Statement before the

Senate Foreign Relations Committee
Subcommittee on Multilateral International Development, Multilateral Institutions, and International Economic, Energy, and Environmental Policy

"Multilateral Economic Institutions and U.S. Foreign Policy"

A Testimony by:

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Center for Strategic and International Studies (CSIS)

November 27, 2018

419 Dirksen Senate Office Building

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

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

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

[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.

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.

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.

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

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.

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

[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.

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., 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

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[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.
[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.

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. strategic 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.

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[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.

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