mandate Still Relevant?" *Global Agenda*, Jan. 2005.

For their part, the United States and the member states of the European Union have been among the most active and engaged participants in these institutions. This is unsurprising, given the role the transatlantic partners played in creating these institutions and the interests they were originally intended to serve. At bottom, the postwar global economic architecture was established as a means to tie the West together in the emerging Cold War context through the liberalization of international trade and capital flows. First through the institutions of the Bretton Woods system, and then through the Marshall Plan, the United States was able to rebuild the shattered production capacity and financial markets of Western Europe. For the United States, the overriding purpose was clear: the political-strategic need to build up a bulwark against

Table 1. The architecture of global economic governance

International Monetary Fund (IMF)	World Bank	World Trade Organization (WTO)
Began with: 44 members **Now:** 186 Members	**Began with:** 44 members **Now:** 186 Members	**Began with:** 23 GATT parties **Now:** 153 Members
Mandate: • Promotes international monetary cooperation • Macroeconomic surveillance • Promotes exchange stability • Develops multilateral system of payments • Makes resources available to member's experiencing balance of payments difficulties.	**Mandate:** • Evolved from facilitator of post-war reconstruction and development to mandate of worldwide poverty alleviation • Promotes long-term economic development by providing technical and financial support • Funds loans through member country contributions and bond issuance	**Mandate:** • Forum for trade negotiations • Handles trade disputes through dispute settlement process • Monitors and implements trade agreements • Technical assistance and training for developing countries • Cooperation with other international organizations
Revenue: $325 billion in quotas contributed by members (as of 3/09)	**Revenue:** In 2009, IBRD raised $44.3 billion. In FY 09–11, commitments of $41.7 billion made available to IDA	**Revenue:** Administrative budget of $173 million, paid by contributions from members based on a share of world trade
Loans or grants: $175.5 billion in loans committed, of which $124.5 billion not drawn (as of 9/09)	**Loans or grants:** $58.8 billion in total commitments (loans, credits, guarantees, and grants) in 2009	**Loans or grants:** $28 million of training and technical assistance provided; support for Aid for Trade initiatives

Source: IMF, World Bank, WTO websites

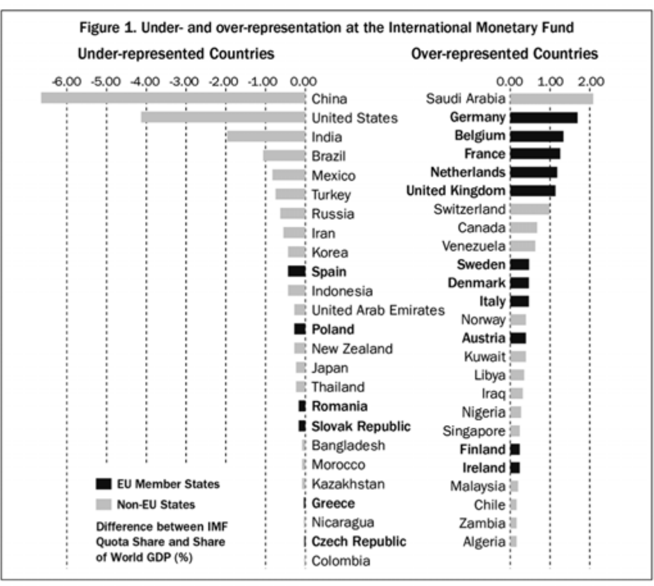
The legacy of this history is that the United States and Europe enjoy outsized control at the Bretton Woods institutions.

Communism. But it also served U.S. economic self-interest: a significant portion of Marshall Plan aid effectively went to boost European demand for goods from the United States, helping stave off domestic fears of a postwar slump or renewal of the Great Depression. Over the medium term, the Bretton Woods system helped create foreign markets for the United States by conjuring up a middle class in U.S. economic partners around the world, something from which the Europeans—once they were back on their feet following the Marshall Plan and the reconstruction program of the Organization for European Economic Cooperation—have also been able to benefit. Today, by way of illustration, nearly one-third of U.S. and EU exports are to developing countries where the World Bank has lending programs.

By together establishing the rules and standards of conduct by which the global economy is governed, the United States and European Union became the stewards of the international economic order, running the system for much of the postwar era. In return, the three pillars of the global economic architecture they established—covering the financial side of economies (IMF), trade in goods and the real side of economies (GATT/WTO), and international development and poverty alleviation (World Bank)—have delivered enormous economic benefits to their founders. Despite occasional challenges, the system has fared well. It has provided stability and market opening, relatively stable foreign exchange rates, the ready availability of capital, and a forum for the coordination of macroeconomic policies. Between the first GATT round in 1947 and the launch of the Doha Round at the WTO in 2001, international trade increased enormously, by more than 100 fold. Global financial flows have grown by a still greater amount. The integration of the world economy has proceeded apace, propelled by freedom of capital movements, the development of new and expanding markets, economies of scale, cheaper sources of supply of raw materials and finished goods, the international migration of labor, and technological advances in production processes, transportation, and communications.

The legacy of this history is that the United States and Europe enjoy outsized control at the Bretton Woods institutions. Both benefit from the unwritten rule that the president of the World Bank is always an American, while the managing director of the IMF is always a European. Seven of the top ten countries that are "overrepresented" at the IMF (in terms of the difference between their IMF quota share and their share of world GDP) are European.

Both the World Bank and the IMF have a board of 24 executive directors, with most of the executive directors speaking for (and voting for) a group of countries. Five countries, however, have their own appointed seats: the United States, Germany, France, the United Kingdom, and Japan. In addition to the German, French, and British seats, the 24 other members of the European Union are part of the group of countries represented by seven other executive directors, thereby giving Europe three exclusive seats and a significant presence in seven others. As such, the EU's member states can influence 32 percent of the votes at the IMF—and a similar (although not exactly equal) number at the World Bank. At the WTO, the United States and Europe have traditionally made up two of the so-called "quad" countries (the United States, European Union, Canada, and Japan) that for a long time were viewed as the "dealmakers" for any trade agreement, to which the rest of world was expected to simply sign on.



Notes: 25 IMF members with the smallest and largest differences between IMF quota share and share of world GDP. GDP is adjusted for purchasing power parity (PPP).

Source: Rebecca Nelson, "The G20 and International Economic Cooperation: Background and Implications for Congress," Congressional Research Service, Dec. 9, 2009.

3 The Great Recession and the Steering Committee of the World Economy

The second major systemic response to the Great Recession has been the transformation of the little-known G20 into the premier forum for international economic cooperation.

With the bursting of the housing bubble in the United States in 2007 and the train of events that led to the destabilization of the global financial system, the world economy collapsed into a steep recession in the final quarter of 2008, with global real GDP dropping at a 6 percent annual rate. This is undoubtedly the sharpest decline in world output—and especially in world industrial production and world trade—of the postwar era. Worldwide exports plummeted from $16.1 trillion in 2008 to $11.2 trillion in 2009, a drop of over 30 percent. Virtually all countries were sucked into the downturn, with the world witnessing the first significant decline in world real GDP (of nearly one percent) in six decades.

The full story of why this collapse occurred is still being written, but it starts with a focus on developments in the United States—especially the expansion and subsequent collapse of the real estate and real estate financing bubble and its impact on an overleveraged U.S. and global financial system. Add to the tale the accounts of persistently easy monetary policies, very low interest rates and interest rate spreads, and a general disregard of growing risks in the financial system, and the key causes begin to come into focus. Others would point to huge current account savings and reserve accumulations in Asia, particularly China, and the mirror-image deficits in the United States as another major underlying cause of the troubles.

This Great Recession of 2008–2009 has tested the international economic institutions as never before. In response, the IMF has stepped up its role as a lender of last resort, providing financial support packages to (among others) Iceland, Ukraine, Hungary, Pakistan, Belarus, Serbia, Armenia, El Salvador, and Latvia, and has also extended credit to Mexico, Poland, and Colombia under a new flexible credit line. In order to better equip the Fund for this task, G20 leaders at their London summit in April 2009 pledged to triple the IMF's lending capacity to $750 billion. Additionally, they urged the Fund to intensify its economic surveillance and early warning systems.

The World Bank has also moved to expand and speed up lending, assistance, and advice to developing countries, committing a record high of nearly $60 billion to countries hit by the financial crisis in fiscal year 2009—an increase of 54 percent over the previous year. An additional $8.3 billion was mobilized as part of the World Bank's global crisis response initiative to lessen the impact of the crisis on the most vulnerable, especially in low-income countries. These initiatives focus on safety net programs to protect the most vulnerable, maintaining long-term infrastructure investment programs, and on sustaining the potential for private sector-led economic growth and employment creation, particularly through the support of small and medium-size enterprises.

The WTO for its part began a new monitoring and reporting mechanism on protectionist actions taken by WTO members and worked to ensure that markets remained open and that countries adhered to their WTO commitments. The WTO also pushed G20 members to keep their pledges of support for Aid for Trade initiatives and worked to ensure that trade finance remained available and affordable.

The second major systemic response to the Great Recession has been the transformation of the little-known G20 gatherings of finance ministers and central bankers into an affair involving heads of state, declared by these leaders to be "the premier forum for international economic cooperation."[5] The G20 started in 1999 in the wake of the 1997 Asian financial crisis as a forum that brought together finance ministers from

[5] The Pittsburg Summit: Leaders' Statement, paragraph 19. "We designated the G20 to be the premier forum for our international economic cooperation."

major advanced and emerging economies with the goal of stabilizing global financial markets. With its ascendancy as part of the response to the Great Recession, it has now supplanted the G7/G8 meetings as the "chief steering committee of the world economy."[6] The inclusion in the G20 of a number of countries beyond the historical G7/G8 grouping no doubt stemmed, at least in part, from a recognition of the growing power of the emerging market and developing countries, who now account for more than 40 percent of the world economy. To have any sense of legitimacy throughout the world and particularly among the emerging market economies, expansion of the leadership circle was critical.

However, the initial G20 Leaders Summit, held in Washington in November 2008, was something of an EU-U.S. joint venture. British Prime Minister Gordon Brown had been calling for a "Bretton Woods II" to completely revise global economic governance, and the United States responded by promoting the idea of a G20 gathering, elevated to the level of heads of state, and extended the invitation for an initial meeting in Washington. European leaders at first exhibited differences of viewpoint on this approach, with French President Nicolas Sarkozy needing to be convinced of the appropriateness of the G20 as a venue, given that EU member states hold four of the seven seats (57 percent) at the G7 but only those same four seats plus one for the European Union (25 percent) at the G20. But in the end there was acceptance of the G20 as the only available forum with the scope of membership required to develop ideas, reach consensus on their desirability, and work to implement them.

[6] C. Fred Bergsten, Peterson Institute for International Economics, "A Blueprint for Global Leadership in the Twenty-First Century," Keynote Speech at the Global Human Resources Forum, Seoul, Korea, Nov. 4, 2009.

The evolution of the G20 also caused an evolution in the European approach to such summits. Efforts were made prior to and after each meeting to come to a Europe-wide position, with the European Council adopting a number of principles for action where agreements could be reached—principally in the area of enhancing sound regulation and reforming the international financial institutions. The European Commission was given the task of developing proposals for comprehensive reform of the financial system, which were then endorsed by the European Council and urged upon the rest of the G20 leaders by European heads of state. Throughout these efforts, Europe needed to find common ground among competing positions, with the United Kingdom arguing for more stimulus from other governments, Germany emphasizing the need to avoid major budget deficits, and France pushing for a major clampdown on executive compensation and a general tightening of financial regulation. The United States joined the United Kingdom and Japan in pushing for more stimulus from others while initially resisting any shift of financial regulatory policy out of the hands of national regulators.

The inclusion in the G20 of a number of countries beyond the historical G7/G8 grouping partly stems from a recognition of the growing power of the emerging market and developing countries, who now account for more than 40 percent of the world economy.

What emerged from these G20 summits is fairly remarkable—both in terms of the substance of the consensus that was reached and in terms of the process. Despite starkly differing views on how to stimulate economic growth and recovery, agreement was reached to pump more than $1 trillion into the global economy—albeit through the IMF, rather than individual countries—in the form of $500 billion in new lending capacity, $250 billion in new Special Drawing Rights, and $250 billion in trade finance. Separately, the G20 asserted that commitments by individual countries for fiscal expansion would total $5 trillion over two years. Demands from some European countries for a major toughening of the regulation and oversight of financial institutions were met through the creation

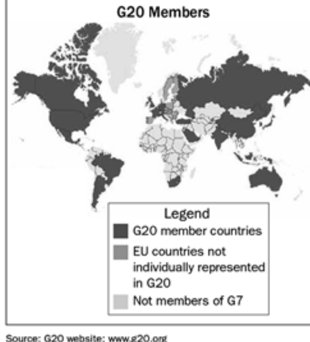
Table 2. Numbers count: From the G7/G8 to the G20

G7 Members

Source: G20 website; www.g20.org
EU G8: France, Germany, Italy, United Kingdom.

G7/G8		
Country	**GDP (millions of dollars)***	**% of world GDP**
Canada	1,499,551	2.46%
France	2,866,951	4.71%
Germany	3,673,105	6.03%
Italy	2,313,893	3.80%
Japan	4,910,692	8.06%
United Kingdom	2,680,000	4.40%
United States	14,441,425	23.71%
G7	32,385,617	**53.16%**
Russia	1,676,586	2.75%
G8	34,062,203	**55.92%**
EU countries in G8	11,533,949	**18.93%**

G20 Members



Source: G20 website; www.g20.org

[1] EU 27: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

[2] Non-G8 EU members: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden.

G20/G20 + non G8 EU		
Country	**GDP (millions of dollars)***	**% of world GDP**
Argentina	324,767	0.53%
Australia	1,013,461	1.66%
Brazil	1,572,839	2.58%
China	4,327,448	7.10%
India	1,206,684	1.98%
Indonesia	511,765	0.84%
Mexico	1,088,128	1.79%
Saudi Arabia	469,426	0.77%
South Africa	276,764	0.45%
South Korea	929,124	1.53%
Turkey	729,983	1.20%
Subtotal	12,450,389	**20.44%**
G20 total	46,512,592	**76.35%**
EU (27)[1]	18,387,785	**30.18%**
G20 + non-G8 EU countries[2]	53,366,428	**87.60%**

* 2008 GDP
Source: IMF World Economic Outlook Database (Oct. 2009)

of a Financial Stability Board (FSB).[7] The FSB was designed to bring about greater coordination and coverage of regulatory systems to include hedge funds, principles on pay and compensation, controls on excessive bank leverage and bank secrecy, and oversight of accounting standards and credit rating agencies. Those calling for a "Bretton Woods II" and a revamping of the institutions of multilateral economic governance were met at least halfway: there was eventual agreement on the U.S. proposal to increase the IMF quota share of the emerging market countries by five percentage points, along with an increase in the voting power of developing and transition countries at the World Bank of at least three percent and a commitment to reform the "mandates, scope and governance" of the financial institutions, while Europe's desire to keep the number of seats on the Executive Boards of the IMF and the World Bank at 24 was met. The WTO was included in the later G20 meetings, and was given the task of monitoring G20 pledges not to take any protectionist action and to complete the Doha Round of trade negotiations.[8]

A pattern began to emerge from the G20 summits whereby the heads of state would assign tasks to the multilateral economic institutions related to specific issues, with instructions to report back to the next meeting of G20 leaders. While the response to the initial Washington summit was not impressive, with markets around the world falling significantly after its conclusion, as the actions by the multilateral institutions and governments to carry out their assigned tasks started to take shape, the reaction to the subsequent summits was much more positive. Also of interest is the emerging process by which disagreements among, for example, major European players like Germany, France, and the United Kingdom, or between Europe and the United States, were brokered by other G20 members, with India or China or Brazil serving this role of referee and conciliator.

[7] The Financial Stability Board was established at the London G20 Summit as a successor to the Financial Stability Forum, which was created in 1999 by the G7 finance ministers and central bankers as a forum to promote coordination and information exchange among those responsible for financial stability. The FSF was made up of financial regulators from the G7 countries, Australia, Hong Kong, Netherlands, Singapore, and Switzerland, as well as international financial institutions, international regulatory and supervisory groupings, committees of central bank experts and the European Central Bank. When the G20 leaders transformed the FSF into the FSB, they expanded its membership to include 64 participants—all G20 countries, plus Hong Kong SAR, the Netherlands, Singapore, Spain, Switzerland, the European Central Bank, and the European Commission. They also significantly expanded its mandate to include assessments of vulnerabilities in the financial system, monitoring market developments, advising on best practices in meeting regulatory standards and the establishment of guidelines and support for supervisory colleges. U.S. Treasury Secretary Timothy Geithner described the FSB as "a fourth pillar to the architecture of cooperation established after the second world war" referring to the IMF, the World Bank and the WTO, noting his expectation that the FSB will set high global financial standards and hold all FSB members accountable to those standards.

[8] The WTO's scarce resources and prescribed impartiality places strong constraints on its ability to effectively name and shame members for adopting protectionist measures. A number of independent monitors, most prominently Global Trade Alert (GTA), www.globaltradealert.org, have stepped in to analyze protectionist measures using a much broader definition of what constitutes a protectionist action. With regard to the G20 pledge to "refrain from raising new barriers to investment or to trade in goods and services," GTA found that, "on average, a G20 member had broken the no-protectionism pledge every three days" in the year following the Washington Leaders Summit.

Table 3. G20 leaders summits: Pledges and commitments

G20 Leaders Summits	Pledges/Commitments
Washington, November 2008	• Adopted 5 principles for reform relating to transparency, accountability, and enhanced regulation of financial markets, products, and participants, including credit rating agencies, with an action plan for their implementation • Pledged to coordinate regulatory reforms internationally • Committed to reform Bretton Woods Institutions to reflect changed economic weights in the world economy, but no specifics • Pledged to use expansionary macroeconomic policies, both fiscal and monetary, to stimulate aggregate demand and encourage economic growth • Committed to refrain from protectionist trade policies and to "strive" to reach agreement on the Doha Round of WTO talks.
London, April 2009	• Reiterated commitments of 2008 • Creation of Financial Stability Board (FSB) as successor to Financial Stability Forum with all G20 countries, FSF members, Spain and the European Commission as FSB members, set up to establish and enforce high global standards for financial regulation and monitoring • IMF: Pledge to increase funding for the IMF and MDBs by $ 1.1 trillion, including a tripling of the IMF's lending capacity by restocking the IMF with $500 billion and creating $250 billion of new Special Drawing Rights. • World Bank: support for increase in lending of at least $100 billion and implementation of 2008 reforms • Commitment to conclude an "ambitious" Doha Round and to avoid protectionist measures
Pittsburgh, September 2009	• Agreed on a "Framework for Strong, Sustainable and Balanced Growth" to coordinate and monitor national economic policies to correct the current global imbalances and prevent future such imbalances, with some peer review and some IMF oversight of this macroeconomic policy coordination • Specific plans to increase the representation of emerging-market countries at the IMF by increasing their quota by five percentage points to 43% of the total and similar initiatives at the World Bank • Commitment to crack down on financial institution excesses, including raising capital standards, implementing international compensation standards and adopting frameworks for cross-border resolutions of failed institutions • Commitment to conclude the Doha Round by the end of 2010
Participants	**Washington:** Argentina, Australia, Brazil, Canada, China, France[1], Germany, India, Indonesia, Italy, Japan, Mexico, the Netherlands[2], Rep. of Korea, Russia, Saudi Arabia, South Africa, Spain[2], Turkey, United Kingdom, United States Ex-officio participants: European Commission (President), World Bank (President), Secretary General of the UN, IMF (Managing Director), Financial Stability Forum (Chairman) **London:** All Washington participants plus Czech Republic[3] and ex-officio participants: Chair of New Partnership for Africa's Development (NEPAD), Chair of Association of Southeast Asian Nations (ASEAN), WTO (Director-General) **Pittsburgh:** All participants from London with Sweden[3] representing the EU Council rather than the Czech Republic

[1] Representing EU Council and themselves
[2] Permitted extraordinary presence
[3] Representing the EU Council

Source: G20 website, www.g20.org

4 THE IMF, WORLD BANK, AND WTO: FROM CRISIS TO REFORM

With each successive wave of economic crisis to hit the world—from the Asian meltdowns in 1997 to Russia's ruble crisis in 1998 to the collapse of Argentina in 1999 and 2000—there has been a subsequent torrent of hand-wringing, post-mortem analysis, and calls for reforms to the architecture of global economic governance in order to speed recovery and prevent such crises from reoccurring. Equally compelling has been a wave of tragedies—from the tsunami in the Indian Ocean to Hurricane Katrina in 2005 to the enduring poverty throughout much of Africa—that have tested the world's ability to respond, accompanied by calls for a better approach to development contained in many a bestselling book or prominent commission report. On the trade front, the WTO took center stage not long after its creation, when protestors outnumbered delegates at its Ministerial meeting in Seattle in 1999, setting a precedent for civil disturbances at meetings of the WTO, IMF, and World Bank ever since. Overall, the clamoring for reform reached a crescendo with the Great Recession of 2008-2009, which has prompted a number of pledges from political leaders to learn from the mistakes of the past and to reform the global economic architecture to meet the challenges of the 21st century.

The various calls for reform have pin-pointed problems of relevance, effectiveness, and legitimacy. Waning *relevance* in the case of the IMF has been detected as a result of the ascendance of private capital markets; at the World Bank, as a result of the rise of China and other new economic powers engaging in infrastructure development; and at the WTO as a result of the proliferation of regional trade agreements. Waning *effectiveness* at the IMF is a claim directed at the Fund's inability to tackle global imbalances and its "mission creep" into bailouts; at the World Bank it has been identified in relation to the inability substantially to improve poverty rates, particularly in Africa, or adequately address environmental, human rights or corruption concerns, along with a perceived "mission creep;" and at the WTO it has arisen from the inability to conclude the Doha Round despite the nine years that have lapsed since talks began in November 2001. Finally, waning *legitimacy* has been diagnosed at both the IMF and the World Bank as a result of the lack of voting power or quota levels held by emerging and developing countries and the perception that the institutions are controlled by a handful of wealthy countries that impose conditionality on others but not themselves; at the WTO, it arises from a perceived lack of transparency in its operations combined with concerns that the consensus-only decision making process may be getting in way of reaching conclusions, and from a longstanding failure to ensure that the benefits of free trade are more evenly distributed.[9]

The various calls for reform have focused on a perceived lack of relevance, effectiveness, and legitimacy at the IMF, the World Bank, and the WTO.

[9] Much work on reform proposals had been done well before the G20 Summits. See, for example, World Trade Organization (2004), *The Future of the WTO: Addressing Institutional Challenges in the New Millennium: Report of the Consultation Board to the Director-General Supachia Pantichpakdi* (the"Sutherland Report"); and the report of the IMF's Independent Evaluation Office, *Governance of the IMF: An Evaluation*, 2008. In addition to the work of such commissions, there have been countless books and articles written, many of which are noted in the bibliography at the end of this article. Key among them would be *Losing the Global Development War*, John W. Heard, 2008; *Reforming the IMF for the 21st Century*, Edwin M. Truman, 2006; *Redesigning the World Trade Organization for the 21st Century*, Debra P. Steger (2010); *Studies of IMF Governance*, Ruben Lamdany and Leonardo Diaz Martinez (2009); *The IMF and its Critics*, (2004) and *The World Bank: Structure and Policies* (2000) David Vines and Christopher Gilbert; "Reforming the World Bank," Jessica Einhorn, *Foreign Affairs*, Jan./Feb. 2006, Vol. 85, Issue 1, and *The IMF, World Bank and Policy Reform*, Alberto Paloni and Maurizio Zanardi, Routledge Studies in Development Economics, 2006. In addition, a number of groups have been formed devoted to reform of these institutions, including The Bretton Woods Project (www.brettonwoodsproject.org), New Rules for Global Finance Coalition (www.new-rules.org) and The Fourth Pillar (www.fourthpillar.org).

It is in the face of these challenges that G20 leaders have called for reforms to the international financial institutions. These reforms will primarily focus on changes to their mandates, scope, and governance to reflect the increasing complexity in the world and changes in the economic weight of the various players. In addition, the reforms will also involve greater coordination and coherence among the three economic institutions, along with the newly created Financial Stability Board.

Implicit in various calls for reform is a reaffirmation of support by the G20 leaders for a multilateral approach to economic problems and for increased reliance on the multilateral economic institutions to help solve them. Such increases will necessarily also involve finding a way to "multilateralize" many of the existing regional agreements that cut into the scope of the work of these institutions. Equally implicit in the G20 leaders' statements is support for the ongoing work of these existing institutions of global economic governance.

In the wake of the Second World War, it was America that largely built a system of international institutions that carried us through the Cold War. Leaders like Harry Truman and George Marshall knew that instead of constraining our power, these institutions magnified it.

Today it's become fashionable to disparage the United Nations, the World Bank, and other international organizations. In fact, reform of these bodies is urgently needed if they are to keep pace with the fast-moving threats we face. Such real reform will not come, however, by dismissing the value of these institutions, or by bullying other countries to ratify changes we have drafted in isolation. Real reform will come because we convince others that they too have a stake in change—that such reforms will make their world, and not just ours, more secure.

Then-presidential candidate Barack Obama
The Chicago Council on Global Affairs
April 23, 2007

5 Guardian of Global Finance: The International Monetary Fund

Mission

The principal international institution involved in financial stability and finance matters is the International Monetary Fund. The Fund has evolved considerably from its original role, which focused on management of the par value system of fixed exchange rates. When the United States eliminated adherence to the gold standard and the system of pegged exchange rates in 1971, countries were left free to choose their exchange rate regimes and the IMF's charter was radically amended, pushing it to focus heavily on member countries with persistent balance-of-payment problems and on responding to crises that threaten the international monetary system as a whole. The Fund's scope was also fundamentally altered by the emergence of newly independent nations in Africa and elsewhere beginning in the late 1950s, followed by another wave of new entrants after the end of the Cold War, both of which required a change in financing and policy advice to support growth-oriented structural reforms and transitions from centrally-planned to market economies. The IMF currently carries out its mission through a combination of financing (typically done through stand-by arrangements or special loans), surveillance of countries' economic and financial policies, technical assistance, and policy endorsements.

Governance

Both the IMF and the World Bank have a Board of Governors made up of a representative of all 186 countries which meets twice a year. The IMF's Board of Governors is advised by two ministerial committees, the International Monetary and Financial Committee (IMFC), and the Development Committee. While some specific powers reside with the Board, the real management of the IMF is done by its Executive Board of 24 members, five of whom are appointed (the United States, Japan, Germany, France, and the United Kingdom), three of whom are elected by a single country (China, Russia, and Saudi Arabia), and 16 of whom are elected to represent a group of countries, along with the managing director of the IMF, who serves as the chairman of the Executive Board.[10] Over and above the appointees of Germany, France, and the United Kingdom, the remaining members of the European Union are all represented on the Executive Board in one of seven different country groupings. Each member of the Executive Board controls a share of the total vote at the IMF, depending on the size and level of participation of those countries in his or her group. The United States has the largest single voting share with 16.77 percent, followed by Japan (6.02 percent), Germany (5.88 percent), France (4.85 percent), and the United Kingdom (4.85 percent). While many decisions at the Executive Board are made on the basis of majority rule, some key decisions require a super-majority vote of 85 percent, which gives the United States, with its 16.77 percent share, the ability to block such decisions. If the three appointed European representatives voted together, they too would have more than 15 percent of the vote and would have, like the United States, enough power to "veto" any action that required a supermajority vote of 85 percent. While the IMF's quota shares are automatically updated, these updates have not resulted in a substantial shift in power away from overrepresented Europe to underrepresented emerging market economies.

With respect to recent governance reform efforts at the Fund, Managing Director Dominique Strauss-Kahn created a "four pillar" approach to reform, calling for a report from the IMF's Independent Evaluation Office, from an internal Working Group

[10] Including the managing director, there are currently 10 Europeans (40 percent of the total) serving on the IMF's Executive Board.

Dissatisfaction with Fund governance well pre-dates the crisis, reflecting a sense of declining relevance (given ascendant private capital markets), effectiveness (demonstrated by the Fund's inability to tackle global imbalances), and legitimacy (with institutional structures described as outmoded and feudalistic).

on IMF Corporate Governance, from civil society organizations, and lastly from the Committee on IMF Governance Reform headed by South African Finance Minister Trevor Manuel. As the Fund's internal report noted, "dissatisfaction with Fund governance well pre-dates the crisis," reflecting a sense of waning relevance (given ascendant private capital markets), effectiveness (demonstrated by the Fund's inability to tackle global imbalances), and legitimacy (with institutional structures described as "outmoded and feudalistic").[11]

In attempting to address at least the concerns about relevance and legitimacy, the Manuel Committee was established in September 2008 and issued its report on March 25, 2009, in advance of the spring meeting of the IMF. The Committee's report called for:

- The creation of a high-level ministerial council (IMF Council) to foster political engagement in strategic and critical decisions;
- An acceleration of the quota and voice reform begun in 2009 by shifting to a 70 to 75 percent majority for decisions, which would have the effect of removing the U.S. veto power while giving low income countries the ability to band together to veto activities they do not like;
- A broader mandate for surveillance to include macroeconomic policies, prudential issues, and financial spillovers;
- Clearer lines of responsibility and accountability among various decision-making entities in the Fund with more authority for member-specific surveillance given to management and greater strategic and supervisory roles for the Executive Board; and
- The introduction of an open, transparent, and independent-of-nationality selection process for the Managing Director, thereby eliminating the unwritten rule that the Managing Director must be a European.

For its part, the Independent Evaluation Office report, *Governance of the IMF*, recommended:

- Clarification and alteration of the roles and responsibilities within the IMF governance structure to minimize overlaps and close gaps;
- Active and systematic ministerial-level involvement in setting strategic goals and overseeing performance;
- Reorientation of the Board away from executive functions to a supervisory role focused on formulating strategy, monitoring policy implementation, and exercising executive oversight; and
- Establishment of a framework to hold management accountable for its performance.

Civil society organizations, for their part, emphasized through their "fourth pillar" process a greater need for transparency and communication, particularly with the executive directors, along with strong calls for changes to the distribution of voting power and quotas and increased accountability for the executive board. They also insisted that the selection of the managing director and the deputies should be conducted via a merit-based, transparent process without any restrictions as to the nationality of the candidates.

Mandate

With respect to the mandate of the IMF, the current economic crisis has pointed to the need for a number of substantial changes to the mandate of the IMF. These include the establishment of a

[11] International Monetary Fund, "IMF Governance—Summary of Issues and Reform Options", Strategy Policy, and Review Department and the Legal Department, Jul. 1, 2009.

sound early warning system for macroeconomic and financial risks, broader surveillance of all members' macroeconomic policies (including the United States and European Union member states), tougher oversight of exchange rate imbalances, and broad-based support for growth in developing countries by helping finance counter-cyclical spending, bank recapitalization, infrastructure, trade finance, balance of payments support, debt rollover, and social support.

6 From Reconstruction to Development: The World Bank

Europe has long favored a World Bank focused almost exclusively on poverty alleviation, while the U.S. wants additional emphasis placed on private sector engagement and development.

Mission

Among the multilateral institutions, the task of promoting global development and poverty alleviation primarily falls to the World Bank. The World Bank has evolved from its inception as an institution with 44 member countries and a focus on postwar reconstruction to a development services organization with more than 10,000 employees and an administrative budget of $1.6 billion. Last year, its loan commitments totaled $46.9 billion. Over the years, its core focus has shifted from growth through trade and investment in partnership with middle-income countries to an organization set on alleviating poverty and promoting development in poor countries.

In the main, the United States and Europe have had shared goals for and commitment to the work of the World Bank Group. However, historically there have been some differences in approach. At its inception, the United States saw the Bank as responsible for building a strong middle-class and overall economic prosperity in middle-income countries, in part to provide markets for U.S. exports. As the Bank moved from reconstruction to a focus on development, the United States has typically favored a mission that continues to place strong emphasis on the pursuit of economic growth and productive investment that leans heavily on the private sector. Europe was initially on the receiving end of the Bank's reconstruction efforts, until much of that work was taken over by the Marshall Plan. Once fully recovered, Europe began to push for the Bank to work almost exclusively with the poorest countries and the poorest pockets of the middle-income countries, and the Europeans remain strong proponents of this primary focus on poverty alleviation.

Governance

The governance structure of the World Bank largely mirrors the structure of the IMF, with a Board of Governors that meets twice a year and the real management of the Bank done by its Executive Boards, which are also composed of 24 directors who are appointed or elected by the same member countries or groups of countries as the IMF along with the president of the Bank, who serves as its chairman.[12] The voting weight of each country is made up of both basic votes (whose value has eroded over time) and votes that are dependent on a country's shareholding in the Bank. Unlike at the IMF, which has automatic quota reviews every five years, shareholding adjustments are made through periodic—and generally very political—processes. With 16.4 percent, the United States has by far the largest voting weight at the Executive Board of the International Bank for Reconstruction and Development, followed by Japan (7.87 percent), Germany (4.49 percent), France (4.31 percent), and the United Kingdom (4.31 percent). These five countries have the right to appoint their own representatives to all four Executive Boards. Three other countries elect a single representative to each of the Executive Boards (China, Russia and Saudi Arabia), while the remaining 16 directors are elected to represent a group of countries. As with the IMF, all of the other members of the European Union participate as part of a group of countries represented by one of seven other elected representatives on the Executive Board.

Decisions at the Bank are made by simple majority vote for ordinary decisions and by supermajority (85 percent) for one type of decision—amendments to the Article of Agreement. As at the IMF, because

[12] Technically the World Bank Group has four boards (IBRD, IDA, IFC, and MIGA) of executive directors with slightly different voting percentages for each, but as a practical matter, the same individual typically serves as the executive director on all four.