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WRITTEN TESTIMONY BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE SUBCOMMITTEE ON INTERNATIONAL MONETARY POLICY AND TRADE

ON

WORLD BANK AND MULTI-LATERAL DEVELOPMENT BANKS AUTHORIZATION

OCTOBER 4, 2011

Chairman Miller, Ranking Member McCarthy, and distinguished members of the Subcommittee, it is an honor to appear before the House Financial Services Committee, Subcommittee on International Monetary Policy and Trade regarding the authorization of capital increases for the World Bank and other multilateral development banks (MDBs).

Legislation to authorize capital increases for the International Bank for Reconstruction and Development (IBRD), the Inter-American Development Bank (IADB), the African Development Bank (AfDB), and the European Bank for Reconstruction and Development (EBRD) comes at a crucial moment for the United States, the institutions and the global economy.

We all recall the dangerous moment in 2008, when the world economy fell off a cliff, and the strong response of the World Bank and the MDBs to the G-20 call to stretch their balance sheets. In large measure, that response is why you have capital increase authorization requests before you today.

Speaking of the institution I know best because I lived these moments in the U.S. Executive Director's chair, the IBRD component of the World Bank dramatically increased its loan commitments from the $13 billion per year range to an average of $34.6 billion per year in the three years from July 1, 2008 to June 30, 2011, for a total of $103.8 billion in commitments during the period.

Without more capital, the World Bank cannot continue this pace should another crisis occur, let alone return to the pre-crisis commitment level of $13 billion per year, without slicing through the bottom of its target risk coverage range, which is part of its strategic financial adequacy framework.

Without more capital from the United States, the crucial economic development and poverty reduction mission of the World Bank will suffer, along with the American reputation for leadership in important international institutions. The same will hold at the other MDBs, which also confront depleted capital following their strong response to the financial crisis of 2008.

What is the role of the MDBs and their relevance in today's world? This Subcommittee has held three hearings this year to answer that question. As you heard, the MDBs play a vital role in U.S. national security, the U.S. economy and U.S. job creation.

U.S. leadership is vital in ensuring that MDB operations contribute to safeguarding national and economic security. The MDBs do not automatically pursue our interests. It takes strong leadership to achieve that result.

On the leadership question we start from a good point. We were leaders in the creation of IBRD at the Bretton Woods conference in 1944 and present at the creation of the regional MDBs. When Communism beckoned near our shores, President Eisenhower promoted the establishment of the Inter-American Development Bank. When the Berlin wall fell, President George H. W. Bush championed the European Bank for Reconstruction and Development, which is also now preparing to assist Arab countries with democratic ambitions.

Our leadership manifests itself in part through our financial support. We are the largest shareholder in IBRD and many of the regional banks, because we have contributed the most capital. Without U.S. participation in the capital increases, that situation would change at some MDBs. Worse yet, without U.S. participation in the IADB capital increase, there will be no capital increase and it will be said that the United States is withdrawing from its own back yard and leaving the region to other powers.

Our leadership also manifests itself through the quality of the ideas we present for pursuit of the MDBs' economic growth and poverty reduction mission. We do not possess 50% of the votes in any of the MDBs, so we cannot unilaterally block any particular loan or impose any particular policy. Although the MDBs have a strong American presence, they are not U.S. government agencies or U.S.-controlled entities, so we must use our diplomatic voice to secure the outcomes we desire.

If the United States does not subscribe to the general capital increases our soft power, our ability to persuade others will be reduced. Other shareholders will simply say we do not care any more. In some cases they may even take up the subscriptions we cast aside and try to install themselves as the dominant force in the institutions.

We should not forfeit the position we currently have. At times, our approach to the MDBs can be seen as tough love, but frequently tough love is appreciated by other shareholders. They know that the institutions would not be financially sustainable if we did not speak up for stronger financial discipline, improved governance and accountability and enhanced development impact and effectiveness. But if we do not participate in the capital increases, our messages in these areas will fall on deaf ears.

Members may be asking themselves what was the process for determining the need for capital contributions and the level of the U.S. capital contributions? Why is any new capital needed in a world of economic imbalances with large amounts of capital flowing to many emerging markets?

Indeed, to some markets, there do appear to be significant capital flows. But those flows are increasingly volatile. In fact, some of the countries which experienced substantial inflows and currency appreciation earlier this year have witnessed reduced inflows and currency depreciation in the last two months as global capital markets have retreated, in some cases, by twenty percent or more.

The communiques from the late September meetings of the G-20, the International Monetary and Finance Committee (IMFC), the Development Committee and the speech of Treasury Secretary Timothy Geithner to the IMFC all resonated with warnings of downside risk, potential cascading defaults and severe declines in economic growth. If major developed countries have difficulties, developing countries will be affected. Indeed with globalization, the correlations among markets have become very high.

Growth cannot come only from developed nations; in fact, more than half of all economic growth in the planet is now coming from developing countries. They represent export markets for us. If global growth stalls, those markets could be lost. Therefore, it is extremely important for us that the World Bank and the MDBs carry on, and potentially increase, their financial support for economic growth and poverty reduction among their clientele. Without more capital this will not be possible.

How does an MDB know it needs capital? How does an MDB measure the shortfall? At the World Bank, management and the Board of Executive Directors followed a rigorous analytical process employing a strategic financial adequacy framework. This involved examination of the Bank's risk bearing capacity, stress testing and measurement of the sustainable equity-to-loans ratio (E/L ratio).

In 2007, pre-crisis, the World Bank's E/L ratio stood at 35%; at June 30, 2011, it stood almost six and one half percent lower at 28.68%, near the top of the desirable capital buffer of 23-27%. This decline resulted directly from the Bank's response to the call of the G-20 at the April 2009 summit to join other MDBs in providing $250 billion of support to developing countries as part of the global recovery effort.

Given the long tenor of typical Bank lending, the E/L ratio will continue to fall into the buffer zone for some years to come even if lending reverts to the pre-crisis level. In short the analysis showed that capital was needed even to sustain the status quo ante.

There was a debate about the proper trajectory for future Bank lending. Some thought the status quo ante was adequate. Others wanted the Bank to move to a much higher level of post-crisis lending. If those voices had prevailed, the capital increase would have been three times as large.

Instead, the United States insisted that a hard look be taken at all elements of the financial equation, including loan pricing, compensation, administrative budgets, greater deployment of paid-in capital denominated in local currency, grant facilities and net income allocations. As a result, many reforms were adopted in these areas.

The United States also sought reforms to make the Bank a more efficient and effective vehicle for development financing. These included a greater focus on development results. The United States had successfully pushed the results agenda in IDA negotiations, and now it will be included for IBRD projects. For the first time, at the recently concluded annual meetings, the Bank released a Corporate Scorecard to demonstrate that it not only measures money disbursed but development results.

The United States also insisted on improved governance and accountability. This started with a very significant change in the approach to the Bank's disclosure policy. Instead of listing positively those items eligible for disclosure, the new policy presumes that all documents are subject to disclosure unless they appear on a short list of document types not subject to disclosure. As a result, those who follow the Bank now have access to much more information about its policies, plans and decisions.

Other important advances have come in the fight against corruption. The Institutional Integrity unit has streamlined procedures and disposed of a significant number of cases that had been backlogged. The MDBs also united to promulgate a cross-debarment plan with the result that contractors debarred at one MDB will now be debarred at all MDBs.

The Inspection Panel has also been nurtured from a fledgling pilot fifteen years ago to an active oversight mechanism available to individuals and communities that feel themselves aggrieved by the Bank's failures to follow its own safeguards and procedures in undertaking a project. The United States has been a stalwart defender of the Inspection Panel's independence, and it has become the model for similar mechanisms at the other MDBs.

The United States also sought and obtained important reforms in two other lines of World Bank business that may be less well known. The Bank now administers more than $20 billion of trust funds as well as conducting substantial knowledge transfer activities. Significant new fiduciary controls have been implemented for trust funds. The Bank has also pursued a knowledge agenda of open access to research data and results and undertaken a major overhaul of training and capacity building activities.

One of the very attractive features of the World Bank for the United States is the ability to leverage U.S. contributions. At the same time, the Bank is very conservatively managed in order to remain in high standing in the financial markets. Since 1945, the United States has paid in a little less than $2.0 billion in capital contributions, the last one of which was some twenty years ago. With that capital and that of others, the Bank has made more than $486 billion of loans to 137 countries.

The Congress can calculate that for every dollar it authorizes for World Bank paid-in capital, more than six dollars will be paid in by other shareholders. The Bank itself is then able to leverage the paid-in capital by borrowing in the capital markets of the world to obtain lendable resources five times greater than the paid-in capital. The resulting loans generate income and through the build-up of retained earnings, the Bank can fund even more lending. MDB capital contributions are truly a force multiplier for American taxpayers.

Committee members about to embark on the legislative process may wonder what policy directives or conditions should accompany an authorization to participate in MDB capital increases. Based on the experience I had deploying the voice and vote of the United States, please allow me to suggest the following general philosophy.

Politics is politics, and there will always be subjects on which the Congress or even individual Members will want to influence U.S. policy. Nevertheless, please try to resist the urge to legislate everything. Maybe report language will do. Certainly in my experience, report language was taken very seriously. Treasury brought these items to my attention, and I advocated as strongly for these positions as for others that appeared in legislation.

Second, when the Congress feels that the Executive needs legislative guidance, whether because the Congress thinks the Executive is evading an issue or because the representatives of the American public need to go on record on a particular point, please pay careful attention to precise wording. Please remember that the World Bank Group has both public and private sector windows. In many countries the private sector cannot change policy the way the public sector can. In such situations, it makes little sense to oppose all IFC or MIGA operations for companies operating in a country because we do not like what the government of that country is doing. Yet, if the Congress does not make its intention clear, Executive Directors will oppose all operations without distinction.

Today's passions and circumstances can change. Please remember this and periodically review mandates or consider the inclusion of sunset provisions. Also, inconsistent or contradictory mandates have been known to exist.

Finally, when adopting mandates, please remember that we cannot veto individual loans. As much as U.S. Executive Directors may advocate, there may be subjects on which we stand alone. Once Bank managements realize what those subjects are, they have the ability to embarrass the United States by presenting loans for our allies in circumstances in which they know that we will have to oppose. This happened on several occasions during my tenure. If the legislation had been less prescriptive, there would have been more room for diplomacy, and the overall objective of the Congress might have been met. Unfortunately, with very tight language counterparties had no incentive to negotiate.

In conclusion, I respectfully submit that this Committee should move authorization legislation for the World Bank and MDB capital increases. It is the right decision for U.S. national and economic security.

Further, now is the time to act; the consequences of waiting are potentially severe. At the World Bank, the current President's term expires on June 30, 2012; if we want an American to continue in the position, we need to be seen to be contributing our share. Further, if we do not, we risk our voting rights falling below the 15 percent threshold needed to prevent amendments to the articles of agreement, something the financial markets count on to be sure that callable capital is reserved only to pay bondholders. At the African Development Bank, we risk losing our own chair at the board; at the Inter-American Development Bank, we will send a huge message of profound disinterest in the region at a critical time. For all of these reasons, negative action, inaction and delay would all be detrimental to U.S. interests.

I commend the World Bank and other MDB capital increases to you and thank you for your attention. I stand ready to answer any questions you may have.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	**2. Organization or organizations you are representing:**
The Hon. Eli Whitney Debevoise II	I am appearing in my individual capacity and not on behalf of my law firm or any of its clients or on behalf of any MDB, including the EBRD, where my adult daughter is currently employed.
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	**5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?**
☐ Yes ☒ No	☐ Yes ☒ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
My law firm Arnold & Porter LLP and its clients may have Federal grants or contracts, but I am not appearing on behalf of my law firm.	
7. Signature:	
Eli Whitney Debevoise II	

Please attach a copy of this form to your written testimony.