# THE AFRICAN DEVELOPMENT BANK AND THE UNITED STATES

Mr. Chairman, my name is Donald R. Sherk. It is a distinct honor and privilege to appear before you and your committee colleagues. The subject before the committee, the African Development Bank, is a subject close to my heart. Thank you for circulating to the committee my report on the African Development Bank that was prepared in late 1999 for the International Financial Institution Advisory Commission, better known as the Meltzer Commission.

If I may, Mr. Chairman, I would like to begin with a brief account of my background in the multilateral development banks in general and the African Development Bank in particular. After leaving the U.S. Army in 1966 I began teaching economics at Boston College and later at Simmons College in Boston. In 1975 I joined the staff of the Asian Development Bank at its headquarters in Manila, the Philippines. I served first as an economist in the ADB's research department and subsequently in the Bank's operations department. In 1977, I joined the Office of the Assistant Secretary for International Affairs of the United States Treasury. From 1977 to mid-1982 I held various positions in Treasury's Office of Multilateral Development Banks. These included: Asian Development Bank Desk Officer, Senior Economist for Bank Policy and finally Deputy Director of the Office of Multilateral Development Banks. During the course of 1982 I was a member of the Treasury team that produced the first in-depth report on the role of the United States in the Multilateral Development Banks. It is argued that this report was instrumental in obtaining support for active United States participation in the MDBs by the Reagan White House.

In August of 1982 I rejoined the Asian Development Bank as the United States Alternate Director on the Bank's executive board. In 1984 I served for approximately one year as the acting U.S. Executive Director. Then in mid-1985 I was appointed U.S. Executive Director to the African Development Bank and remained at the AFDB until late 1989 when I joined the private sector. From 1989 to the present I have continued my involvement with the MDBs primarily as an economic consultant. I have had short-term contracts with all the major MDBs with the exception of the European Bank for Reconstruction and Development. My years in the private sector in the consulting industry were interrupted by a two-year appointment at the OECD as the senior multilateral assistance advisor to the Development Assistance Committee, or the DAC. During this time I became familiar with the multilateral assistance policies of all twenty-nine OECD Members and worked to help coordinate their policy positions vis-à-vis the different MDBs.

Two other assignments warrant mentioning in this introduction: during 1994 I was the only American selected as a member of the Knox Committee. The Knox Committee, was established to examine the quality of lending and the organizational strength of the AFDB. This committee, along with similar committees established to investigate the quality of lending at both the Inter-American Development Bank (the IDB) and the Asian Development Bank, grew out of shareholder reaction to what came to be known as the Wapenhans Report. Wapenhans, a former Vice President of the World Bank, was asked by the then President of the World Bank, Lewis Preston, to chair a review committee made up of World Bank officers whose mandate was to be: to examine the quality of the Bank's

$360 billion project and program portfolio and the effectiveness of Bank staff in implementing these projects worldwide. It was the Wapenhans' Committee's findings of significant deterioration in the quality of the Bank's portfolio that led the shareholders of the regional development banks, including the African Development Bank, to undertake similar investigations of the loan portfolios in the regional banks as well. And during the period 1993-1994 all three major regional MDBs came out with similar studies. It is noteworthy for this committee to understand that the results of all four MDB portfolio studies came to similar conclusions; to wit there had been a significant deterioration in project quality and that the Banks seemed more committed to making new loans than to ensuring that each existing loan had the maximum economic impact possible.

Then in 1998 I was appointed to a joint World Bank and African Development Bank Taskforce that reviewed the status of partnership between the two Banks to the end of greater synergy and effectiveness of the two most important development institutions for Africa. The report of the Taskforce incorporated recommendations that eventually led to the drafting of a memorandum of understanding between the two Banks about how they would cooperate in their programming and lending activities on the continent. Finally during the course of 1999 I served as a resource person for the Meltzer Commission and my paper prepared for this commission has been circulated to you in advance of this hearing.

Having served on the staff of one MDB, the Boards of Three MDBs (I had a brief tenure on the Board of the IDB as well), worked on U.S. MDB policies as Treasury staff, and on the MDB policies of the other 28 OECD countries, as DAC Secretariat staff, and participated in the drafting of three major MDB reviews, one solely American and two international, having been a consultant for four of the five major MDBs, I believe I probably know the Banks as well as anyone.

What are my thoughts? I continue to believe that the multilateral financial institutions are vital ingredients of a healthy and growing world economy. The MDBs together with the IMF and the WTO might be thought of as a "World Economic Safety Net." Had these organizations existed in the 1920s and 1930s the world might not have had to experience the disruption, dislocation and suffering brought on by the world depression and the Second World War.

But these institutions clearly do not work in the way we all hoped they would when they were created. Unfortunately the Multilateral Development Banks fall short in a variety of ways. All too frequently multilateral or global goals for the institutions are sacrificed on the alter of perceived "national interests." This shortfall between institutional achievement and institutional potential subjects them to periodic crises of confidence. Why does this happen?

I would argue that no two countries view the MDBs in the same way. Countries participate in multilateral institutions for a variety of reasons, noble and ignoble. The G7 members may appreciate the Banks for their geo-political advantages and their ability to mobilize sizable pools of non-budget funds. But for most other countries a variety of other motives can be mentioned: procurement, staff and management positions, resource transfer needs, regional and sub-regional associations, national pride, technical assistance, private sector collaboration, education, health, agriculture and infra-structure externalities and one could probably go on. But for most countries this package of perceived benefits is judged to be significantly larger than the costs of membership as to easily justify remaining involved. One would be hard-pressed to list more than one or two countries that chose to withdraw from membership over the half century of the institutions existence.

When it comes to how the MDBs are managed, problems endemic to each institution are all too visible. The Boards of Directors drawn from all over the world have no real "bottom line." There is rarely an important policy issue that is capable of uniting all the board members given the variety of motives prompting their membership in the first place. This diversity of goals across the shareholders makes a truly unified board most unlikely. Consequently the managements of the institutions are in a position to advance their own agendas by simply finding a group of sympathetic (read pliable) allies on the board. Of course, management's ability to determine lending volumes is a powerful inducement to insure the support in policy debates of the borrowing member countries. And, all too often, managements seek to fulfill predetermined global lending targets to establish conditions for further capital increases and soft fund replenishments. This might be called the mandate of institutional aggrandizement. It is an accident that the annual reports of all the MDBs typically begin by mentioning how much lending was achieved during the year and what percentage increase over the previous year this represented**; not how much development actually took place due to these loans.**

Before turning to the African Development Bank, I would like to focus briefly on the subject of shareholder influence in the MDBs and how that influence is used. The committee staff has circulated one of the papers that I prepared for the Meltzer Commission. That paper contains two appendicies. Appendix A lists the primary ways that shareholders can influence the policies and operations of the Banks, if you will, the "avenues of influence". The other appendix lists over fifty shareholder objectives that have been pursued by the United States in the MDBs using these avenues of influence. Those of you that have followed the development literature over the past several decades will recognize that a number of the objectives cited have more or less "faded from the scene" to be replaced by objectives given more currency in today's environment, i.e. "good governance", "civil society" and "transparency" have replaced "appropriate technology", "integrated rural development" and "environmental review" as current "hot button" issues. How much influence needs to be "spent" to achieve any one of the objectives is dependent upon many factors. Suffice it to say, the countries most adept at seeing their objectives incorporated into MDB operational guidelines are those that focus their objectives narrowly, stayed informed of Bank policies and procedures on a day to day basis and successfully lobbied other shareholding countries in support of their objectives most effectively. I personally have admired the way that the Scandinavian countries have succeeded in getting MDB policies to reflect their own goals so successfully. Basically these countries have joined forces to maximize their influence, done their homework diligently and have advanced their development goals most adroitly.

These general comments can only go so far. It would be a mistake to view all the MDBs as the same. Each has its own history, with a unique set of circumstances calling it into existence. Shareholder ownership varies widely from bank to bank, with key shareholders being similar but never the same. The staffs of each MDB, in spite of the similarity of their professional training, view the other MDBs differently and this difference often impinges on how cooperative each bank can be with the others. To be fair, one should point out that over the last two to three years and under the leadership of World Bank President Jim Wolfensohn, the MDBs have undertaken a review of their strong points and their weak points, or their comparative advantages in the development field. These reviews have begun to materialize in the form of Memoranda of Understanding among the MDBs that establish the principles and approaches of effective cooperation. I am most familiar with the MOU agreed to between the World Bank and the African Development Bank and early indications are that the two institutions are working together more effectively than heretofore. This is certainly a plus and whatever the U.S. Congress can do to help intensify this effort will pay dividends for both the developing member countries and for the MDBs themselves.

Allow me to close by some comments on the Bank you are focusing on today, the African Development Bank. In many ways the AFDB is the most interesting of the MDBs. I have gone into this Bank's difficult evolution in the paper distributed to you earlier. In the opening summary of that paper I conclude: "If the AFDB were held up against the World Bank and the other regional development banks, and compared by any common standard of business efficiency, the AFDB would most likely be ranked at the bottom. But if a more relevant yardstick of achievement and maturity were employed measuring how far the Bank has traveled in its thirty seven year history, in what is easily the most difficult working environment on earth, it would probably be ranked first.

In viewing the AFDB one should not lose sight of the importance of the Bank's remaining "African" to its original shareholders. This quality was a driving force in the Bank from its beginning and remains a strong force today. When the Bank was founded in 1964 immediately after the independence most African states, a key motivation was to establish a Pan-African development finance institution that would not be dependent on the industrial countries of the north. The AFDB would operate as an exclusive African Bank until 1972 when a soft fund window was opened and non-African developed countries were encouraged to contribute. Then in 1982, nearly two decades after the Bank was established, the African Shareholders agreed to allow non-African states to become shareholders on a limited basis. In total, non-African states were allowed to subscribe to a maximum of 33 and 1/3 percent of the total share capital keeping the African states, owners of the remaining 2/3 of the shares firmly in control. This 2/3-1/3 division of ownership existed until 1998 when the non-African states were allowed to raise their total shareholding to 40 percent.

Other restrictions were enacted to the end of maintaining the "African Character" of the institution: The headquarters was to be in Africa, annual meetings were to be held only in Africa (this restriction lasted until this current year, 2001, when the Bank's Board of Governors authorized the holding of the first annual meeting to be held outside of Africa– Valencia, Spain.) and the majority of Bank staff were to be African. Today most African Governments recognize these provisions as warranted pragmatism enabling their Bank to mobilize significantly more investment capital for Africa, while at the same time, remaining "their bank".

The United States and its OECD Partners joined the AFDB with their eyes wide open. The Bank had impressed the non-African states as one of Africa's few success stories. Admittedly the AFDB was not given much credit for the quality of its operations nor for the quality of its staff. But the Bank was seen as an institution capable of commanding loyalty from most African countries and a Bank that would improve with the assistance of its new membership. This has happened and there is little talk nowdays that the AFDB will not survive. Indeed the World

Bank's opinion of her sister institution has also grown steadily over the last decade stimulated in part by a genuine desire to cooperate with the AFDB in the development of Africa. As for the United States, her decision to join the AFDB in 1982 must be regarded as the right one. For the future one can only hope that the United States will remain on of the Bank's strong non-African supporters and will use it significant influence in that institution carefully and wisely for the benefit of the entire African continent. Thank you Mr. Chairman and I will be pleased to answer any questions at the time you so designate.

Donald R. Sherk
April, 25, 2001