THE FUTURE OF THE MULTILATERAL DEVELOPMENT BANKS

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THE FUTURE OF THE MULTILATERAL DEVELOPMENT BANKS

Friday, October 9, 2015

U.S. House of Representatives,
Subcommittee on Monetary
Policy and Trade,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:34 a.m., in room 2128, Rayburn House Office Building, Hon. Bill Huizenga [chairman of the subcommittee] presiding.

Members present: Representatives Huizenga, Mulvaney, Pearce, Pittenger, Schweikert, Guinta, Love, Emmer; Moore, Perlmutter, Himes, Carney, Sewell, and Kildee.

Ex officio present: Representative Hensarling.

Chairman Huizenga. The Subcommittee on Monetary Policy and Trade will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "The Future of the Multilateral Development Banks."

I now recognize myself for 5 minutes to give an opening statement, which I hope not does not consume all 5 minutes. But I first want to thank our witnesses today very much for your patience.

I know that we gave you notice late yesterday about moving the time of the start of this hearing from 9:00 a.m. till 10:30 a.m., so the ranking member, as well, thanks you for your understanding. She asked how the family was doing this morning. We are healing. So, hopefully, we will be able to get some good progress.

But that is not why we are here today. We are here today because of multilateral development banks (MDBs). And the origins of those MDBs lie within the creation of the World Bank at Bretton Woods in 1944. Its initial purpose as the International Bank of Reconstruction and Development was the reconstruction of war-torn countries after World War II.

Today, the MDBs include not only the World Bank, and its other lending arms, the IBRD and the International Development Association, IDA. But it also includes four regional banks: the African Development Bank; the European Bank for Reconstruction and Development; the Inter-American Development Bank; and the Asian Development Bank. Their core mission is to provide financial assistance such as loans and grants to developing countries to promote economic and social development.

MDBs were created by their member countries, which provide capital to sustain MDB operations. Member countries are awarded shares in MDBs proportionate to the amount of capital they provide. Because member nations provide the MDBs with a large capital base, MDBs have a AAA credit rating, which allows them to borrow at favorable rates from private lenders.

The United States is a member of each of these institutions, therefore Congress plays an important role in determining U.S. funding for MDBs, and engaging in the oversight of the Administration's participation in those.

The MDBs have played a key role in the progress in reducing poverty and hunger—we certainly saw that after World War II—while improving global health and women's rights.

The MDB's goal is to draw in member nations' contributions to leverage additional private sector financing. However, MDBs are facing different development challenges than those they previously faced. The number of people around the world living on less than $1.25 a day has been halved since 1990, which, I would think, we would all agree is a very positive thing.

And there have been major strides in expanding access to schooling and medication for poor children around the world. In addition, governments' commitments to fight poverty has noticeably increased, with development assistance from rich countries reaching $134 billion last year, up from $81 billion in 2010.

Today, the MDBs are operating in the world of new challenges and competitors. Many emerging economies have far greater access to capital markets for funding that I will note that capital that many times was locked up, and not available, starting after World War II has loosened up.

And, additionally, a newly ambitious China has spearheaded the creation of the Asian Infrastructure Investment Bank, the AIIB, the development bank, or the BRIC's Bank as it is known, to finance projects in developing countries.

Meanwhile, researchers have developed new tools to help us understand which MDB programs have or do not have an impact. Given this new environment, this hearing will explore how MDBs should adapt.

I look forward to hearing from our witnesses today regarding the future of the MDBs, and how their operations and organizational structure have changed, and should continue to change in order to maintain their relevance.

And, with that, I would like to recognize the ranking member of the subcommittee, Ms. Moore, for her opening statement.

Ms. MOORE. Thank you so much, Mr. Chairman, and it is always good to be here with you. I think the work of this subcommittee is very significant and I am looking forward to hearing from our witnesses here today.

I just want to join Chairman Huizenga in welcoming you all. In particular, Mr. Morris, welcome back to this room. I am really excited. You have tremendous credentials here, and I am sure that we will be justly informed.

My perspective on the work that these banks do around the world is that I think they represent a source of real strength for the United States, and a source of positive change in the world.

We see the impact of poverty in our own country here: unfulfilled dreams; lost generations; and lack of opportunity leading to frustration, which leads to all kinds of social problems.

And these problems spill out into all aspects of society. People are victimized by crimes, and no one—not even the very wealthy—is immune or escapes the adverse impact of poverty. And so the impact of poverty abroad is no less devastating and in a global world, the problems of far-off places are our problems as well.

Now, development banks don't impose world order with force, military might. They promote it through understanding and economic stability. And I do believe that American leadership in multilateral development banks is critical to our world leadership. That is why I have been pushing the World Bank to negotiate strong, enforceable safeguards, including labor standards, LGBT rights, road safety, women's rights, and accommodations for the disabled.

It is so humbling when I consider how this committee, and particularly this subcommittee, is really at the center of so much in terms of global leadership. And I truly hope that we on this committee can figure out how to agree to get some of this important work done.

It is not just reauthorizing the EX-IM Bank, to give our workers a fair shake in global markets. But—and I know it is not necessarily the subject of this hearing—also to improve the IMF quota reforms.

I will commit to working with you, Mr. Chairman, in good faith on addressing some of the concerns of the Majority, but I believe that we must work with some urgency to immediately approve quota reform.

And I also want to work with the World Bank to figure out how to make sure that its premiere development, because it is the premiere development institution in the world. To borrow a phrase from the Department of Labor Secretary Perez, we need to agree on a North Star, and to work on a path to get there.

And with that, I yield back, Mr. Chairman.

Chairman HUIZENGA. The gentlelady yields back. We will now hear from our witnesses. And our first witness is Dr. Dean Karlan. He is a professor of economics at Yale University, an affiliate of the Bureau of Research and Economic Analysis of Development, also known as BREAD, and the president and founder of Innovations for Poverty Action.

His research focuses on microeconomic issues for public policies and poverty. Dr. Karlan is the author of the book, "More Than Good Intentions: Improving the Way the World's Poor Borrow, Save, Farm, Learn and Stay Healthy."

And with that, I will recognize you for 5 minutes for your opening statement.

Thank you.

STATEMENT OF DEAN KARLAN, PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. KARLAN. Thank you. Thank you, Chairman Huizenga, and Ranking Member Moore, for hosting this hearing, and giving me the opportunity to provide this testimony. The charge that I took here is to talk about evaluation at the multilateral development banks, which is a critical issue to improve the return on investment that we get as taxpayers from our investments in the multilateral development banks.

So, in the coming decades, most of the poor are going to live in fragile and economically deprived states. And this makes it even more important for U.S. interests and leadership to address issues of extreme poverty. But I want to be clear: we are not going to end extreme poverty. That shouldn't be the aspiration. We can do a lot to fight it, and a lot to reduce it, but ending it is not actually a realistic goal.

What is important is that we can make major inroads if we do it well, and if we are surgical about what we can do.

It is also important to realize that we have made huge progress. This is not—we have made tremendous progress in the past few decades in fighting poverty around the world, but more can be done. So, I want to focus on three areas where we can help the MDBs do better, and with that, we can do better.

The first is through generating rigorous research on what works in development. Like I said, this is something the MDBs already do some work on, but we could do more to encourage that kind of research.

The second is that we can do more to build stronger links within the MDBs, between those who are doing the research within the MDBs, the research groups, and the policy, so that the knowledge that is acquired from the research that is done can actually get into the policies of the people on the ground, doing—setting—working with countries on the specific programs.

The third, and this is in some sense the most important, is to think about the MDBs as a global public good of knowledge, that what they are doing is they are creating knowledge that the world can use. They use it internally, yes, but even better, other countries can use it for setting their policy. The United States can use it, we can see benefits to the USAID, Millennium Challenge Corporation, and how they set policy based on knowledge created at the MDBs.

My written testimony details five different examples of exactly that process having taken place. But five is not too many, and we should have a lot more.

There are two things I want to note about what I have just said. One is that the MDBs are doing the three things I just said. They just need to do more of it, and we can help them do more. So, I am not—these are not completely brand new ideas, right?

The second is that I would like to think that this is something that can get bipartisan support, right? If someone is skeptical of aid, there is nothing better than rigorous research to help understand what is not working, so that those things can stop, and the other things can happen.

If you are someone who is an enthusiast for aid on a particular policy, there is nothing better than rigorous research to help further that. The nice thing is that there is a clear winner in all that, and it is the U.S. taxpayer. If we have better knowledge on what is actually working, we get more leverage for our money, and higher return on investment.

Let me share a specific example of this from my own work, and work that was done collaboratively with the Consultative Group to Assist the Poor (CGAP), which is housed at the World Bank. So, it started—one way of thinking about is it starts with microcredit, which is a set of programs around the world that have been very, very popular. And they had an initial promise of reaching the poorest of the poor to raise average income.

We have now seen eight randomized trials done of microcredit, some done by the multilateral development banks, some by me and others. And they found important benefits, things that are really helping people, but are not achieving the two things they set out to do: they are not reaching the poorest; and they are not increasing average income. They are good, and we should help markets make those things work.

Instead, when CGAP came to me, along with the Ford Foundation, and they had a particular program that they had seen work, and they wanted to know—let's test this in six other locations. So, it was an integrated program that was a grant program, and instead of lending money, it provided a grant for goats. It provided healthcare, access to savings, and training and coaching.

And the basic idea here was that the problem with being poor is not any one thing; if it was that simple we probably would have solved it long ago. To do lots of things at once, there is a big push at the household level. It is actually very successful.

And, now we are seeing that the knowledge from that, we published this paper in, "Science," and now we are seeing it in the hands of, with the help of the group from the World Bank, as well as others, get into scale-up mode. We are seeing it scaled up in India, Pakistan, Ethiopia, and Ghana already.

So to conclude, I want to lay out two basic ideas from this that are kind of broad policy points. The first is to think about evaluation at the MDBs as a portfolio. It is not right to take any one approach. I have just told you a lot about randomized trials, but the last thing in the world you want to do is encourage everything to have a randomized trial. That would be an awful overinvestment in a lot of inappropriate research being done.

So, we should think about the two basic purposes you want. One is accountability. Did an organization do what they said they would do? And the other is research, which helps us learn about whether they achieved what they said what they would achieve.

The second point to leave you with is to think about the global public good created through this research, the knowledge spillovers, the benefits we get to MCC, USAID. And frankly, also issues that this committee faces in America on things like the underbanked and the unbanked. A lot of research has been done at the Millennium Development Banks that actually speaks quite well to issues we face here in America as well.

Thank you.

[The prepared statement of Dr. Karlan can be found on page 37 of the appendix.]

Chairman HUIZENGA. Thank you. The gentleman's time has expired. With that, I would like to welcome Dr. Martin Ravallion, who is the Edmond D. Villani Chair of Economics at Georgetown

University. He has also been a director of the World Bank's research department.

He joined the bank in 1988, and from 2007 until 2012, served as the director. And in 2012, he was awarded the John Kenneth Galbraith Prize for the American Agriculture and Applied Economics Association. So, with that, Dr. Ravallion?

STATEMENT OF MARTIN RAVALLION, EDMOND D. VILLANI CHAIR OF ECONOMICS, GEORGETOWN UNIVERSITY

Mr. RAVALLION. Thank you very much. Thank you for inviting me. Following up on what Dean said, I actually do think it is feasible to virtually eliminate extreme poverty in the world. We can lift 1 billion people out of extreme poverty by 2030 with the right policies. And that is continuing the policies in developing countries over the last 20, 30 years.

It is not like a major overhaul of existing policies, but we would also need some good luck. Obviously, major crises could overturn that objective. But I really do think we are at a really critical moment for achieving that.

I do believe that the development banks have a major role, but the other thing we have to realize is that a lot has changed in that 70 years since the Bretton Woods institution, and I think the role of an institution like the World Bank has also changed, fundamentally changed.

When the institution was formed, there was no global financial market. There was virtually nothing. The institution was the main lender, the main source of money, to developing countries. That has changed dramatically. The bank accounts for maybe 5 percent of the capital flows to developing countries today. That is not the rationale today.

Today, the rationale is anchored very much with the ability of the World Bank and institutions, and other development banks, and the IMF to deal with problems of global public good, and those problems center fundamentally on knowledge.

The bundling of knowledge with lending, the bundling of the ability of an institution like the bank to combine those two elements is what is really unique.

I don't see the private sector doing that. And I don't see the private sector investing in very risky environments as well. But I also don't see them dealing with the public good problem I have talked about.

That public good problem essentially is about two things: dealing with the constraints that countries face in escaping poverty, how do we achieve that 1 billion target; and what are the specific things we need to do in each country?

That is an important role for the bank to develop the knowledge, which is analytic, it is database, but it is also analytic. About how we actually do that in those countries. What are the binding constraints in each country and how do we tackle those constraints? And we have to make that step if we are really going to achieve that goal.

One reason I am optimistic about that goal, by the way, is that this country did it. This country was just as poor as many countries in Africa in the early 19th Century. This country did it. And, actually, a developing world is escaping poverty at a pace now which far exceeds the long run pace in the United States.

So, there are reasons to be optimistic, but I think that the key issue is tackling the specific constraints in each country, identifying those constraints, and addressing them fully.

I don't think the bank is doing as well as it could, in this respect. And I think one of the limitations is that there is an excessive focus on the volume of lending, and this permeates—this lending culture permeates thinking within the bank. Managerial and staff incentives do have to change. The lending culture has to change. I am not the first person to say that. People within the bank, reviews of the bank have been saying this over many years. But it really does need to change.

Knowledge must drive the lending, not just be a residual claimant. You don't just turn to knowledge when you are not sure exactly what to do in a particular situation. The knowledge, particularly in addressing those binding constraints at the country level, has to drive the bank's lending.

And a second area is global public goods in not just knowledge, but in the global public bads. We are going to have more pandemics. We are going to have more global financial crises. The bank has to be mobilized to deal with that. Unfortunately, the country model, which developed for out of Bretton Woods, which was targeted very much to delivering money, borrowing from rich people in the world, and lending to poor people in the world, that country model is not ideal for dealing with global public good.

It needs coordination—a different model, a model that coordinates people and information in a much more effective way globally. Because those global public goods are threatening all of us, and it is a global problem.

We all saw it with Ebola. Suddenly people realized just how bad the health systems were in poor countries. We saw that graphically with the Ebola pandemic, but that is only the first of many going ahead. So, dealing with that global public goods problem is going to require some significant changes, I believe.

Thank you.

[The prepared statement of Dr. Ravallion can be found on page 60 of the appendix.]

Chairman HUIZENGA. Thank you. With that, we go to Mr. Patrick Chovanec, who is the managing director and chief strategist at Silvercrest Asset Management. He also teaches part-time as an adjunct professor at Columbia University's School of International and Public Affairs.

But prior to that, he was a practicing associate professor of practice at Tsinghua University's School of Economics and Management in Beijing, where he also served as chairman of the Public Policy Development Committee for the American Chamber of Commerce in China.

And, with that, welcome to you, and you have 5 minutes for your opening statement.

STATEMENT OF PATRICK CHOVANEC, MANAGING DIRECTOR AND CHIEF STRATEGIST, SILVERCREST ASSET MANAGEMENT

Mr. CHOVANEC. Chairman Huizenga, Ranking Member Moore, and members of the subcommittee, thank you very much for inviting me to talk, and for asking me to talk specifically about China's recent initiatives in development funding, development financing, including the establishment of a number of institutions such as the AIIB, the BRIC's Bank, and the new Silk Road Initiative. I will very briefly summarize my written testimony, and cover the main points.

The first thing to recognize is that although these initiatives have attracted a great deal of tension recently, they do not represent a new trend, or a completely new trend. China has—back in 2007, China founded the Sovereign Wealth Fund, China Investment Corporation, to help deploy capital abroad.

It is not mainly focused in that case on development funding, but for the past several years, China Development Bank and China Export-Import Bank have actually provided more funding to developing countries than the World Bank. And that has raised both interest and concern. So, what we are seeing is a further development of an existing trend.

Why are the Chinese doing this? And that is what I focus on, because I think to understand the implications, we need to understand the motivations. And there are multiple motivations, and some of them are actually conflicting.

The first is to find a better use for China's foreign exchange reserves. China has accumulated huge amounts of capital, both from inflows of investment and also from running chronic trade surpluses. That is, right now, at about $3.5 trillion. Most of it goes into very liquid sovereign bonds, like U.S. Treasuries that earn, especially these days, a very, very low return.

And, so, the purpose behind establishing CIC, for instance, was to generate a higher return. Now, this kind of motivation places an emphasis upon disciplined investment practices, and a disciplined attitude towards risk.

The second motivation is driving Chinese growth, in particular absorbing China's overcapacity. One of the results of all this capital accumulating in China has been an overinvestment boom in China, a buildout of too much capacity in a whole host of different industries.

And, so, in the past China has looked to drive growth by making foreign investments, but that motivation has intensified because now there is this desire to have some of that overcapacity absorbed.

The danger, of course, is that China, up until this point, has not followed OECD principles in its investment practices, which basically bar offering subsidized financing in order to buy business.

And one of the problems with buying business, subsidizing contracts through cheap financing, is not just that it is poor governance, but also that it conflicts with China's first goal, which is to earn a higher return on their investment.

The third goal is securing access to natural resources. Some of the motivation for this has lost its rationale, given the steep decline in commodity prices recently, over the past year, led, in many cases, by declining Chinese demand.

The fourth is enhancing China's soft power abroad. Winning friends and influencing people has some obvious advantages, but the politicization of investment decisions, again, potentially conflicts with other goals, and when investments go sour, can create some real problems.

China has already—China invested about $37 billion in Venezuela that has already had to be renegotiated because the Venezuelans cannot pay it back. If the Venezuelan opposition ever came to power, there is a good chance that they would simply default on that. So, China is investing in some risky places in order to make friends, but whether it actually will end up making friends is another story.

And, it is important to remember that gunboat diplomacy developed because people were trying to collect on debts that had gone bad.

The fifth is rivaling the World Bank and the Asian Development Bank. But again, establishing multilateral organizations to do this can constrain China just as much as it creates an opportunity. China doesn't actually have to rely on multilateral institutions to invest its wealth.

And, sixth, establishing China's Renminbi as the top global currency.

I will just conclude by making a note that it is very important to realize that although—the world is really awash in savings. What the world needs is not so much more savings from China as reform that generates demand. That includes for the purposes of development.

A lot of development projects would be more stimulated by the Chinese turning their savings into consumer demand than it would by adding that much more capacity to the global economy.

And, with that, I conclude my remarks and welcome your questions.

[The prepared statement of Mr. Chovanec can be found on page 32 of the appendix.]

Chairman HUIZENGA. Thank you. I appreciate that, Mr. Chovanec. And, with that, last but certainly not least, we are welcoming Scott Morris back to the House Financial Services Committee. Previously, he had served as a senior Democratic staff member on Financial Services, where he was responsible for the committee's international policy issues.

He went on to much bigger and better things when he became deputy assistant treasury of development, finance and debt at the U.S. Treasury Department during the first term of the Obama Administration, and he currently is the senior fellow at the Center for Global Development. And he works on issues related to the international financial institutions, and particularly at the relationships between IFIs and the United States.

So, with that, Mr. Morris, you are recognized for 5 minutes.

STATEMENT OF SCOTT A. MORRIS, SENIOR FELLOW, CENTER FOR GLOBAL DEVELOPMENT

Mr. MORRIS. Chairman Huizenga, Chairman Hensarling, Ranking Member Moore, thank you for this opportunity to testify before your subcommittee on a topic that I believe is of critical importance to U.S. interests in the world.

Earlier this year, the United States faced a gut-check moment when it comes to its leadership in the multilateral development banks. In June, 56 countries, including important U.S. allies like Germany, the U.K., and Australia, joined the Chinese government in creating a new MDB, the Asian Infrastructure Investment Bank.

I think much of the criticism leveled at the United States has been misguided in putting the focus on poor diplomatic outreach, or Congress' failure to pass IMF reform.

While I very much believe that action on the IMF quota package is critical in its own right, the challenges to U.S. leadership in the MDBs run deeper. If Congress and the Administration are unwilling to address these deeper challenges, then we are likely to see a world in which institutions like the World Bank are eclipsed by new actors like the AIIB, and where the United States finds itself increasingly on the outside looking in.

So, why should we care about that? Broadly speaking, institutions like the World Bank and the Asian Development Bank are important strategic and economic partners that have been shaped by U.S. leadership over many decades. And I will highlight five ways that they deliver particular value to the United States.

First, the MDBs amplify U.S. assistance. In 2013, the United States contributed $2.8 billion to MDBs, leveraging over $100 billion of on-the-ground assistance from the MDBs themselves.

Second, the MDBs operate at a scale and across a range of sectors that the United States alone cannot. This is why the African Development Bank is a key partner in the Administration's Power Africa initiative. And it is also why MDBs have garnered praise from the U.S. military leadership for their infrastructure investments in fragile states.

Third, the MDBs can pursue U.S. objectives more effectively as an honest broker in countries and environments where a visible U.S. role can be problematic. I point to a country like Pakistan as emblematic of this.

Finally, the MDBs have been rated as the most effective development institutions by multiple independent reviews of foreign assistance.

So, how are all these benefits at risk today? The answer rests on whether the United States is willing to embrace ambition for the MDBs in which it already leads, or whether we will simply be satisfied to watch as other countries play that role through new institutions.

Ironically, the AIIB episode shows that much of the rest of the world is actually looking to embrace division of the MDBs that the United States itself first laid out, over 70 years ago, at Bretton Woods. In particular, that these institutions are primarily banks, not charities. And, as Ronald Reagan put it in 1981, that their aim is to ensure that economic growth and development would spread to all parts of the globe. That is a broader and more ambitious goal and one that is almost exclusively focused on direct poverty alleviation in the poorest countries.

But the Bretton Woods architects understood then what still holds today: a world in which a growing number of countries are prosperous and economically integrated is also a more peaceful world and one that ultimately benefits the United States.

So, when U.S. officials resist calls for MDB capital increases, or press MDB borrowers to graduate from assistance, they are taking positions that are increasingly out of step with the rest of the world. It shouldn't be a surprise, then, that the Chinese found so many willing partners when they conceived a new MDB without the United States.

So how can the United States not only get back in step with its multilateral partners, but actually lead on a new MDB agenda? In short, it is about money and policy. The United States needs to show greater ambition when it comes to MDB financing. It can do so by channeling a larger share of its existing foreign assistance resources through the MDBs, and showing more flexibility around compelling uses of MDB capital and grant money.

When it comes to policy, U.S. leadership is critical. And I want to highlight how it is being undermined in one area. The rise of MDB-related policy mandates attached to appropriations bills has become problematic.

Yes, Congress has a key role to play in setting U.S. policy direction in the MDBs, but I strongly believe that work should be spearheaded by this committee, and its counterpart in the Senate, with the histories they have of transparent deliberation, robust debate, and open markups.

I have been troubled by the growth of policy mandates emerging in spending bills with little explanation and no history of hearings or debates around them. This has led to hollow victories for the advocates of these policies when there is no wider buy in for the mandates themselves. At worst, it sometimes leads to conflicting mandates and messages which have undermined the ability of the United States to pursue policies internationally, when there is just a basic amount of confusion about what the U.S. position actually is.

So, I believe it is this authorizing subcommittee, in particular, that can play a crucial role in fixing these particular problems, but more importantly helping to set a strategic vision for the U.S. role in the MDBs going forward.

So, I am greatly encouraged by your calling this hearing, and I very much hope that it will be followed by more hearings, debates, and even markups in the months and years ahead.

Thank you.

[The prepared statement of Mr. Morris can be found on page 46 of the appendix.]

Chairman HUIZENGA. Thank you. I appreciate that, and with that the Chair recognizes himself for 5 minutes of questioning. And Mr. Morris, I will start with you, maybe not so much a question as a comment.

Could you please let our colleagues in the Senate know that we, too, would like to go through with the appropriations process; continuing C.R.s indefinitely does not allow anybody within any body to advance that debate and to figure out what is working and what is not working. So, I will just make a special note of that.

Dr. Ravallion, I would like to ask you about a little bit about MDBs. You were asking, how do we do that? How do we lift those billion people, as you were saying, out of poverty? You talked a little bit about how the lending culture needs to change. And I guess one of my questions is how, specifically? And are the MDBs really prepared to focus in on this?

I am afraid, and, Mr. Chovanec, you might be able to go into this, or Mr. Karlan as well, are they so diffused at this point that we need a refocus? Or is it fine with the various issues that they are sort of dealing with?

So, Dr. Ravallion, I would like to hear from you first.

Mr. RAVALLION. Thank you. Yes, a refocus is going to be needed, but that is not the main problem. I think, as I said, the challenge of getting out of poverty is very country-specific, right? It is not a generalized thing. I can't give you an answer. I just wrote a 700-page book, and it is coming out in 2 months, which is essentially trying to address your question. And I am not sure the 700 pages was enough.

[laughter]

And I don't have—this clock is ticking.

But I do want to emphasize very much that the specifics of how you deal with poverty is figuring that out at the country level. That is how we have done it in the past. That is how China did it.

Chairman HUIZENGA. So, you might have been leading up to this. You had an article in April 2015 where you wrote, "A veritable gauntlet of procurement rules, safeguards, and approvals at the World Bank has sort of blocked a lot of that."

And I think there was a senior official at the World Bank, David Dollar, who had said that an Indian official once told him, "Mr. Dollar, the combination of your bureaucracy and our bureaucracy is deadly."

So, how do we cut through that?

Mr. RAVALLION. Well, let me assure you nothing compares to Indian bureaucracy.

[laughter]

I work on India, and have done so for 30 years. In the present situation, the reality is that bank staff are assessed by the volume of their lending, dollars of money lent. And that is just a poor indicator of impact on poverty. You have impact on poverty sometimes when you don't lend at all.

You just argue it out in your policy dialogue at the country level to get the kinds of reforms that are needed to deal with the specific problems in that context. Or you use money, you use lending bundled with knowledge and bundled with good evaluation, feeding back into future lending.

And it is that bundling of lending and knowledge that you can't just measure success by the dollar value of the lending. As long as the incentives of staff and managers are tied to that goal, you are not going to have the impact the bank could have.

Chairman HUIZENGA. So is it fair to say that many assume that MDBs are fighting poverty, and that is their focus, even though nonconcessional lending to middle-income countries can actually equal or exceed the loans to poor countries?

Mr. RAVALLION. Yes, but the bulk of poverty is in those middle-income countries.

Chairman HUIZENGA. You believe that is a proper—

Mr. RAVALLION. That is not a huge problem. Also, those categories, low income, middle income are very arbitrary—

Chairman HUIZENGA. Okay.

Mr. RAVALLION. —and disappearing. But thankfully, the task of realigning, as I keep emphasizing, realigning incentives towards that goal, I think the recent reforms have been a step in that direction. But it is not about the organogram. It is not about the way you organize the bank. That is one aspect, but it is a minor aspect. And, in fact, the old organogram resolidified quite quickly. It is about those incentives at the staff level. That is the culture that has to change.

Chairman HUIZENGA. In my remaining 35 seconds, Mr. Chovanec, we talked a little about the AIIB, and Silk Road, and a number of other initiatives. Is this a threat, is China's involvement a threat? Or is it really just a modern reality of global financing of what is going on, and there are just more people who are out in that space?

Mr. CHOVANEC. It can be either. It is a reality. The fact that China has accumulated so much capital that it wants to deploy, the United States is not in the position of being able to tell China what to do with its money. China can deploy that capital with or without the assistance of other countries.

However, and the reason why I focused on the different motivations that China has, is that some of those motivations are things that we can live with. Some of those things are things that we actually would like to encourage. And some of them are actually problematic.

So, I think the response should be how do we shape the way that China interacts with the world, not can we stop China from providing capital.

Chairman HUIZENGA. My time has expired. And I will just note that Professor Karlan, I would like to follow up with you in writing, and talk a little bit about your research on the effectiveness of microfinancing, and how much or how little should that be regulated as we are moving forward.

So, thank you.

With that, I now turn to the ranking member for 5 minutes. She wanted to know if I was going to gavel myself. Yes, I was—I am trying to be that evenhanded. I was going to gavel myself. So, with that, the ranking member is recognized.

Ms. MOORE. This hearing certainly has met my expectations in terms of just the collective knowledge that you all have. And, it is—I would be really interested almost in a colloquy between Mr. Karlan and Dr. Ravallion regarding the importance of research in alleviating poverty.

It seems that Dr. Karlan, you gave some examples of stuff that has really worked, like in Mexico, the Progresa Opportunidades, where women win conditional support and, Dr. Ravallion, you have said that we just haven't employed research enough. So, I guess I am just sort of interested in what the disconnect is? Or am I perceiving something that is not there?

Mr. KARLAN. No, I would say there is—and I think, actually, that part of what we were saying is that we agree very much that there is tremendous value in the knowledge that is generated out of those types of research examples.

My point was that there is just a—I gave a few examples of which you named one, and I think we can do a lot more. And, in that sense, what Professor Ravallion was talking about was the same basic idea: how do we get that knowledge actually into the hands of the policymakers.

Ms. MOORE. Okay.

Mr. KARLAN. And linking it more tightly with loans, for instance, so that we very proactively think about our value added in the MDBs is—I shouldn't say our, I mean, I am not there. But is by not just making loans, but bringing knowledge to the world.

Ms. MOORE. And Dr. Ravallion?

Mr. RAVALLION. Very quickly, I have a worry, a concern that the volume of research is increasing, but I don't see it fully deployed towards our key knowledge gaps. Think about it this way: there are knowledge gaps coming out of the problems, finding those binding constraints at country level, what—how do we deal with them. There is a disconnect—the key disconnect is between essentially policymakers and research.

Ms. MOORE. Yes.

Mr. RAVALLION. Right? They are asking questions, and we are answering some of them, but not all of them. And to bring the two together, in a more effective way, is the charge.

Ms. MOORE. It—like, the United States, for example, just hit—just mentioned some research that had been done on poverty, that—where we haven't deployed that information toward alleviating poverty here.

Mr. RAVALLION. What is the question?

Ms. MOORE. I'm sorry. As an example, is there some body of research out there regarding poverty in the United States, which we haven't deployed on a policy level?

Mr. KARLAN. No, I think there isn't, actually. It goes a little bit to what was referred to earlier, there is a lot of work on the unbanked and the underbanked in America. And this is actually a perfect—not to say that it is right—segue in the sense that some of that research that actually should influence U.S. policy was done by MDBs.

But that link wasn't made. I think there are people trying to make it. I am trying. Others are trying. It is not to say there is no effort, but that is exactly where the research—

Ms. MOORE. I would love to follow up, and my time is waning. Mr. Chovanec, you—I read, perused your testimony, and then I heard you talk, and I was waiting to hear whether or not the Renminbi part of the basket of currencies in the SCR. And what impact would that have?

Mr. CHOVANEC. It is another question, but yes, I think the economic and financial significance of the Renminbi part of being—part of the SDR is insignificant. I don't think—

Ms. MOORE. Is insignificant—

Mr. CHOVANEC. Insignificant. I don't think it has any significant economic and financial impact. The thing that makes a reserve currency a reserve currency is not some kind of official imprimatur.

It is the role that it plays in the global economy, and it requires a currency to be both desirable and accessible.

Desirability—on the one hand, a lot of people want to use the Renminbi to buy things from China. But on the other hand, it is not very easy to hold it. There are not that many places where people can invest it.

The other aspect, though, which a lot of people ignore, is accessibility. In order for China's currency to function as a reserve currency, it has to move from being an importer of foreign currency to being an exporter of foreign currency.

Ms. MOORE. Thank you. And, Mr. Morris, I have to ask you a question. You have been critical of the United States' foreign aid budget. We should do more with multilateral. How would it be better to provide it to multilaterals rather than bilateral support? I ask for indulgence, Mr. Chairman.

Chairman HUIZENGA. Ms. Moore, I gave myself 30 seconds, so keep going.

Mr. MORRIS. Thank you, no, just very briefly, and I did try to outline why I think these institutions provide particular value to the United States. I think it is important to recognize how small of a share of the foreign assistance budget they account for, and as I advocate for more of that share, I am not talking about dramatic changes here. Really, very small shifts in how much we rely on these institutions, which, in a strictly financial sense, leverages our money tremendously. We could get a lot out of that. And that is really what my point is.

Ms. MOORE. Thank you for your indulgence, Mr. Chairman.

Chairman HUIZENGA. The gentlelady's time has just expired. With that, we recognize the vice chairman of the subcommittee, Mr. Mulvaney of South Carolina.

Mr. MULVANEY. I thank you, Mr. Chairman, and Ranking Member Moore, and I thank all of you gentlemen for being here. Dr. Ravallion, I actually thank you most especially. Unbeknownst to you, you are a part of an important friendly competition between myself and the chairman.

You will notice that he has stepped out. As a person who holds a degree in economics from your fine institution, I will inform you that the competition now between witnesses from Georgetown University versus witnesses from Texas A&M is dramatically in the Hoyas favor. But the chairman left before I had a chance to have some fun at his expense.

I want to try and draw some themes together. If I heard this correctly—and that is what I enjoy about these hearings is actually trying to find out information—Dr. Karlan, Dr. Ravallion, and Mr. Morris, I think what I heard was that there was a common theme. I heard Dr. Ravallion talk about public common good. Dr. Karlan talked about microfinancing.

And if I looked for a theme between those two things, it might be that those two things, in my mind, are things that the private sector might not be doing. Certainly, they are not doing it for the public goods. And they are doing it a little bit, I think, in micro. And then I think about Mr. Morris' arguments saying, well, we need to be doing more and more. But then he uses a quote from 1981.

Dr. Ravallion, I think, mentioned that one of the biggest changes in the last 30 years has been the globalization of the economy, and the fact that a lot of what the World Bank, especially, used to do is now done by the private sector.

So, I want to drill down for a few minutes on this concept of filling in the gaps where the private sector does not provide liquidity, credit.

Dr. Karlan, am I right on that? What is the private sector doing with microcredit, and could the World Bank be doing more in a more effective way?

Mr. KARLAN. I think there are two basic thoughts here. One is that there is—what I think to Professor Ravallion's points that I completely agree with is that the knowledge, the private sector is not going to provide the knowledge, and that knowledge is a great public good that the MDBs can provide.

Mr. MULVANEY. And for the benefit of—

Mr. KARLAN. And that is knowledge at micro as well as macro kind of—

Mr. MULVANEY. And for the folks who might not be familiar with the term "public good," why won't the private sector do it?

Mr. KARLAN. The private sector is not going to do that because it costs too much money relative to the profit that they will make as an individual firm. The society as a whole benefits, and so it is worth it for society to do it, but for any one firm, the money is just not there. It is just not that valuable for any one particular firm.

On the micro side, the second thought is that one of the striking things with the microcredit industry is it started off as a subsidized program around the world. And, basically, people learned that actually this can be done in a profitable way, and make people's lives better off. It just isn't solving some of the issues that it set out to solve initially.

So, I think one of the things we can do here is let markets work with—regarding microcredit. Do some things, there are some regulations that are needed to help make it work well. But let the markets work for that.

But meanwhile, let's not forget the original goal that we set out with, which was alleviating poverty and increasing income for the world's poorest, and for that microcredit is not doing that, and we need to address some other—look for other paths to do that. And that—some of those things do actually require a subsidy. There is not a market solution for some issues.

Mr. MULVANEY. Thank you, Dr. Karlan. Dr. Ravallion, I want to come back to something you said, because you talked about knowledge, which I understood, and I understood perhaps the connection between a development bank, like the World Bank, getting involved in that. But then you went someplace I want to press you on a little bit; you talked about health. You talked about the Ebola crisis.

And, just without knowing the answer to the question, is the bank really the best vehicle for doing that? Wouldn't a health organization be best suited to do that, instead of a development bank?

I get it on knowledge. You sort of lost me at health, and I am just asking you to fill in the blanks.

Mr. RAVALLION. It is sad—somewhat sadly the case that there is really nobody doing it. That is the problem. Now, if we could get the WHO to reform, we could get the—it to be properly funded, maybe. But it needs a global institution. I think the funding role, and the convening role of the bank would remain even if we got the WHO working better.

Mr. MULVANEY. Give me an example of how the bank—what the bank could do to help build this public body of knowledge regarding health?

Mr. RAVALLION. Yes, it has a lot to do with building health systems in poor countries, right? And that is also about information. Dealing with a pandemic is about information; it is amazingly important to know what is happening locally, what is happening in the next country, and getting that information really quickly, and being very responsive. The fundamental infrastructure on health systems, and the information just flows have to be much more effective.

Mr. MULVANEY. Super. Gentlemen, thank you very much. I appreciate the input and I thank the chairman for the time.

Chairman HUIZENGA. The gentleman yields back. With that, we will recognize Mr. Carney for 5 minutes.

Mr. CARNEY. Thank you, Mr. Chairman. This is a very interesting conversation. I must admit ignorance on what these development banks do, and trying to figure out what our role is as Members of Congress, and members of this committee.

So, maybe we should start at a basic level. Where do each of you feel that the banks are not serving American interests as well as they could? Why don't we just go right across, starting with Dr. Karlan.

Mr. KARLAN. So, first of all, I do think they are serving U.S. interests well. They can just do better. And I think—

Mr. CARNEY. And how could we do better?

Mr. KARLAN. Basically, by drawing tighter links between knowledge and policy. By making it so that others can use that knowledge that they are creating more, and that, internally, to the multilateral development banks. That it is kind of like the way Professor Ravallion described: it is not just—the banks are not just going out and making a loan to another country. But bring with that loan knowledge about how to set policy, and help that country learn themselves in their context what is working best.

Mr. CARNEY. So, Dr. Ravallion, and I am going to come back to ask the question, what countries are more successful than others that are not so successful. Dr. Ravallion?

Mr. RAVALLION. Which countries are more successful? And which are—

Mr. CARNEY. No, I am going to come back to that question. You are the one who said these—

Mr. RAVALLION. Yes, okay, on your first question, I love the way that the senior member put it, that poverty is a global problem. It is a—poverty in Africa, Sub-Saharan Africa is a problem for America. We are global citizens.

But it is not just our citizenship, it is not just the moral and ethical argument. It is the spillover effects. The way poverty costs people globally, we see that in things like the Ebola crisis and the risks that has to this country. The world as a whole is better off.

So, all of the issues we have addressed, about how the banks, banks plural, could be more effective in supporting knowledge based financial intervention to assure poverty reduction in those countries is in America's interest.

Mr. CARNEY. So, maybe you can answer the second question now. Where in Africa is it more successful than others? Or where has it been successful, and countries where it has not been so successful?

Mr. RAVALLION. Actually, Sub-Saharan Africa as a whole has been on a new trajectory since the turn of the millennium that is really impressive. People don't realize the success story. We used to say it was mostly the work of China and India in reducing global poverty. That is no longer true.

The trend rate of poverty reduction in Sub-Saharan Africa went up from a trend of just a miserable 0.4 percent per year in reducing the poverty rate by $1.25 a day, to a very respectable 1 percent trend rate of reduction since 2000. So the region as a whole—now, obviously, there are exceptions. Zimbabwe is doing very badly, and we know why. But we are seeing it, it is not just a few little—

Mr. CARNEY. One country that stands out?

Mr. RAVALLION. I am talking in over 48 countries, so you just go through the board. You are seeing progress on some or all dimensions of poverty across Sub-Saharan Africa, with a few exceptions. So, in other words, I would answer your question by pointing out the cases where it is not happening.

Mr. CARNEY. Okay. Mr. Chovanec?

Mr. CHOVANEC. I don't want to claim to be in a position of critiquing the existing development banks. What I would say is that with the new Chinese development banks, the concern is that they may not bring the same level of governance to the table that the existing banks did. And that concern is based upon the lending practices already of China Development Bank, China Export-Import Bank, and some of the kind of mixed motivations that they have brought to the table.

Maybe other countries flocking to join these banks will actually be a blessing in disguise in the sense that it gives a higher level of transparency and a higher level of attention to governance. But—and that is one of the reasons why perhaps we should—we, the United States should consider taking an observer role, even if we don't participate, taking an observer role with some of these new institutions.

Mr. CARNEY. Mr. Morris?

Mr. MORRIS. I guess the one area I would point to where the MDBs have struggled, and have not shown as much success as we would like, is the relatively small set of countries that we consider fragile and conflict-affected. And here, I think it is not the MDBs alone. I think the international community struggles with these situations, but it is of great importance for the United States. And I think for the MDBs they have to find a way going forward to be more effective in these environments, and particularly to be more agile.

I think, if you look at a case like Cote d'Ivoire a few years ago, where after a great deal of instability you finally have a democratically elected government coming in, the MDBs struggled greatly to respond quickly to that situation, and show support. Once they did, it is a good news story. I think there is tremendous success happening now in that country, and the MDBs are actually playing a good role, but it took them a while to get there.

Mr. CARNEY. I see my time has expired. Thank you, Mr. Chairman.

Chairman HUIZENGA. Thank you for your honesty. I was just trying to give a light gavel. So, with that, I would like to recognize Mr. Pittenger, the gentleman from North Carolina, for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman. I thank each of you for being here. I would like to follow up on Mr. Mulvaney's questioning, and get some clarity on the role of the MDBs as it relates to the reduction of poverty. Were they the primary factor? Were there other factors involved? Did the private sector play any role? Give me some additional information, Dr. Karlan and Dr. Ravillion.

Mr. RAVALLION. It certainly wasn't just the banks. The biggest single thing I would point to is the change in the policy environment. The more market-friendly policies—I am not a pro-markets guy all the time, and I am all the time talking about problems like market failures and addressing those, but there were some major reforms starting from the mid-1990s that put a lot of the developing world on a new trajectory. And we have to realize that.

Macro stability was key. This is something that the banks and they fund, encourage in dialogue, but the attribution problems are huge in terms of saying, well, how much was there—the external players versus the internal domestic players.

We are in a kind of dialogue all the time about better policies, ranging from macro stabilization, macro instability is one of the worst things for poor people. People don't realize just how bad that is often.

All the way through to the micro policies that Professor Karlan talked about on microcredit, for example. All the way through, it is really—the best way to think about is the institutions—the international institutions are in a dialogue with policymakers in countries, trying to encourage, and learn, too. We are learning from one country to help another. Learning and encouraging a better policy—evidenced based policy environment.

Mr. PITTENGER. As you look toward, I think you said 2030 and the elimination of poverty for 1 billion people, what role do the MDBs play? And what other factors are involved there?

Mr. RAVALLION. A big factor is going to be in the global finance going to developing countries, and maintaining that is going to be key. Now, that is hardly about the direct financing of the banks, but also about their facilitating role, and their leadership role. You have to realize there are many countries where there is risks, for example. The private sector, one of the problems in private sector lending is getting to risky places. The World Bank has persistently identified places being the first in lead the private sector into that country.

Mr. PITTENGER. When you look at risky places are you referring to countries that have an intense amount of corruption? What role does corruption play in terms of how assistance is given out?

Mr. RAVALLION. Part of what we do, what we—not we, I am no longer part of what the World Bank does—is very much building the institutions that will be more robust to the existence of potential corruption. It is not like you get rid of corruption and suddenly everybody is going to behave differently. You just have to make the institutions, and the capacity of the state itself is key to that.

One of the mistakes that we make is we think that—we abandon the states because we see corruption. You have to make those states stronger. You have to increase capabilities for monitoring. You are strengthening legal systems and property rights is part of the process of better development policy, facilitated in part through lending. Lending is also—the bank does, is also part of the process of ensuring those things don't happen as much. It will never go away, though.

Mr. PITTENGER. Sure. Dr. Karlan, your research is it—regarding the poor, what have you learned or discovered about institutions like MDBs that has altered your thinking, and upended maybe some of the essential understandings that we have had about MDBs?

Mr. KARLAN. Well, there we go. Not sure, you know—

Mr. PITTENGER. Are there blind spots that you discovered about MDBs that we didn't have before?

Mr. KARLAN. Any what spots?

Mr. PITTENGER. Blind spots.

Mr. KARLAN. Blind spots. So I think what we have seen is a dramatic increase in the past 10 years, 10, 15 years, in doing careful randomized trials of micro level policies. So, not the kind of macro structural types of issues, and there are a lot of other issues out there that the World Bank has also been working on. But we have seen a huge increase in micro level studies that help understand did this particular policy actually change outcomes for a set of people.

It kind of goes to the question you asked, how do we attribute the global changes in poverty and it is saying, no, no, that is—for exactly the reason Dr. Ravallion said, it is very difficult to actually establish attribution, or what caused poverty to drop in Ghana.

But what is possible to do is say this particular policy over here, what effect did it have in this context? And, so, this is one of the areas that the MDBs have made massive inroads in, in the past 15 years, doing that kind of research. And it—you would basically think about it as kind of a three prong attack.

It is, first, establish causality, establish that in this context this micro policy had this impact. Second, is have some understanding as to why it worked. And, third, is to then replicate and test this elsewhere, and see how do you take this lesson from that context and bring it somewhere else, bring it to another country, et cetera. And that is the knowledge spillover that we keep talking about that is essential, is to make sure that you have kind of thought through those things.

But this is about micro level policy, and I just want to be clear what I am talking about. That is not going to be—you don't use that tool to answer the question why has poverty dropped around the world.

Mr. PITTENGER. Thank you. My time has expired.

Chairman HUIZENGA. The gentleman's time has expired. With that, the gentleman from Michigan, Mr. Kildee, is recognized for 5 minutes.

Mr. KILDEE. Thank you, Mr. Chairman. I want to thank my friend from Michigan for holding this hearing. It is an important discussion. I want to start off with Mr. Morris, and ask you to make some observations on the global need for water infrastructure.

And I just want to point out a bit of an irony. I come from Flint, Michigan, which is currently going through its own emergency related to available drinking water. It has been revealed that the water source that the City has been using is highly corrosive, and has led to lead levels in the water that have made it very dangerous, undrinkable, and has forced unanticipated expenditures in the tens of millions of dollars for a City that has an annual budget of $50 million.

I point this out because this is a situation, a condition occurring in my district, in the State of Michigan, in the richest country in the world, at the richest time in its history, and we have a hard time finding ways to sustain water infrastructure.

I wondered if you could discuss, and I would ask maybe each of you to offer any observations on the difficulties in developing water infrastructure in economies that are far less robust than the one that I represent. And what the hurdles look like, and, I guess, maybe even further, how water infrastructure fares in terms of project selection as a priority for MDBs.

Mr. MORRIS. Thank you, Congressman. This is a very important point, and there was this earlier discussion about, well, let's look globally at all the money that is flowing today, and capital flows, and of course the MDBs are a shrinking—ever shrinking share of global capital flows.

But it is important to focus on where they actually lend, and what situations, and what we would call market failures. And water infrastructure, and infrastructure more broadly, is a very relevant example of, among all those capital flows that are flowing from private sources, they aren't reaching what are often pressing needs, water is one area. And, yes, there are some models that bring in private investment to develop water infrastructure. But they aren't meeting the needs that we face globally on this.

I did want to make another point, because you raised the situation in Flint. I think it is important, from a U.S. perspective, to recognize—we think of these multilateral development banks, and development banks, as something that we give money to so that stuff can get done elsewhere. And then you rightly observed, in fact, we have the kinds of needs that, water infrastructure needs in the developing world, we have them here, too.

One thing to recognize, and this, frankly, is within your jurisdiction is the United States has, in fact, saw fit in the past to create this kind of model for itself. We have something called the North American Development Bank, which does infrastructure projects along the southern border, on both the U.S. side, and the Mexico side.

And it is well worth looking at that model as something, and more generally, realizing that it is not so much the MDBs operating in a very small group of countries we consider poor. They actually are operating in a diverse group of countries, some of which look, in many ways, a lot like us.

Mr. KILDEE. Would any other panel members like to comment on water infrastructure? Or the particular challenges? I guess, the question I have really has to do with developing these sorts of infrastructure which traditionally we think of as being sort of rate-based, or supported on a market basis. And communities, even challenged communities in this wealthy country, see that as a difficult prospect. What about in nations that have far less robust economies?

Mr. RAVALLION. Very quickly on that, a couple of points, most developing countries today are a long, long way from a point where you could consider the water drinkable. A key behavioral thing is then how you deal with that. You boil the water, which means that the problems of water and ill health, particularly in kids, diarrhea, diarrheal diseases is a huge problem.

How you deal with that is about other aspects of what we do in development, and particularly in maternal education. A huge factor in the interaction effect between bad water and child ill health is maternal education.

But this is a long, slow road for building that basic infrastructure in water and sanitation, and that is something the development banks do a lot of. But we have to be realistic here. It is going to be a long time before that happens.

Mr. KILDEE. Thank you. My time has nearly expired. I just want to say thanks to the chairman for holding this important hearing.

Thank you.

Chairman HUIZENGA. Thank you. The gentleman yields back. With that, Mrs. Love, from Utah, is recognized for 5 minutes.

Mrs. LOVE. Thank you. Thank you, Mr. Chairman. First of all, I understand that the MDBs may be feeling some competition from the Chinese development banks, and the BRIC bank—the BRIC's banks. And that perhaps they may be lowering their standards in order to meet the competition.

What do you think we need to do in terms of the standards and the safeguards in this new landscape? And I ask each one of you, do you think that we need to adjust traditional methods? Do you think that we need to adjust a little bit to accommodate for what is happening in this type of landscape?

Mr. KARLAN. So, I have a thought from afar.

Mrs. LOVE. Okay.

Mr. KARLAN. It is not like I have dealt with that directly, but the thought would be if the loans that are being offered by the MDBs are actually attached to better information about how to implement better policy, that would be a good way of winning. And if there was some sort of competition between development banks.

But realistically, I don't see that kind of directly hands-on. So, it is not like I have been at the table, where I have experienced this kind of competition to be able to speak—

Mrs. LOVE. Okay.

Mr. KARLAN. —too well.

Mrs. LOVE. Okay. Thank you.

Mr. RAVALLION. Very quickly, the World Bank will not be, I am very sure, lowering its standards as part of competition with the China banks. The China banks will be raising their standards, and we are seeing that already. I was also, for many years, one of the few, I think the only, international advisor to Chinese government on aid policy. And I saw this in that experience.

I saw the change. I saw from a great naivete about things like evaluation, assuring that the processes work on the ground, to a great sophistication. So, China is capable of raising its standards in all of this to a global, international level. And I think we will see that. It might be—

Mrs. LOVE. So you think you will see them raising them their standards?

Mr. RAVALLION. Exactly.

Mrs. LOVE. Okay. I will just move on. Professor Karlan, in reading your testimony, you highlight the value of translating knowledge and you have mentioned that several times today, into policy and practice. In other words that the MDBs can provide great value through the research they conduct, and determine which programs have the great—have the greatest positive effect on development, and therefore give us the best return on investment.

So, the MDBs collectively have many decades of experience, and you give some examples of specific programs, such as Kenya, and the public transportation there. In my view, they are very micro level programs, so my question is: what are the broader conclusions, do you think we can draw about the types of reforms that would be most effective in spurring development? For example, the policies that encourage the private sector to grow as a key to sustainable growth.

Mr. KARLAN. So, I think—that I go back to kind of Dr. Ravallion's answer, which is that would require longer than a 700-page book, to really get at very, very specific things. And the reality is that there is no generalized answer to that question.

There are guiding principles that we have seen consistently happen over and over again. But I think the most important thing is to put in place a process of learning, so that in a particular context you can use information from elsewhere, but if you have a process of learning in that context what then works, you can then learn better how to implement policy.

So, there are some general guiding principles we have seen, take—the example of the study that I referred to that worked with the ultra-poor. A guiding principle there was very simple, which is it wasn't any one thing that was a problem.

And so policies which just go and try to tackle one thing at a time, we are having issues. And they weren't achieving their goals. But an integrated package was. And this does speak to an important theoretical idea that there is interlinking—

Mrs. LOVE. I have one more question I need to get in, because this is an important question for me. How do you think the MDBs can better support entrepreneurship in business-led growth, as a foundation for stronger economic growth and higher living standards? I can ask you, Mr. Morris, do you think that we can?

Mr. MORRIS. Sure, no—and I agree it is an important question. And it is a dilemma for the banks, frankly, because I think there is broad recognition over many years that private sector development is central to development—

Mrs. LOVE. Yes.

Mr. MORRIS. —and job creation. The model the MDBs have tends to be dominated, and it is some of the concerns that Dr. Ravallion raised, they are essentially lenders to private firms, and sometimes private equity funds effectively. And it has tended to crowd out probably more focused efforts, whether its micro, SME, their dominant approach is to go after, frankly, what in too many cases what is safer investments, and raising questions about how much value they are bringing to the transaction that wouldn't happen anyway from other sources of investment.

I think they really have a lot of work to do to figure out how to be more innovative in this area.

Mrs. LOVE. Yes. Thank you.

Chairman HUIZENGA. The gentlelady's time has expired. With that, the Chair recognizes Mr. Schweikert, from Arizona, for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman. I am actually elated that we are having this hearing, and by looking around you can see how many of us truly are geeky enough to love this.

I want to do two things. I was actually, and I am hoping I am not too much of an outlier here, I was not enraged but I was close. I thought it was inappropriate, I thought the United States should have participated in the chartering of the Chinese-sponsored Asian Development Bank for the governances. A quick question, and then I want to get into something I have a great interest in. The four of you obviously know this area well, am I right or wrong in that position?

Mr. CHOVANEC. I would say that you are not wrong. I don't think is a right or wrong position on whether the United States wants to join the AIIB. I don't think—I think what the United States did, though, was fall into the trap of simply thinking that it could oppose it without offering—

Mr. SCHWEIKERT. As you see—

Mr. CHOVANEC. —any kind of—if it had issues, it needs to offer a compelling, competing vision.

Mr. SCHWEIKERT. Look, it is a little duplicitous to say, we don't want to play because we are worried about governance issues, but if we don't show up, we can't have influence on governance issues. Meaning you can't have both. So, and you see the number of our allies, who we care about that we tried to influence not to participate and they did.

Mr. CHOVANEC. Right. I think to be fair, though, some of them of them were also motivated by less high-minded—

Mr. SCHWEIKERT. Oh, of course.

Mr. CHOVANEC. —ideas.

Mr. SCHWEIKERT. There is money involved.

Mr. CHOVANEC. The U.K.—there is this idea that China is sort of doling out money and you want to be there when it happens.

And the U.K. in particular, which was the first one to break, was driven very much by this desire to be the center of Renminbi trading. So, I think everybody kind of brings some mixed motives to the table.

Mr. MORRIS. If I could—

Mr. SCHWEIKERT. Mr. Morris.

Mr. MORRIS. —to the degree we pose this question today, look, I don't think when it comes to being country number 58 in the new institution I don't think there is tremendous value. We can go back and look at the earlier question.

Going forward, to me the obvious area of emphasis for the United States from a perspective of leadership is how are we leading in the institutions where we are already the number one shareholder.

Mr. SCHWEIKERT. And that is fair, but look, we know we have some bureaucratic problems. We had some allocation problems. We also have some decision-making design problems. And I am hoping over this next few months, we can actually sort of dig down in that.

A one off, but I think it is actually not focused on enough. Doctor, you eloquently spoke about the microfinancing, the layering within there. Something I don't—and I would love to find someone who has a publication where I can delve into this, someone has researched it, is micro trade. Before I got this job, I was blessed to do lots and lots of traveling to a lot of unusual places in the world.

And had to—a 30 second example. A family I met about 70 kilometers north of Bagan in Myanmar, carved tables. A couple of months ago, I was playing on the computer, and I found out they have this little tiny website selling their carvings, and their version, I guess, of PayPal.

I just bought a table from them, from someone who is in a rural area in Burma. If you care about micro financing, if you care about economic growth, if you care about the empowerment of the poor, isn't my ability using the new platforms, we are all walking around with these supercomputers, to engage in that type of trade. How do we promote that?

Mr. KARLAN. Great question, and I can send you some papers. There has been work on it. It is much newer, I would say, but it is one of the—and I am not—I can't, like, in this time, go into all the details, but there are a lot of market failures that do exist there, and just as you said, there are gadgets out there that are reducing the transaction costs, making transactions and trade that was not previously possible, possible. But there is a lot of work to figure out how to make those markets work exactly right. And there is recent research that I can forward.

Mr. SCHWEIKERT. And generally, because so many of us have focused on the capital facilities, infrastructure facilities down to the micro financing, how about also now on the sort of micro production side? The ability to produce and sell your products. The ability to communicate you have the availability of those products to a world market. I have always thought that was the portion that was missing in this discussion for alleviating poverty around the world.

Mr. RAVALLION. That is interesting, actually, because I never thought it was missing. In some sense I always thought that trade, micro trade, all kinds of trade between people, is one of the things that gets sorted out, that just starts to happen once you deal with the fundamentals: access to credit, access to information, access to infrastructure. And that development was about working on those things.

Now trade between people is one of the things that happens when you get the fundamentals in place. No, I am not trying to avoid the question—

Mr. SCHWEIKERT. I would love to give this a little intellectual thought, and I am way over time, but this is something I—

Chairman HUIZENGA. The Chair is prepared to move forward, though, with a second round of questioning, and seeing no objection, we have gotten an okay. If the gentleman will yield back.

Mr. SCHWEIKERT. I yield back.

Chairman HUIZENGA. What I would like to do is recognize myself for a brief question, and then we can go to you for a second round, if that is okay with our witnesses? I want to make sure everybody is able to make their trains and planes after we have delayed you somewhat today already.

So, I guess, Dr. Karlan, I would like to revisit you, instead of writing to you. I would really like to know a little bit more about your research on the effectiveness of microfinancing, and really how much or how little should microfinancing be regulated, as we are in a very—in an increasingly regulatory mind bent by government.

Mr. KARLAN. Sure. There is a lot that can be done to facilitate markets, but yes, there are some regulations that I do think need to be put in place. So, I will give you an example of one study that actually has implications for here in the United States. It is a study we did in Turkey.

Whether people are aware of the price they are paying, and any sort of hidden fees in terms and conditions is obviously an important issue for regulatory purposes. How to make it so that people are aware of the prices, and how to actually write those disclosure policies is not so easy and obvious.

Chairman HUIZENGA. Who is the appropriate governing body to be doing that? Should it be the MDBs that are then giving some of these grants?

Mr. KARLAN. In this context, no. It is not the MDBs, but it is research MDBs can do to figure out how to do this, and that they then work with the regulatory bodies, for instance. So, there is one instance in Malawi, where a World Bank researcher did work to help understand how to get better biometric data into the use by the banks, so that when you take out a loan you know, kind of, who you are borrowing from. And then that information now is in the hands of the banking system, and the central banks to try work with other banks, such as when you try to encourage that type of exchange. So, it is not coming through the loans. That is coming directly from the research group.

Chairman HUIZENGA. Okay.

Mr. KARLAN. To the—

Chairman HUIZENGA. But the MDBs do have some involvement with these microfinancing organizations, correct?

Mr. KARLAN. Yes, but it is actually a little bit more removed. So, there is this—there is CGAP, which is a unit that is housed at the World Bank, which does a tremendous amount of work to try to influence policy, and establish regulations that are appropriate for the markets, to let markets work, but not hinder them. But it is not that CGAP is making direct loans. That is just—it isn't—

Chairman HUIZENGA. No, I understand it may not be direct loans but their involvement in there, could they not be helping to then set the parameters of disclosure or any other?

Mr. KARLAN. Exactly.

Chairman HUIZENGA. Okay. Would anybody else care to comment on that? All right. With that, I yield back my time and recognize the gentleman from Arizona for his additional question.

Mr. SCHWEIKERT. Thank you, Mr. Chairman. Gentlemen, first off, if my sort of outlier question or dialogue we are having in regards to that ability to sort of engage, and I use the term micro trade because I haven't come up with a better one, and I am actually not familiar with what is actually in the literature, but if you look at the technology platforms in Africa, you know, where this is also your bank, that should empower the ability to engage in other levels of trade.

Can you share with me your experiences of what you are seeing out there in this happening? Because, it may be a little more chaotic, it may be outside a more structured, but you could also get some pretty good data on its philosophy. What do you see happening? And that is an open question, because I have no idea who should respond to it.

Mr. KARLAN. I can give you an example of some research which shows that, and it is not going to get at velocity in terms of international trade, but trade just more commerce and trade improving outcomes. So, and this goes to, I think understanding what the market failure is, at the first place, that was preventing trade from happening. It is kind of like what Dr. Ravallion was saying, was it a credit market failure? Was it information failure?

So, this is a perfect example of cell phones actually changing something. There are two different examples I can give you. One is from fishermen in India. So, when cell phones first got built, and towers got put up in—for the fishermen in India, in—beforehand they would have to just dock, and take the price whatever it is.

A lot of fish were literally thrown away because they would dock, and there were no more buyers that was it, they couldn't go back to sea and go to another dock. When cell phones came out, they were—in that basically, it is just improving information from markets.

Mr. SCHWEIKERT. The price efficiency.

Mr. KARLAN. Price efficiency, yes, and all of a sudden what happened was the fishermen could send a text, find out the price at the different docks, and go to the right place. All of a sudden, you saw smooth prices across the villages on the shore, and much less waste. More trade was taking place. More efficiency. And that was a direct byproduct of understanding.

In this case, they didn't set up cell phones to solve this problem, but it was the case that they reduced transaction costs and made that happen.

In Kenya, a much shorter example, but mobile money, the ability to send money cheaply from one place to another, is reducing a transaction cost, making transactions that were not otherwise possible, possible. And that has increased people's ability to share risk, so that when something bad happens to them, others are able to help them.

Mr. SCHWEIKERT. But in these examples, if we start to think about, if our passion is dealing with global poverty, and a path out of it, I am concerned or hopeful that the new information age, the fact that I often have very poor citizens around the world who are still holding some type of smart phone. And the information, the ability to move money now on those platforms, but also the ability to offer services or an indigenous product, or an enhanced—a value added product.

How do I see the layering of, okay, yes, we have the huge development banks over here, they are going to build a bridge and a dam, but I have this other world that has also focused at the poverty level of providing at the community, at the individual, at the village level.

And how do we, as Members of Congress, also make sure that we understand it, and are actually promoting those things that help the poorest around the world?

Mr. RAVALLION. Okay, I think what you have to realize these days is a place like the World Bank is not just doing big infrastructure, big dams and so on. In fact, it is not doing much of that. In fact, dams are pretty much out of the picture these days. Rather, it is trying to—a lot of it is community-based work, which is exactly what you are talking about, in countries, which isn't necessarily the kind of World Bank lending to a village.

It can be the World Bank setting up a social fund to which villagers apply, or individuals apply. It is creating a kind of infrastructure at another level, which tries to facilitate those things. And the community-based aspect, based on individuals own initiation is key.

Mr. SCHWEIKERT. Now, years ago, just as in that same line, rural India and the participation of an NGO that I believe had some resources, they actually weren't giving money to the village, they weren't giving money. What they were doing is they were subsidizing the transportation of the product to go from here to here, so it was economical.

So, I accept it is complicated. There are lots of layers. But do understand there are a number of us who are just really interested in how commerce, the ability to work and trade, is a key solution to dealing with world poverty.

And, with that, I yield back, Mr. Chairman.

Chairman HUIZENGA. The gentleman yields back. I want to again thank the witnesses for their flexibility today, as we had a few things coming up. And I really appreciate that.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And again, I would like to thank each one of you for joining us today. I think this was very enlightening. It is very helpful, as we are looking at examining the various roles that we play around the world. And with that, the hearing is adjourned.

[Whereupon, at 11:58 a.m., the hearing was adjourned.]

A P P E N D I X

October 9, 2015

Statement of Patrick Chovanec
Managing Director
Silvercrest Asset Management

Before the U.S. House Subcommittee on
Monetary Policy and Trade
October 9, 2015

Chairman Huizenga, Ranking Member Moore, and Members of the Subcommittee, thank you for inviting me to testify today on China's recent initiatives in the area of international development financing, and their significance for the global economy and for U.S. interests.

My name is Patrick Chovanec and I am the chief strategist and a managing director at Silvercrest Asset Management, based in New York, which manages $19 billion on behalf of families and institutions, invested in U.S. markets and abroad.. I am also an Adjunct Professor at Columbia University's School of International and Public Affairs, where I teach on U.S.-China relations. Until I moved back home to the U.S. two years ago, I worked for over decade in China as an investment professional and, later, as an Associate Professor of Practice at Tsinghua University in Beijing, where I taught in their business school. During that time, I also served as chairman of the Public Policy Development Committee for the American Chamber of Commerce in China.

Earlier this year, the United States was blindsided by the decision of several of our longtime friends and trading partners to join the new Asian Infrastructure Investment Bank (AIIB), an initiative promoted by the People's Republic of China that the Administration had quietly – and sometimes not so quietly – opposed. The U.S. set itself up for a very public rebuff that was completely unnecessary, both because blanket opposition to China playing a more prominent creditor role was untenable, and because the U.S. did little to pinpoint and clarify its more legitimate causes for concern.

For more than a decade, until just the past year or so, China was the recipient of large inflows of foreign currency, because of the large trade surpluses it runs, and the huge amount of foreign investment pouring into the country. To keep its own currency from rising, China's central bank purchased this foreign currency and kept it as reserves, investing much of it in U.S. Treasuries. The RMB it printed to buy all this foreign currency was initially frozen in China's banking system, then – in the wake of the 2008 global financial crisis – was released to fund a huge credit and investment boom that boosted GDP, but ended up creating a dangerous amount of industrial overcapacity, which is now becoming a big drag on China's economy.

So China has two challenges: what to do with all the foreign currency reserves it has piled up, and what to do with all the excess industrial capacity it has built.

The move to invest more of China's accumulated savings abroad, or at least in something more productive than U.S. Treasuries, did not begin with AIIB, the New Development (or "BRICS") Bank (NDB), or President Xi Jinping's "One Belt One Road" (OBOR) initiative. China Investment Corporation (CIC), the country's sovereign wealth fund, was set up in 2007 with $200 billion from China's foreign exchange reserves, to invest in companies and projects that would hopefully earn a higher return. As early as 2009, two of China's largest policy banks, China Development Bank and China Export-Import Bank, together surpassed the World Bank in the amount of money they lent (over $110 billion) to developing countries.

In contrast, China will contribute only a portion of of AIIB's initial capitalization of $50 billion and NDB's $100 billion, and not all at once, although presumably other Chinese banks could lend more money to projects that AIIB or NDB seed. China has pledged another $40 billion to create the Silk Road Fund, which will help finance OBOR-related projects. Altogether, however, China has only begun to deploy a fraction of its $3.5 trillion foreign currency stash.

Despite talk of China having a "master plan," the motivation for these initiatives are varied, and sometimes conflicting. Possible motivations include:

1. Finding better uses for China's foreign exchange reserves. In other words, earning a higher return on the foreign claims the government, in effect, borrowed from the Chinese economy, by investing them in something besides low-yielding Treasuries and negative-yielding German Bunds. That means making disciplined investment decisions with an eye towards getting your money back and then some, charging enough to cover the risk of losses along the way. It also means investing with the U.S. dollars or other foreign currencies in China's reserves, not in RMB. This was the rationale for setting up CIC, and remains an important motivation for opening up additional channels for investing Chinese capital abroad.

2. Driving Chinese growth, and absorbing China's overcapacity. By financing projects abroad, China can create business opportunities for Chinese construction contractors, equipment manufacturers, and materials suppliers, and even overseas employment opportunities for Chinese laborers. One of the criticisms of past development lending by China Development Bank and China Export-Import Bank is that they do not abide by OECD guidelines that bar the offer of preferential financing terms to win contracts and, in effect, "buy" business. The temptation to subsidize bids using cut-rate credit has grown all the greater as China's economy slows, and once-thriving industries find themselves simultaneously facing massive debt loads, shrinking domestic demand, and yawning overcapacity. One oft-expressed hope is that the projects sponsored by AIIB, NDB, and OBOR will absorb that overcapacity. In fact, however, most analysts estimate that the demand generated would barely make a dent in China's overcapacity problem.

Using cheap credit, often to high-risk borrowers, to prop up struggling industries at home is obviously at odds with the goal of earning higher returns on China's foreign exchange holdings. The temptation to cut corners on good governance, and count the costs later, is clear. So is the incentive to lend or invest in Chinese RMB, so the money can make an easy round-trip back to China in the form of demand, but at the cost of leaving China's foreign currency holdings untouched and underutilized. The strategy of "buying growth" is not without significant drawbacks.

3. Securing access to natural resources. Relative to its population and the size of its industrial economy, China is poor in many mineral resources and in arable land. One rationale often given for Chinese outbound investment, including development finance, is to ensure sufficient supplies of food and raw materials. This rationale, however, may have lost some of its logic over the past year, in the wake of a sharp decline in commodity prices, caused in large part by China's own falling demand.

4. Enhancing China's "soft power" abroad. Clearly one motivation behind China's development financing initiatives is to win friends and influence people in strategic regions like Southeast Asia, Africa, Central Asia, and Latin America. Certainly Chinese money has been welcomed in many places with open arms, and has raised China's profile. Letting politics dictate investment decisions, however, can come at a high cost. China Development Bank's estimated $37 billion in development loans to Venezuela, for instance, could not be repaid on schedule and recently had to be "restructured," at an undisclosed loss. The political opposition in Venezuela has hinted they might refuse to pay China back at all, if they came to power.

When loans and investments go sour, the good will initially generated can easily turn to bad. It's worth recalling that the term "gunboat diplomacy" originated in the 19th Century when creditor nations, including the U.S., literally sent gunboats to collect on unpaid debts, and protect their citizens working abroad. Today, China lacks the force projection capability to engage in "gunboat diplomacy," but one can readily imagine a world in which China has the means and the motive to protect its new interests abroad, and the complications that might pose for U.S. foreign policy.

5. Rivaling the World Bank and Asian Development Bank. Closely related to China's desire to expand its influence abroad is the idea that China might wish to supplant the "Bretton Woods" system, including the IMF and World Bank, with a new global architecture of its own. The AIIB, in particular, was seen by many as a bid to eclipse the Asian Development Bank (ADB), where Japan has the largest number of voting shares. Ironically, the rush by so many countries to join AIIB has somewhat diluted China's dominance over the institution. That would be all the more true if Japan – or even the U.S. – decided to join. In any case, China does not need to form new multilateral institutions in order to deploy its own overflowing stockpiles of capital abroad. Aside from the prestige gained, it may even find them a hindrance to its own objectives.

6. Establishing China's RMB as the world's top currency. Much has been made of China's desire to establish its own currency, the RMB, as an international reserve currency, potentially eclipsing the dollar. Rarely is it recognized – by experts either inside or outside of China – that such a role would require a dramatic change in China's relationship with the rest of the global economy. Rather than importing foreign currency by running trade surpluses and sucking in foreign capital, China would need to became a currency exporter, supplying RMB to the world either by running trade deficits or channeling its own capital abroad. This means turning China's own development model on its head, something it's not clear the Chinese have seriously wrapped their minds around.

If they do want to supply the world with RMB, investing a lot more money abroad is certainly one way to do it – with two caveats. First, with China holding \$3.5 trillion in reserves, it makes little sense to lend or invest in RMB when it has more foreign currency than it knows what to do with. It makes far more sense for China to re-export a large part of this stockpile before it begins exporting its own currency.

Second, China's recent development financing initiatives – AIIB, NDB, the Silk Road Fund, etc. – do seem to paint a picture of a China determined to replicate, consciously or unconsciously, the model of Britain in the 19th Century, and the United States in the early 20th Century. Both countries ran chronic trade surpluses and recycled the proceeds in the form of capital outflows. This made sense in the context of a world economy, in both cases, that was fundamentally supply-constrained. Britain was the world's first and only industrial country, leaving huge space for other countries to catch up. Later, the rest of the world needed the United States to help it rebuild from two devastating world wars. There was a need and a place for both countries to function as a supplier of goods and capital.

At the moment, today's global economy is fundamentally demand-constrained. Many commentators say there is a need for more infrastructure finance in Asia and elsewhere, which the Chinese can help to provide. But the real problem isn't lack of capital; the world is awash in savings, to the point where investors have been actually paying the Germans to borrow their money. What is lacking are credible projects that stand a decent chance of earning a positive return, because it's not clear the customers will be there. What the world, and the United States, needs from China isn't a supplier of goods and capital, it's demand – and not just intermediate demand that goes into building out more supply, but final, end-user demand. Rather than rebalancing its economy to deliver that consumer demand, China appears to be trying to prop up its export-led growth model. But this time, instead of building excessive capacity at home, it is hoping to build even more excess capacity abroad. I do not believe this model, which might have made sense in the past, can work today. To the contrary, it will only exacerbate the imbalances that are already weighing down the global economy.

So what does all this mean for the United States and the multilateral development institutions it has helped to create and sponsor over the years? Should we be alarmed, encouraged, or simply unconcerned? What, if anything, should we do about China's recent initiatives? Our response should have four elements:

1. Think. The U.S. is never going to be able to tell China what to do with its own money. The question is not whether China will continue being a creditor country, but what form that will take. China has many conflicting motivations and objectives in pursuing these latest initiatives. The U.S. needs to distinguish, in our own minds, between those that are problematic, such as China "buying" business or extending its influence abroad at the expense of sound financial and economic management, and ones we can live with or even assist, for our common good.

2. Monitor. The decision of so many friends to "defect" and join the AIIB may prove a blessing in disguise. Left to their own devices, China Development Bank and China Export-Import Bank have already deployed development funds in ways that raise serious concerns. The presence of so many new partners gives them and us a window into China's activities, and a way to press for more transparency and better governance. With this is mind, the U.S. should consider applying for observer status at AIIB, NDB, and similar Chinese-sponsored platforms.

3. Communicate. China rebalancing its economy and deploying its savings in ways that boost global demand, rather than add to the global supply glut, is good for China and good for the United States and the world economy. Yet at no point did the U.S. formulate, much less persuasively articulate, this idea as it related to the objectives of the AIIB and its participants. Instead of explaining why more Chinese funding for building infrastructure in Asia was not really the solution, whereas spurring more Chinese consumer demand to generate better returns on such projects could be, we rather lamely appeared as though we were opposing for selfish and petty reasons, standing in the way of what everyone, including, ourselves, unquestioningly accepted was a good thing.

4. Lead. "You can't beat something with nothing." If the U.S. has problems with the economic path China is proposing to other countries, and is willing to put its own money behind, then we had better be ready to offer a compelling alternative. TPP is a start, but only a start. The topic of international finance may seem arcane, but it lies at the heart of our relationship with China and our competition with China for global influence. A proactive agenda that reflects our values and our interests needs to be at the heart of our foreign policy, just as it was with Bretton Woods and the Marshall Plan at the end of World War II.

Thank you, and I'm happy to answer any questions.

TESTIMONY
OF
PROFESSOR DEAN KARLAN[1]
YALE UNIVERSITY and INNOVATIONS FOR POVERTY ACTION
before the
U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

"The Multi-Lateral Development Banks:
A Strategy for Generating Increased Return on Investment"

October 9, 2015

In the last quarter century, we have seen huge reductions in poverty around the world. Extreme poverty rates have fallen by more than half,[2] the under-five mortality rate has fallen by more than half,[3] and 91% of kids in developing countries are enrolled in elementary school.[4] But many problems remain, and better evidence on what actually works can help guide us to more effective ways to reduce poverty and improve lives. The multi-lateral development banks (MDBs) have made important inroads in the quest for better policy guided by evidence. But the full potential of their research is yet to be realized. The United States could see a higher return on its MDB investments by encouraging the MDBs to generate evidence on what works in development, build processes to use such evidence most efficiently within their own operations, and disseminate the evidence effectively so that others, such as the United Stated Agency for International Development (USAID) and the Millennium Challenge Corporation (MCC) can benefit. Such "knowledge spillovers" improve the return on investment the U.S. taxpayers receive from their investment in the MDBs.

The MDBs have played a key role in the progress in reducing poverty – but there is still much to do to build stable countries and markets where everyone has the opportunity to flourish. In the coming decades, most of the poor will live in fragile and economically deprived states, making it even more important to U.S. interests and leadership to address extreme poverty. Naturally, resources are limited, so we must figure out the most cost effective approaches, so that limited dollars can have the most impact.

This ought to have bipartisan appeal: those skeptical of aid programs want evidence in order to minimize wasted money on useless programs; those enthused by aid programs want evidence in order to maximize effectiveness with the money spent. Luckily, there is a clear winner: the better the use of evidence to create effective programs and policies, the more leverage US taxpayers can get from our contributions to the MDBs.

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[1] dean.karlan@yale.edu
[2] For more information, visit http://www.un.org/millenniumgoals/2015_MDG_Report/pdf/MDG%202015%20rev%20(July%201).pdf.
[3] For more information, visit http://www.who.int/gho/child_health/mortality/mortality_under_five_text/en/.
[4] For more information, visit http://www.un.org/millenniumgoals/2015_MDG_Report/pdf/MDG%202015%20rev%20(July%201).pdf.

So how can we ensure that the MDBs use our precious resources wisely to have the greatest impact on the world? In this memo, I argue that the MDBs are most effective when they are generating "knowledge spillovers," i.e. knowledge that helps other organizations as well and thus influences policy and practice beyond their own operations.

I detail two broad points about the optimal role for evaluation at the MDBs.

First, to date, the MDBs have done their share of high quality research, and there are clear examples of policy-wins that came to be because the MDBs first gathered rigorous evidence on how to deal with specific problems. But their ability to translate research into practice and policy has room for growth. I lay out specific "wins" below, but there are not hundreds to choose from, and we need to position the banks to be more effective in using and applying the most rigorous research throughout their work. To do this, we need to realign incentives and build stronger feedback systems within the MDB processes so that evaluations are used as strategic tools to guide policy reform.

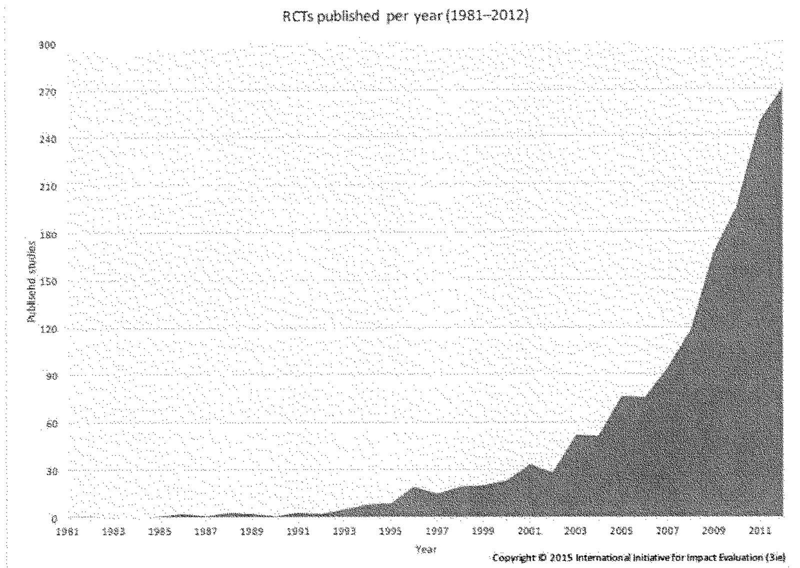
Second, often evaluations have blurred purposes, both trying to evaluate for the purpose of accountability (did the activities under a program or policy take place as expected?) and impact (how did the activities engaged in under a program or policy change the world, compared to how the world would have changed without that program or policy?). Although both questions are critical, they require different toolkits, and not all circumstances call for answers on both accountability and impact.

1. The Value Added of the MDBs: Translating Knowledge into Policy

The MDBs are large institutions. But in reality they are quite small relative to the world they aim to influence. Their impact should be measured not by the work they do with their direct funds, but rather with the policies they can influence by producing knowledge for governments around the world. I refer to knowledge for wealthy country governments and their aid programs, such as USAID and MCC, as well as knowledge for less wealthy countries and their programs, such as ministries of health, education, and social protection. This means that they should focus on a key value added: turning good research into policy and practice.

Building this value added of course necessitates conducting rigorous research on what works best at solving poverty problems and what kinds of programs can give us the biggest return on investment.

The MDBs are already doing quite a bit of this research, and in this capacity I have personally worked with multiple colleagues from the MDBs to conduct rigorous research. This rigorous research employs a method called randomized control trials (RCTs), which are changing how development works in the same way that the methodology changed how medicines were evaluated and used. RCTs allow us to measure with confidence and less bias what works and what does not. As you can see from the graph below, the number of RCTs has increased dramatically in development, especially in the last decade, from 19 published RCTs in 1996 and 23 published in 2000, up to 270 published in 2012.



But the value added of rigorous evaluation for the world is not just about counting the number of published studies. It is, rather, having strong links from research to policy so that the knowledge created is then used. Strengthening this link for the MDBs requires ensuring that the knowledge created is implemented within the banks' strategies and shared in policy dialogue with other countries.

Examples of Moving from Evidence to Policy

The examples below illustrate how using rigorous research conducted by one or more of the MDBs can lead to more cost-effective programs that impact millions. These examples span from social protection to reduced corruption to improved financial markets for the poor.

1. Conditional cash transfers: Rigorous research led by multilateral development banks has shown that conditional cash transfers are cost-effective methods of transferring funds and generating long-term investment in health and education. Such programs, after clear and rigorous evidence was brought to light, are now being implemented by many governments directly. In the late 1990s, researchers at the International Food Policy Research Institute (IFPRI), with support from both the World Bank and the Inter-American Development Bank (IADB), partnered with the Government of Mexico to test what is now a flagship program: the Progresa-

Opportunidades conditional cash transfer program. The program gives cash to poor mothers on the condition that their children attend school and receive regular medical check-ups. The research also found the program was cost-effective, and the Government of Mexico received other funding to implement the program widely, reaching over 5 million families.[5] Other countries saw that this was both an effective and politically viable program, and dozens of countries[6] are now funding and implementing their own conditional cash transfer programs, reaching more than 20 million families today.[7]

2. Improved credit markets from biometric recording of fingerprints: A program to fingerprint farmers who took out small loans in Malawi was shown effective through research funded by the World Bank. The RCT was conducted by the World Bank's economic research group and showed that fingerprinting bank clients when they took out loans and informing them that the fingerprint would identify them on any future loan applications substantially increased loan repayment among a bank's riskiest borrowers. The technology allowed banks to reliably track clients' payment histories and reduced the costs and risks of lending. The benefits of the technology outweighed the costs by more than two-to-one. Now with support from USAID DIV, Malawi's central bank is supporting the scale-up of a fingerprinting program.[8]
3. Safer public transportation: A campaign which placed stickers in "matatus" (minibuses that are a popular transportation method in Kenya), urging passengers to speak up against poor driving, led to a 50% reduction in road accident claims and a 60% reduction in claims involving injury or death.[9] The evaluation received partial support from the World Bank, and the scale-up is now supported by USAID DIV[10]: with a cost of around US$7 per vehicle, they are now scaling up to 1,000 vehicles per year, Kenya's largest insurance company now requires matatu stickers for coverage, and the government installs stickers during annual vehicle inspections.
4. Community grants for improved health: In Indonesia, World Bank researchers tested a pilot program that incentivized community-based grants intended for health and education services. The incentive stipulated that a portion of the subsequent year's grant would be allocated based on the community's relative performance on health, nutrition, and education indicators, a community-based

[5]Parker, Susan W, and Teruel, Graciela M. 2005. "Randomization and Social Program Evaluation: The Case of Progresa." The Annals of the American Academy of Political and Social Science, Place Randomized Trials: Experimental Tests of Public Policy, 599: 199-219. For more information, visit http://www.jstor.org/stable/25046100?seq=1#page_scan_tab_contents.

[6] For more information, visit http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALPROTECTION/EXTSAFETYNETSANDTRANSFERS/0,,contentMDK:22055402~pagePK:148956~piPK:216618~theSitePK:282761,00.html.

[7] For more information, visit https://openknowledge.worldbank.org/bitstream/handle/10986/2597/476030PUB0Cond101Official0Use0Only1.pdf?sequence=1.

[8] Giné, Xavier, Jessica Goldberg, and Dean Yang. 2012. "Credit Market Consequences of Improved Personal Identification: Field Experimental Evidence from Malawi." American Economic Review, 102(6): 2923-54. http://www.poverty-action.org/sites/default/files/publications/credit-market-consequences-improved-personal-identification-field-experimental-evidence-.pdf

[9] Habyarimanaa, James, and Jack, William. 2001. "Heckle and Chide: Results of a randomized road safety intervention in Kenya." Journal of Public Economics, 95(11-12), 1438-1446. For more information, visit https://gui2de.georgetown.edu/projects/zusha.

[10] For more information, visit https://www.usaid.gov/div/matatus.

adaptation of the individual conditional cash transfer model in Mexico. Researchers found that linking community grants to performance improved maternal and child health outcomes. Based on the results of the evaluation, the Government of Indonesia moved exclusively to incentivized grants, and increased its annual funding for the program. With additional funding support from the Australian Government and the World Bank, the program reaches 6.7 million women and children per year. The Millennium Challenge Corporation (MCC) is now funding the Government of Indonesia to scale this program even further.[11]

5. Ultra-poor "graduation" safety net program: A six-country multi-site initiative coordinated by the World Bank's Consultative Group to Assist the Poor, with research conducted in collaboration with Innovations for Poverty Action, found that a multi-faceted and integrated package of services for the ultra-poor can generate sustainable increases in consumption, income, food security, and several other measures of household well-being for those in extreme poverty.[12] This program is now being scaled up by the Ethiopian government (in collaboration with USAID), the Pakistan government and in India, with further work afoot in other countries to bring this program to social protection ministries. CGAP at the World Bank is a driving force in the effort to use this research to shape social safety net policies around the world.

These examples are important illustrations of how research can translate into better programs that deliver on their investments. This wave of development policy based on rigorous evidence is new, as the growth in published studies indicates. It is therefore understandable that we have not yet cracked the code for moving evidence to policy, but this is the direction we need to push to make aid more effective.

2. Accountability vs. Research

Evaluations at the MDBs serve two broad purposes: accountability and impact assessment. It is imperative to be clear about which is called for in specific situations. And not all situations call for both. The MDBs need a more strategic approach for selecting when and how to evaluate different parts of the portfolio. They should adopt a portfolio approach to evaluation, rather than simply employing any one method uniformly. In particular, even though I am an advocate of RCTs in many situations, they certainly should not be advocated in all situations.

So when is accountability called for, and when is impact assessment called for? Let me approach each purpose separately.

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[11] Millennium Challenge Corporation. 2011. "Notice of Entering into a Compact with the Republic of Indonesia." The Federal Register: The Daily Journal of the United States Government. For more information, visit https://www.federalregister.gov/articles/2011/11/29/2011-30706/notice-of-entering-into-a-compact-with-the-republic-of-indonesia.

[12] Banerjee, Abhijit, Duflo, Esther, Goldberg, Nathanael, Karlan, Dean, Osei, Robert, Parienté, William, Shapiro, Jeremy, Thuysbaert, Bram, and Udry, Christopher. 2015. "A multifaceted program causes lasting progress for the very poor: Evidence from six countries." Science, 348 (6236), 1260799 For more information, visit http://www.sciencemag.org/content/348/6236/1260799.abstract. Policy bulletin available here: http://www.poverty-action.org/sites/default/files/publications/building-stable-livelihoods-ultra-poor.pdf.

Accountability is an exercise in making sure the program was conducted as it was planned. For a transfer program, this entails examining whether the targeted recipients received the transfer, and the untargeted did not. For a school supplies program, this entails examining whether schools received the supplies that they were supposed to receive, in a timely fashion. For a nutritional support program, this entails measuring whether nutritional supplements reached the intended households.

However, accountability does *not* entail asking how the transfers were used by the households that received them, and how it changed their lives. Accountability does *not* entail asking how the school inputs changed the schools, and thus the students attending the school, their test scores, and later life income. And accountability does *not* entail asking how the nutritional supplements have helped improve body-mass index of the children in a household.

One often finds that evaluations aiming for accountability stretch into measuring *outcomes* when they ought not. Let's take the last example, the nutritional supplements. Suppose children receiving the nutritional supplements did increase their body-mass index in the three months following enrollment in the program. Would this constitute evidence of impact? No. Children grow anyhow. The question one must ask is whether they grew more than they would have had they not received the nutritional supplements. This is a much tougher question to ask, and enters into the space of impact assessments, where RCTs have become commonplace.

But suppose we already know that the nutritional supplements "work." They have the right content, and are tasty. There may be no need to know their impact, just like we do not likely need another RCT of penicillin. It may also be difficult, due to contextual realities, to conduct a proper impact assessment of a specific program. In either case, it would not be prudent to invest resources to measure the impact of the program. But an accountability exercise ought to be done, merely as a check on the organization, to make sure it is adhering to its plans. Such accountability exercises are radically cheaper than a full impact assessment, and ideally are at least partly generated through data collected for management purposes already.

When the MDBs evaluate programs, they must be clear about the purpose of doing so – rigorous evaluation is for determining impact and why, but not every project ought to have a rigorous impact evaluation. That would constitute too much money being spent on research. Rather, impact evaluations should be deployed strategically, not applied universally. In particular, once there is evidence on the impact of specific policies in well specified contexts, further research on impact is unnecessary, and those funds are better used filling in other knowledge gaps, or providing direct services. Reverting back to the analogy in medicine to make this point: once a particular treatment is known to work, one does not continue to conduct rigorous research testing its efficacy.

Research on the other hand should answer the broader question of impact: how has the world changed because of this policy, compared to how it would have changed otherwise, why, and will the results replicate in other contexts? There are three parts to this question, and it is important to deal with each.

The first part asks the basic impact question, but critically includes the causal argument that we must know how the world changed compared to a counterfactual, i.e., what would have happened without the program. RCTs became popular in development specifically because of their ability to estimate this counterfactual with less bias.

However, it is also critical to answer the "why," because understanding why something works is critical for taking ideas to scale. Understanding the "why" is akin to asking whether we have a theory that explains the observed results, and ideally this theory also predicts in what circumstances we can expect similar results. This helps us to leverage research from one context to make well-informed decisions about whether the same policy or program is also likely to be effective in a new context.

The third part, will the results replicate, is a reality check on the first two. Many evaluations may claim to have a clear understanding of the impact, and even the reason why the program worked, but putting such theories and claims to the rigorous test of a replication in another context is critical for taking ideas to scale.

To illustrate research that meets these aspirations, I highlight the fifth example above, the "graduation" program for building sustainable income and well-being for those in extreme poverty, particularly because this project was born out of a collaboration led by an MDB. The program puts forward a simple but powerful concept: the problem with being ultra-poor is not any one constraint, but several interdependent constraints, and attacking poverty with an integrated program may be necessary to generating long term improvements. The "graduation" program includes a grant of income-generating assets (e.g., often livestock), training, coaching, access to formal sector savings, health services and short-term food transfers. The program typically targets those in extreme poverty, living on less than $1.25 a day.

This work began from a partnership between the World Bank's Consultative Group to Assist the Poor (CGAP) and the Ford Foundation, who then enlisted Innovations for Poverty Action to conduct six randomized control trials of this program in six countries. I was a lead researcher on this work. The goal here was two-fold: first, to learn whether this integrated package of services was sufficient to generate a "big push" that helped elevate income and consumption sustainably. Second, as discussed above, by conducting this research in six different countries, we learn how replicable the results are across a multitude of implementing organizations and country contexts.

The research, published in *Science* (available here and policy bulletin available here), followed 21,000 of the world's poorest people for three years, and found that this approach led to large and lasting impacts on the ultra-poor's standard of living and boosted livelihoods, income, and health.

Now that we know the approach works across contexts, the MDBs are already active on two key fronts: bringing this evidence to policy, and leading further research to better understand why this program works (with an eye towards guiding improvements in how it is run and how to make it even more cost effective, particularly when implemented at scale). On the policy front, the government of Ethiopia, which has received support from USAID on this project, expects to scale this model to 3 million people, and the model is already being scaled in Pakistan and India. On the research front, further research is underway in Ghana, Uganda, and the Philippines to help determine if all of the components of this program are necessary. Such knowledge helps understand *why* the program works, and with such knowledge one can build an even more cost-effective program at scale.

Research conducted by the MDBs and institutional policies that tackle these three roles for research -understanding is there impact, why, and does it replicate - can have transformative effects, leveraging a relatively modest research budget into larger impact through its influence on how other MDBs, government, and bilaterals allocate their funding.

3. Conclusion

There are many steps the MDBs can take to facilitate further evaluation that serves this forward-looking strategic purpose, i.e. evaluation intended to guide future decisions. The MDBs have made huge inroads, as discussed above, in the quality of evaluation produced over the past two decades. Improvement naturally should be an ongoing effort, and establishing clear institutional policies can help guide them towards even higher quality standards.

Specific examples of policies and processes to improve MDB policy through evidence

1. Peer reviews, both external and internal, can help provide useful feedback for MDB evaluators.
2. Engagement with peer reviews, external and internal, can help make sure evaluations are addressing key knowledge gaps and not merely serving accountability purposes (as discussed above).
3. More evaluations should take on a multi-site approach, coordinating on specifics of measurement as well as intervention design, so that the world can learn more systematically what works and what does not, rather than accumulate a series of seemingly-related studies. This is akin to mimicking the approach in the fifth example provided above, coordinated initially by CGAP at the World Bank, on the ultra-poor "graduation" safety net program.
4. More systematic engagement of the evaluators at the MDB research departments in follow-on policy decisions and technical assistance after the evaluation, so that the learnings from the evaluation are best used in the next phase of the government policy.
5. To improve the use of evidence to guide decisions, a formal process should require close collaboration between experts in evaluation who are deeply entrenched in the existing knowledge on a topic, and those in operations responsible for implementation. Such integration is already happening at MDBs, and more to

encourage further and tighter collaboration would prove fruitful for improving the return on investment in the MDBs.

Broad policy recommendations

To summarize, this memo lays out the following broad policy recommendations for the committee to consider. The overall goal underlying each point is simple: leverage US government funding to the MDBs by helping create more knowledge, and helping that knowledge get into the hands of critical actors such as government and bilateral donor agencies.

1. Take a portfolio approach to evaluation, encouraging MDBs to *not* overinvest in impact assessments. Impact assessments should only be conducted when knowledge can be generated with an eye towards benefits for others; other situations may be best off with merely accountability exercises, which document that the planned activities were properly implemented.
2. Ensure that the internal organizational structure of MDBs enables the facilitation of knowledge from research to policy (see four examples above).
3. Fund programs backed by evidence – there is already ample rigorous evidence out there showing programs that not only work, but that are cost effective. I named only a handful. But the more we demand programs can demonstrate their impact, the more likely we are to achieve impact and use money effectively.

Center for Global Development

U.S. House of Representatives Committee on Financial Services
Subcommittee on Monetary Policy and Trade
"The Future of the Multilateral Development Banks"

Testimony of Scott A. Morris
Senior Fellow, Center for Global Development

October 9, 2015

Chairman Huizenga, Ranking Member Moore, thank you for this opportunity to testify before your subcommittee on a topic that I believe is of critical importance to US interests in the world.

Earlier this year, the United States faced a gut check moment when it comes to its leadership in the multilateral development banks (MDBs). In June, 56 countries, including important US allies like Germany, the UK, and Australia, joined the Chinese government in creating a new MDB, the Asian Infrastructure Investment Bank (AIIB).

And while the United States was roundly criticized for its handling of this episode, I think much of that criticism was misguided in putting the focus on the short term bungling of diplomatic outreach, or Congress's failure to pass IMF reform. Both are relevant, and I very much believe that action on the IMF quota package is critical in its own right, but the challenges to US leadership in the MDBs – institutions like the World Bank and Asian Development Bank where the US is the largest shareholder – run deeper and are longer term in nature.

If US policymakers, including those in Congress, are unwilling to address these deeper challenges, then we are likely to see a world in which institutions like the World Bank are eclipsed by new actors like the AIIB, and where the United States finds itself increasingly on the outside looking in.

So why should we care about that, and why should the US care about the MDBs? Broadly speaking, these institutions are important strategic and economic partners that have been shaped by US leadership over many decades. And they continue to be particularly valuable partners to the US for a number of other reasons:

- First, the MDBs amplify US assistance, both by drawing in other countries' money and by their own borrowing on capital markets. In 2013, the United States contributed $2.8 billion to MDB programs, leveraging over $100 billion in MDB on the ground assistance that year. That's two and half times as much as the US spends directly on foreign assistance across all federal agencies.

- 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 is why the MDBs are key partners for the administration's Power Africa initiative, and why MDBs have garnered praise from US military leadership for their infrastructure investments in fragile and conflict-affected states.

- Third, the MDBs can pursue US objectives more effectively as an "honest broker" in countries and environments where a more visible US role can be problematic. Countries like Pakistan are emblematic of this.

- Finally, the MDBs have been rated as the most effective development institutions by multiple systematic reviews of foreign assistance. This means that US taxpayers stand a greater chance of getting the results that they pay for and not paying more than they should when it comes to MDB-financed projects.

How are these benefits at risk today? The answer rests on whether the United States is willing to embrace ambition for the MDBs in which it already leads, or whether we will simply be satisfied to watch as other countries play that role through new institutions.

Ironically, the AIIB episode shows that much of the rest of the world is actually looking to embrace the vision of the MDBs that the United States itself first laid out at Bretton Woods, New Hampshire over 70 years ago – in particular, that these institutions are primarily banks, not charities; and as Ronald Reagan put it in 1981, their aim is to ensure that "economic growth and development would spread to all parts of the globe."

That is a broader and more ambitious goal than the one that has largely defined the US agenda in recent years, which has been almost exclusively focused on direct poverty alleviation in the poorest countries. The broader MDB agenda was perhaps much easier for the United States to embrace during the Cold War when it was understood in the context of a global battle for hearts and minds. But the Bretton Woods architects understood then what still holds today: a world in which a growing number of countries are prosperous and economically integrated is also a more peaceful world and one that ultimately benefits the United States.

So when US officials resist calls for MDB capital increases, or press for MDB borrowers to "graduate" from assistance, they are taking positions that are increasingly out of step with the rest of the world. It shouldn't be a surprise then that the Chinese found so many willing partners when it conceived a new institution that in fact looked very much like what the United States had in mind at Bretton Woods many decades ago.

How can the United States not only get back in step with its multilateral partners, but actually lead on a new MDB agenda? In a paper attached to this testimony, I provide some detailed proposals, but in short it's about money *and* policy.

The United States needs to show greater ambition when it comes to MDB financing. It can do so by channeling a larger share of its existing foreign assistance resources through the MDBs and showing more flexibility around compelling uses of MDB capital and grant resources.

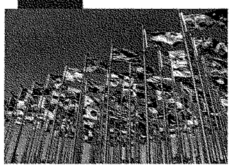
When it comes to policy, US leadership is critical, and I want to highlight how it is being undermined by a dynamic in Congress that has received too little attention in recent years. The rise of policy mandates attached to appropriations bills has become problematic. To be clear, I strongly believe that Congress has a role to play in setting US policy direction in the MDBs. But I also believe that the work should be spearheaded by this committee and its counterpart in the Senate, with their histories of transparent deliberation, robust debate, and open mark ups.

I have been troubled by the growing frequency of policy mandates emerging in spending bills with little explanation and no history of hearings or debates around them. This has led to hollow victories for the advocates of these policies when there is no wider buy in for the mandates or when the language is poorly drafted such that it doesn't effectively serve its own purpose. Worse, this dynamic has sometimes led to conflicting policy direction from the United States. Where does the US government stand on MDB financing for coal, or for hydropower? That question is hard to answer based on conflicting mandates and statements coming from Congress, and as a result, the US voice is diminished in international debates around these issues.

I believe this authorizing subcommittee can play a crucial role in fixing these problems, and more importantly, helping to set a strategic vision for the US role in the MDBs going forward. A robust congressional debate about the level and uses of US funding for these vital institutions and their policy direction is very much needed at a time when a growing number of actors are asserting themselves in the developing world. I am greatly encouraged by your calling this hearing, and I very much hope that it will be followed by more hearings and mark ups in the months and years ahead.

Thank you.

Attachment: Scott Morris and Madeleine Gleave, (Washington, DC: Center for Global Development 2015), "Realizing the Power of Multilateralism in US Development Policy."



Realizing the Power of Multilateralism in US Development Policy

Scott Morris and Madeleine Gleave

Introduction

US leadership in multilateral institutions such as the World Bank and regional development banks is flagging. These institutions, rated as some of the most effective development actors globally, provide clear advantages to the United States in terms of geostrategic interests, cost-effectiveness, and results on the ground. Those are among the reasons the United States played a leading role in creating the institutions and has continued to support them over many decades. Yet the US position in these institutions is less certain today. As a multilateral development bank (MDB) donor, the United States has fallen behind other countries, and it is increasingly seen as an obstacle to expanding MDB capital to address higher demand in the developing world for lending and investment.

Today, the United States too often takes a defensive posture in the MDBs, with a policy agenda set more by budgetary constraints at home than by a clear vision of US goals and priorities abroad. This defensive posture in turn is weakening the global preeminence of the MDBs themselves, as many members of the World Bank and regional development banks are now turning their attention to new institutions such as the Chinese-led Asian Infrastructure Investment Bank (AIIB), frustrated by the lack of growth and slow pace of change in the traditional MDBs. Restoring US leadership in institutions like the World Bank will mean giving a greater priority to MDB funding, which today accounts for less than 10 percent of the total US foreign assistance budget and less than 0.1 percent of the total federal budget. Prioritizing multilateral assistance in an era of flat or declining foreign assistance budgets will necessarily mean some reallocation from other pots of foreign assistance money, as well as an effort to address the structural impediments to considering reallocations.

Currently, there is no policy target for the multilateral share of the foreign assistance budget, despite a commitment to "renew" US multilateral leadership in the 2010 Presidential Policy Directive on Global Development.[1] There is also no policy framework that guides decisions related to multilateral commitments across agencies. Instead, each multilateral program is considered within its own agency budget silo (largely the Departments of State and Treasury), leading to fragmented and ineffective decision-making.

Remedying these weaknesses would start with a policy-level budget target for multilateral assistance, defined as a percentage of the foreign assistance budget. Such a policy goal would help to protect multilateral contributions from the inherent political biases in favor of bilateral assistance. Proceeding from such a target, a common framework for prioritizing multilateral financial commitments across the lead agencies would allow the next presidential administration to determine which of the multilateral institutions provide the most value to the United States

POLICY RECOMMENDATIONS

- Establish a multilateral assistance target (e.g., 20 percent of total US foreign assistance).
- Conduct a multilateral aid review and reallocate scarce budgetary resources to effective institutions that advance US policy objectives.
- Improve budgetary and policy coordination mechanisms within the US government to ensure coherent decision-making about multilateral funding levels.

and are best aligned with US development objectives. This approach would not only allow a more effective use of our limited development dollars but also leverage the powerful position of the United States within these multilateral organizations to make them more effective.

In this brief, we make the case for more multilateralism within US development policy. We examine the value of multilateral assistance to the United States, as well as the problems of the current budgetary decision-making approach that leads to the flow of too little money into too many multilateral institutions. Recommendations for a new multilateral target and decision-making structure follow from this analysis.

Why Multilateral Assistance?

All donors employ a mix of bilateral and multilateral development assistance. Although US bilateral assistance—from headlining programs like the President's Emergency Plan for AIDS Relief (PEPFAR) to targeted support for strategic countries—has played and will continue to play the foundational role in US development policy, the unique characteristics of multilateral assistance merit its elevation in the development agenda. The case for multilateral assistance, drawn here in part from the US government's own arguments, can be thought of in six categories: leverage, instruments, geographic and sectoral scope, political buffers, effectiveness, and finally, the "privilege" the United States enjoys by being the largest collective shareholder in the MDBs.

1. Leverage

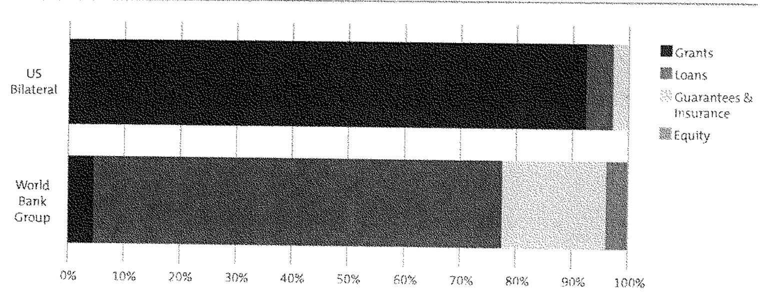
From a financial perspective, the multilateral channel allows the United States to leverage its foreign assistance. By US Treasury estimates, the combination of multidonor leverage and the leverage provided by the ability of MDBs to borrow in capital markets means that every dollar of US paid-in capital leads to $25 in lending. According to the US Treasury, "over time, this effect is compounded, as demonstrated by a capital increase contribution of $420 million made under the Reagan administration that helped support $325 billion in lending over the subsequent two decades."[2]

This dynamic financial model contrasts sharply with most US bilateral assistance, which by definition has no multidonor leverage. Typically, there is not any capital leverage either, since almost all US bilateral assistance has been provided as grants since the early 1980s.

2. Instruments

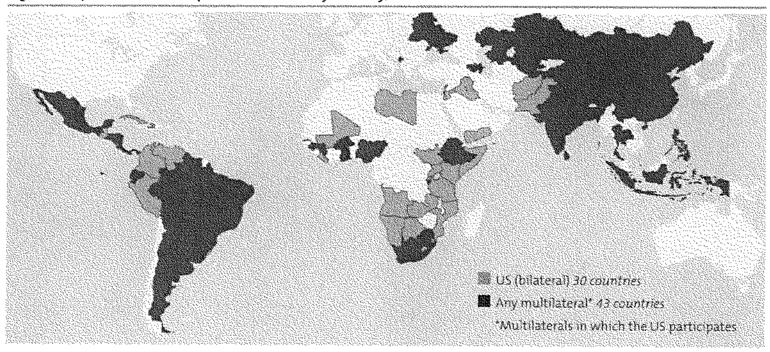
The range of instruments provided by multilateral institutions is greater than those employed by the United States bilaterally. The biggest difference is the prominence of loans in MDB programs and the paucity of them within US bilateral programs (see figure 1). Similarly, multilateral institutions offer far more in the

Figure 1 US Bilateral Development Programs Rely Heavily on Grants at Expense of Other Instruments



Source: World Bank, IFC, and OPIC 2013 annual reports; OECD

Figure 2 Top Donor of Development Assistance by Country, 2012



Source: OECD, includes official development assistance (ODA) and other official flows (OOF, e.g. non-grant assistance, export credits, or investment support)

way of equity investment, guarantees, insurance, and knowledge products. Increasingly, nongrant instruments are better aligned with major development initiatives such as infrastructure investment and private-sector development. These characteristics often make the MDB model more attractive to recipients relative to the US government's traditional grant-based model. Moreover, multilateral institutions can provide multiyear financing commitments; that is difficult to do bilaterally because of the annual appropriations process.

3. Geographic and Sectoral Scope

Multilateral institutions operate in more countries and sectors than US bilateral programs, offering the United States the ability to focus its bilateral programs on fewer countries while still maintaining broader geographic reach and influence through the multilateral channel. The United States is the largest donor in 30 countries worldwide. But these are clustered in regional pockets, mainly in eastern and southern Africa (because of large health and agriculture programs) as well as in frontline countries like Afghanistan, Pakistan, and Libya (see figure 2). On the other hand, US-supported multilateral organizations are the top donors in 43 countries across nearly every region. The multilaterals also tend to have far more presence in middle-income countries, with lending and investment programs that are better matched to these countries' financing needs than the grant-dominant model employed by the United States.

The MDBs also offer much greater sectoral diversity to US development policy. Despite a great deal of rhetoric about US policy's supporting broad-based development, the bilateral assistance budget continues to be dominated by health and humanitarian assistance (see figure 3). MDB dominance in infrastructure finance explains why the institutions play explicit roles in prominent US initiatives such as Power Africa, where most traditional bilateral grant programs are not well matched to the objectives of the initiative.

4. Domestic and International Political Buffers

Multilateral assistance often provides a useful political buffer at home and abroad. At times when US bilateral support for a particular country, sector, or program is politically problematic at home, multilateral institutions allow the United States to maintain support but at arm's length when it has a compelling reason to do so.

For example, in 2010, the United States "abstained" on a decision at the World Bank to finance a large coal-fired power plant in South Africa. The US government formally withheld its support amid competing environmental, development, and diplomatic interests. Nonetheless, the US abstention came with an implicit understanding that the project would be approved by the broader World Bank board of directors. A contemporaneous US Treasury statement reflected the mix of competing interests, as well as the utility of an arm's-length decision, by formally opposing the project while clearly acknowledging the merits of its going forward.[3]

Multilateral institutions also provide the United States a political buffer in other countries, where direct engagement with US officials is problematic. For example, the US-Pakistan relationship has experienced degrees of estrangement over the years in part because of a shifting domestic political environment within Pakistan. In fact, public-attitude surveys suggest that nearly 90 percent of Pakistanis have an unfavorable view of the United States.[4] Nonetheless, Pakistan has compelling development needs and remains a geopolitically important country for global security, counterterrorism, and other national security issues. In cases such as this one, the World Bank and regional development banks can provide a stable source of financing, even when the US relationship has soured.

In general, by allowing for degrees of political separation, the MDBs can be a better instrument than the US government for driving difficult reforms in politically sensitive sectors such as energy and banking when the United States has defined them as a priority in a bilateral relationship.

5. Effectiveness

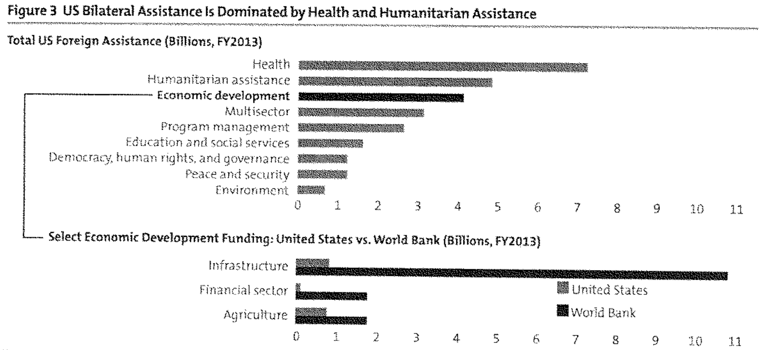
Multilateral channels afford the United States more opportunities to achieve positive development outcomes with its foreign assistance dollars. In various initiatives that evaluate global aid agencies, multilateral organizations have consistently outperformed bilateral institutions in organizational effectiveness (overhead, transparency, and learning), programming (fragmentation and specialization, alignment with country priorities), and "best practices" (selectivity against corrupt recipients, limiting tied or ineffective types such as food aid).[5] Figure 4 reports the performance of US bilateral aid programs as a whole relative to the leading multilateral programs according to the 2014 edition of the Quality of Official Development Assistance Assessment (QuODA).[6]

Not only do US bilateral programs underperform against the average of all aid agencies (more than 100 agencies and 35 donor countries) in the study, but they greatly underperform on all four dimensions against the major multilateral agencies, defined here as the International Development Association (IDA) at the World Bank, the African Development Fund at the African Development Bank, the Asian Development Fund at the Asian Development Bank, and the Global Fund to Fight Aids, Tuberculosis and Malaria.

6. The Value of Being Number One in the MDBs

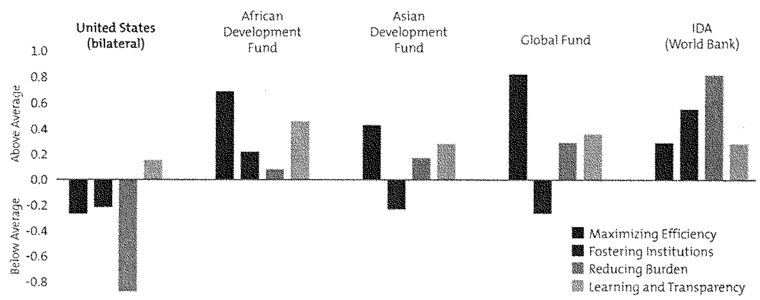
All of the aforementioned benefits depend to some degree on US influence within the multilateral institutions. The United States enjoys particular benefits

Figure 3 US Bilateral Assistance Is Dominated by Health and Humanitarian Assistance



Sources: US Foreign Assistance Dashboard, *World Bank Annual Report 2013*

Figure 4 US Bilateral Aid Programs Perform Poorly on the Quality of Official Development Assistance (QuODA) Assessment



Source: Nancy Birdsall and Homi Kharas, *The Quality of Official Development Assistance (QuODA)*, 3rd ed. (Washington: Center for Global Development and the Brookings Institution, 2014)

from being the largest (or second-largest) shareholder in these institutions, relative to other countries. Unlike the governance system of the United Nations, which relies on "one country, one vote," the MDBs employ weighted shareholding, which gives the United States greater say as a large shareholder, both formally through voting power within the institution and informally through direct access to senior management of the institutions.

As the largest shareholder at the World Bank, Inter-American Development Bank, and Asian Development Bank (along with Japan), the United States has unique formal power in the form of veto authority over key decisions in the board of directors, as well as a unique degree of informal influence, evidenced by the ability of the United States to shape broad policies (procurement rules, environmental safeguards) and programs of the MDBs as well as to steer them to particular initiatives, such as extraordinary support for Afghanistan during the past decade or financing the post-earthquake response in Haiti in 2010.

Of course, the value of being the top shareholder in the MDBs also depends on the value of the MDBs themselves and, in particular, how much they continue to matter to the rest of the world. In the remainder of this brief, we describe how the United States is failing in this regard and what can be done about it.

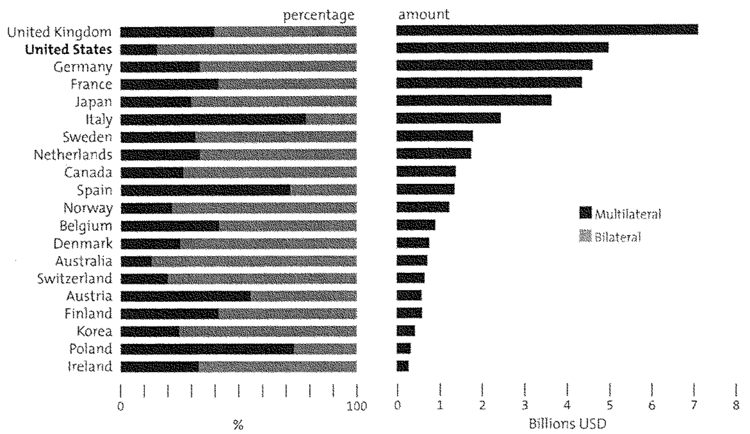
US Multilateralism: Too Little Money through Too Many Channels

Despite the benefits of multilateral assistance, the United States greatly favors funding bilateral over multilateral channels. This imbalance is especially acute when compared against other donor countries. In 2013, the United States channeled $5.1 billion through all multilateral agencies (the MDBs plus other multilateral funds), or just 16 percent of the $31 billion the United States provided in total net development assistance. The average multilateral share for members of the Organisation for Economic Co-operation and Development (OECD) is 41 percent, putting the United States at 19th out of the 20 largest donor countries (see figure 5).

The multilateral share of the US foreign assistance budget has declined from an average of 27 percent in the late 1990s (see figure 6), the result of a dramatic expansion of bilateral foreign assistance programs during the years 2000 to 2013, such as PEPFAR, the Millennium Challenge Corporation (MCC), and large bilateral programs in Afghanistan, Pakistan, and Iraq.[7]

The United States clearly is underfunding multilaterals on a relative basis. At the same time, it is providing these modest resources through too many multilateral channels. The World Bank alone receives support from 10 different US government agencies through more than 175 dedicated

Figure 5 The United States Gives More Aid through Multilateral Channels Than Most OECD Countries, but Multilateral Assistance Is a Small Share of the US Total



Source: OECD, 2013

channels, most of which are trust funds. These proliferated funds are difficult to track, often have overlapping mandates and one-off financing patterns, and broadly contribute to an inefficient and incoherent system (see figure 7).

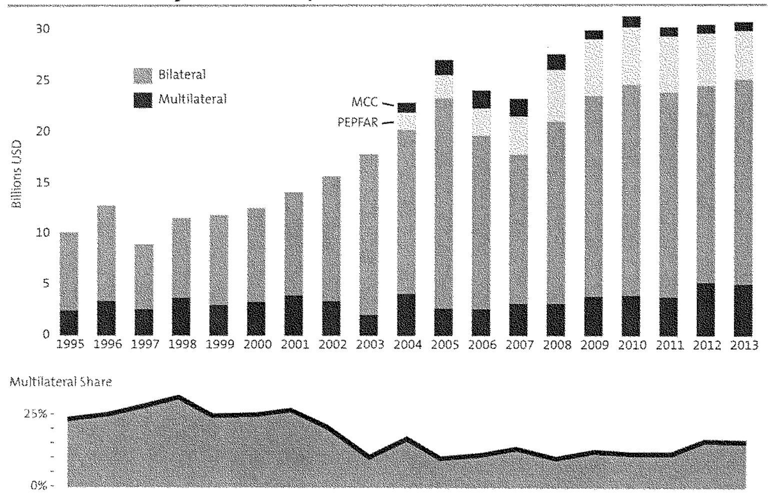
There are a number of reasons why the US multilateral agenda is underfunded and lacking coherence. Decisions about multilateral funding are spread across multiple agencies. A majority of US multilateral funding flows through Treasury's International Affairs budget, followed by global health funding decisions made through the State Department budget process. A distant third are many small decisions made mostly by the United States Agency for International Development (USAID) with regard to multilateral trust funds.

The Treasury Department's International Affairs budget almost wholly comprises multilateral commitments. As a result, these funding decisions cannot draw on potential trade-offs between multilateral and bilateral programs.

Further, existing budget processes do not consider bilateral and multilateral trade-offs between agencies. The only coordination occurs between each agency and the White House Office of Management and Budget (OMB). However, OMB seeks only to enforce what is typically a small decrease or increase in the agency's budget over the previous year's budget. Existing executive branch budgeting processes fail to consider trade-offs across agency budgets, including both multilateral and bilateral allocations.

Similarly, absent overarching policy direction, existing coordination mechanisms do not seek to prioritize *among* multilateral programs. This situation contributes to the lack of coherence and fragmentation evidenced in figure 7. This bureaucratic breakdown has led to surprising outcomes. For instance, in 2013, US contributions to single-issue vertical funds such as the Global Fund (overseen by the State Department) surpassed those of the World Bank's global, multisector concessional finance institution (managed by the Treasury Department). A further example is the Obama administration's decision to cut core funding for the African Development Bank (AfDB) even as the president was championing the AfDB's role in his signature Power Africa initiative. Even more confounding, the AfDB cut was juxtaposed with a USAID decision to contribute $5 million to a small energy-related trust fund at the AfDB, funds that could have been better leveraged through the bank's core operations.[8]

Figure 6 The Share of US Multilateral Development Assistance Has Shrunk Since the Late 1990s as Bilateral Foreign Assistance Has Expanded



Source: DFI annual reports and authors' calculations

The sum of these failures is a diminished US position in the MDBs, and a diminished position for the MDBs themselves as they are forced to reject capital increases because of US opposition. The positive reception that China's AIIB has received in Asia, with 57 member countries and counting, comes on the heels of frustrated multiyear efforts within the Asian Development Bank (ADB) and World Bank for capital increases to support greater infrastructure investment in the region. The defensive posture struck by the United States in these circumstances fundamentally fails to recognize the potential for leadership in and through multilateral institutions. Clearly, US interests in Asia would be better served through a bigger ADB, in which the United States is a leading shareholder, than they will be through a new AIIB, of which the United States isn't even a member.[9]

The next presidential administration should seek to restore US leadership in multilateral development institutions. To do so, we propose a three-step framework to guide future actions and decisions.

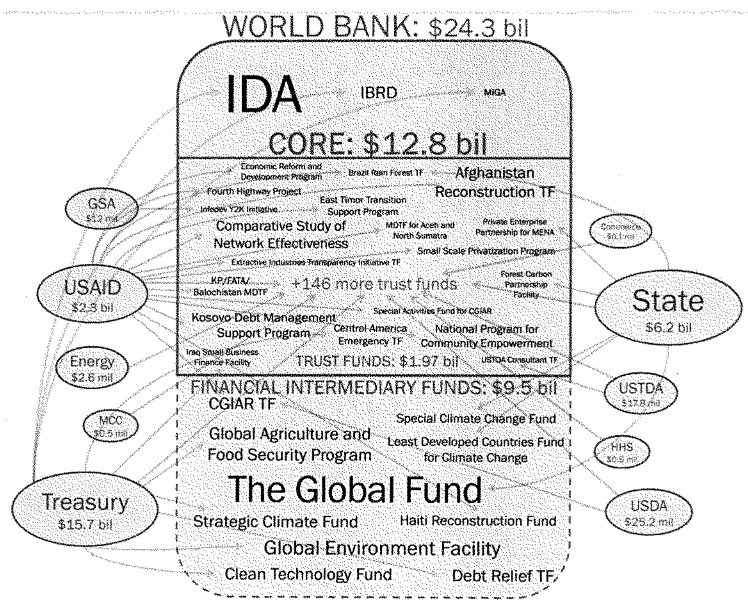
A Reform Agenda in Three Steps

The next president should promote a multilateral development agenda by first adopting a guiding policy target for the multilateral share of the US foreign assistance budget. From this starting point, we recommend an inaugural multilateral aid review (MAR) aimed at informing the allocation of funds within this multilateral share and at providing some impetus for stronger interagency engagement on multilateral development policy issues. Finally, we identify measures that would sustain this engagement through relying on existing statutory authorities, roles, and functions.

1 Establish a multilateral target.

The next administration should use the White House-led Interagency Policy Committee (IPC) on Global Development to establish a target for the multilateral share of US foreign assistance. Given the political challenge of shifting large portions of the budget at

Figure 7 Dedicated US Funding Channels



Source: authors' illustration

once, and absent a nonarbitrary starting point for a multilateral target, the best approach is an incremental one.[10]

For example, the White House–led interagency process could make an initial commitment to increase the multilateral share from 16 percent to 20 percent over a three-year period, yielding an additional $1.2 billion annually for multilateral assistance. Reassessment of this target could then be a part of the ongoing engagement outlined below. This process would allow for a smoother reallocation of resources from the bilateral side of the US foreign assistance budget and a more orderly scaling up of resources in the MDBs. Assuming a flat overall budget, this implies some cuts to bilateral programs, but they would be very modest, less than 5 percent of the bilateral assistance budget.

❷ Conduct a multilateral aid review.

Multiple donors have initiated MARs, which evaluate and rank all multilateral agencies receiving government funding against a standard set of criteria, including operational efficiency, program effectiveness, and alignment with the donor's national priorities.[11] The purpose of a US MAR would be to help guide the government's decision-making and prioritization within the multilateral portion of the foreign assistance budget.

An effective MAR depends critically on the multilateral share target discussed above. One risk of a multilateral review versus a comprehensive foreign assistance review (multilateral and bilateral) is that bilateral programs will escape the critical scrutiny that is being applied to multilateral programs.[32] As a result, any criticism of multilateral programs within the MAR could be grounds for cutting multilateral funding relative to bilateral. The ex-ante multilateral share target serves to guard against this outcome.

The analytical framework of the MAR would be constructed by a core agency working group (State, Treasury, USAID, and MCC, with its data-driven approach to policy decisions) coordinated by the Global Development IPC. Agencies would be tasked with engaging with their respective multilateral partners to collect evidence and report results. And while we have emphasized the MDBs in characterizing multilateral channels and programs, the MAR would appropriately assess all multilateral assistance, including the (much smaller) funding provided to UN agencies for development purposes. Existing comparisons of MDBs and UN agencies, such as the UK's MAR, demonstrate that not all multilateral programs are created equal, with UN programs tending to significantly underperform as compared with the MDBs.

The process of constructing a MAR framework would give life to a more robust interagency decision-making process around multilateral funding issues and force an internal discussion about the relative weight to place on sectors and regions. For example, how much does the United States wish to prioritize infrastructure investment relative to global health when it comes to multilateral contributions? While we may be able to infer an answer to this question now based on budget outcomes, in reality there is no direct policy deliberation that seeks to answer it.

An additional key value of the MAR framework would be the clear articulation of criteria for assessing these institutions. Given the considerable body of work to date, there would not likely be many surprises about which multilateral institutions "perform" better than others on criteria such as budget overhead or transparency. But the relative weight the US government places on these measures and others, particularly around strategic alignment, would be illuminating in its articulation (to US taxpayers, the MDBs, aid recipients, and other donors) and would usefully help guide policy in its construction.

❸ Make better use of existing coordination mechanisms.

The Global Development IPC provides a high-level coordinating mechanism to oversee the multilateral target and conduct the MAR exercise. The IPC should also devise a multiyear strategy for determining and prioritizing multilateral commitments following the MAR exercise. In order to operationalize a multiyear budget strategy, it will also be necessary to employ other mechanisms:

- **Treasury-chaired National Advisory Council on International Monetary and Financial Polices (NAC):** By law, Treasury is tasked with coordinating policies related to the MDBs through the NAC, an interagency policy committee. Given this statutory responsibility, Treasury should play a leading role in MDB-related funding decisions, which points to the need for clarity around roles between the White House–led process and the NAC.

- **OMB:** The OMB-led budget process will benefit from the guidance of a multiyear, multilateral funding strategy. As it stands, OMB has struggled to incorporate multiyear financing commitments such as US pledges to IDA or the Global Fund into an annual budget process. Bringing these commitments together under a common policy framework would improve the quality of OMB's guidance in this area as well as the quality of the interaction between OMB and the respective US line agencies.

- **State and USAID:** A number of multilateral funding decisions are internal to State and USAID. In the same way the Treasury-led NAC process would need to be better aligned with the multiyear strategy, multilateral decisions within State and USAID would need to adhere to the agreed-upon principles and priorities. The interagency process would also be improved by more discussion in the NAC of MDB-related funding decisions made by these agencies.

Of course, coordination between the administration and Congress is also critical. Although the reforms articulated here do not require changes in law, congressional action in favor of this agenda could be highly beneficial in sustaining the reforms across administrations. Congress has in fact been more supportive of multilateral channels than is commonly perceived, providing over the past decade slightly more funding than requested for multilateral programs and slightly less than requested for bilateral assistance channels.

Conclusion

The United States has valued its multilateral partners over many decades. In recent years, rhetoric and policy engagement suggest that the US government continues to value institutions such as the World Bank and the regional development banks as instruments of US development policy. Yet budgeting for foreign assistance is increasingly telling a different story, one in which the multilateral funding relationship is undervalued and disconnected from policy.

The MDBs are operating in an increasingly dynamic landscape, with new sources of financing tempting them away from traditional funding arrangements and with new multilateral institutions emerging in which the United States is not a member (e.g., the AIIB and the New Development Bank). From a narrow budgeting perspective, this seems to mark an advantageous moment for the United States to step back while others step forward. But just as the United States chose to lead a multilateral development agenda at Bretton Woods as a way to promote peace and prosperity in a post–World War II era, today's officials should take a more expansive view toward US multilateral leadership. The United States can continue to be a force for good in the developing world, perhaps no more so than when it chooses to work in the cooperative spirit that defines multilateralism.

Notes

[1] US White House, "Presidential Policy Directive on Global Development," September 22, 2010, 6.

[2] US Department of the Treasury, "International Programs Justification for Appropriations, FY 2013 Budget Request," n.d., 2.

[3] US Department of the Treasury, "Treasury Department Statement on the U.S. Position on the World Bank's Eskom Investment Support Project," April 8, 2010.

[4] Pew Research Global Attitudes Project, "Chapter 1: Attitudes toward the United States," in *America's Global Image Remains More Positive Than China's* (Washington: Pew Research Center, 2013), 8–18.

[5] Nancy Birdsall and Homi Kharas, *The Quality of Official Development Assistance (QuODA)*, 1st and 3rd Eds., (Washington, DC: Center for Global Development; Global Economy and Development at Brookings, 2010 and 2014); William Easterly and Tobias Pfutze, "Where Does the Money Go? Best and Worst Practices in Foreign Aid," Journal of Economic Perspectives 22(2): 29–52; Stephen Knack, F. Halsey Rogers, and Nicholas Eubank, "Aid Quality and Donor Rankings," World Development 39(11): 1907–17.

[6] QuODA is an ongoing joint initiative by CGD and the Brookings Institution to assess aid quality for 31 Development Assistance Committee member countries and multilateral agencies according to four dimensions of aid quality that draw upon international declarations: maximizing efficiency, fostering institutions, reducing burden, and transparency and learning. For more information see the Center for Global Development, "Quality of ODA (QuODA)", www.cgdev.org/page/quality-oda-quoda.

[7] US President's Emergency Plan for AIDS Relief, "Focus, Partner, Achieve: An AIDS-Free Generation; Latest PEPFAR Funding," www.pepfar.gov/documents/organization/189671.pdf; Curt Tarnoff, *Millennium Challenge Corporation*, CRS Report 7-5700 (Washington: Congressional Research Service, 2014).

[8] African Development Bank, "Sustainable Energy Fund for Africa Scales-Up Operations with USAID Support," www.afdb.org/en/news-and-events/article/sustainable-energy-fund-for-africa-scales-up-operations-with-usaid-support-12292/.

[9] Scott Morris, "How China and the United States Can Come to Terms on AIIB," *Boao Review*, January 19, 2015, www.boaoreview.com/Opinions/Finance/20150119/483.html.

[10] Trying to match, for example, the OECD average multilateral share of 41 percent would imply a nearly $8 billion annual increase over the current level of $5 billion. Even if a reallocation at this level were politically feasible, it is unlikely that the United States could effectively channel such an increase through multilaterals without raising questions of absorptive capacity and disrupting governance arrangements within the MDBs, which are tied to funding contributions.

[11] Starting with the UK government's first high-profile MAR in 2011, other large donors have followed with their own reviews, in addition to an annual multidonor Multilateral Organisation Performance Assessment Network exercise. With this proliferation of official reviews, the multilateral institutions themselves are suffering from review fatigue, and the OECD has raised concerns about multiple assessments. But these concerns are misplaced when it comes to the United States. As the second-largest multilateral donor, with the potential to be significantly larger, the United States should conduct its own comprehensive, data-driven review following the establishment of a multilateral target.

[12] We do not believe a transparent, comprehensive foreign assistance review would be politically or practically achievable. A multilateral review entails a much smaller universe of actors and is naturally at arm's length from the programs in a way that a bilateral review could not be.

For more information please contact Beth Schwanke, CGD senior policy counsel, at bschwanke@cgdev.org.

Testimony to the Financial Services Committee of the U.S. House of Representatives, October 9, 2015

The World Bank: Why it is Still Needed and Why it Still Disappoints

Martin Ravallion[1]

The decade or two after WW2 saw many of the world's poorest countries gain their independence from Colonial rule, and they were hoping to rapidly become less poor. Economics taught policy makers in those countries that a higher investment rate is crucial to assuring faster economic growth. Being a poor country makes it harder to finance the required investments from domestic savings. Yet rich countries should have ample savings available that might be profitably diverted to this task. In an ideal world, global capital markets could be expected to bridge the gap. But 70 years ago those markets were thin and/or not trusted as a source of finance.

In response, the United Nations Monetary and Financial Conference, held at Bretton Woods in 1944, created the International Bank for Reconstruction and Development (IBRD)—a core component of what came to be known as the World Bank. (The International Monetary Fund was created at the same time.) The essential idea was that the IBRD would borrow money on global markets to lend to developing countries. The Bank's AAA credit rating (stemming from conservative lending policies relative to its capital) allowed it to lend on favorable terms. An aid-facility (with a large grant component), the International Development Association (IDA), was added in 1960.

Much has changed in the 70 years since the famous Bretton Woods conference. World Bank lending (IBRD+IDA) now represents only about 5% of the aggregate private capital flows to developing countries. In the last 10 years or so there have been prominent calls for radically reforming, or even closing, the institution on the grounds that international capital markets have developed greatly over those 70 years. It is also claimed by some that the Bank's efforts are wasted due to poor governance in developing countries.

Does the Bank still have an important role? If so, does it fulfill that role, and if not, how might it do better? In a new paper I argue that the Bank's development role today overlaps only partially with its original role, as conceived at the Bretton Woods Conference 70 years ago (Ravallion, 2015). Its role today is complementary to (rather than competing with) the private financial sector, other development banks, and academia. Knowledge-generation is central to that

[1] The author holds the inaugural Edmond D. Villani Chair of Economics at Georgetown University. He is also President of the Society for the Study of Economic Inequality, a non-resident Fellow of the Center for Global Development, and a Research Associate of the National Bureau of Economic Research. Prior to taking up his position at GU, the author was the Director of the World Bank's research department, the Development Research Group. He was on the staff of the World Bank for 24 years, working in a number of sectors and on all regions.

role. Development knowledge has properties of a public good, which the Bank can generate in the process of actually doing development on the ground.

Threats to the Bank's effectiveness: There is still much appeal to the bundling of knowledge with lending that has been the distinctive feature of the Bank's operations. But there are a number of threats to the efficacy of this model.

There have been some longstanding concerns that the Bank's "lending culture" rewards operational staff for the volume of their lending, with only weak incentives for assuring that knowledge is both applied and generated in the lending operations. The pressure to lend influences the Bank's ability to deliver objective policy advice to client countries, even when it is not welcome politically. Too often the Bank's "country strategy" essentially mirrors that of the government, which may or may not serve broader long-term development goals.

Another threat is the perception that the Bank's most powerful shareholders have excessive influence on its operations and policy advice. The U.S. has long been identified in this role, though some other countries have also been keen to have their say. Some critics are concerned (rightly or wrongly) about conflicts of interest when the Bank gives advice to developing countries.

These are threats to the Bank's effectiveness as a knowledge leader in both the public and private sectors. All parties—both clients in developing countries and private investors—must have confidence that the institution is not pushing lending for its own sake or beholden to a few powerful owners. Only then can the Bank be accepted as the source of the objective policy advice and information that is needed.

Recent organizational changes have made some effort to put knowledge in the driver's seat by organizing the Bank around a set of sectorally-defined "practices." In the end the organogram has changed rather little. However, the threats to the Bank's effectiveness are unlikely to be solved by changing the Bank's organogram. The incentives of managers and staff also need to change, to assure a better alignment with development goals. (See Ravallion, 2015, for some examples of specific proposals for reform from past Bank staff.)

Knowledge Bank? There has been much rhetoric about the "Knowledge Bank" over the last 15 years, but I am not alone in believing that the reality has fallen short of the rhetoric. There is a chronic and growing underinvestment in the kind of rigorous research that is needed to identify and address pressing development issues—both the constraints on rapid poverty reduction at country level and the global public bads that threaten us collectively (ranging from climate change to pandemics). Research has been under-valued and under-funded.

Granted we still see some high-quality research at the Bank, though not always on high-priority topics. We see more *ex-post* evaluations today than 20 years ago. However, much does not get evaluated, and what gets evaluated is a non-random subset of all projects, casting doubt on what we learn about the whole. Too often, methodological preferences drive what gets evaluated rather than the knowledge gaps facing policy makers. Alongside this, we see fewer and less rigorous *ex ante* evaluations, which make explicit a project's economic rationale—why the project is expected to have a social value justifying its cost.

Three changes are needed: Echoing the observations of others within and outside the Bank, three things need to change:

- First, the Bank needs to be more ambitious in identifying and addressing the most pressing knowledge gaps we face today. Policy advocacy must give way to well-informed and objective country-specific analysis. This can be accommodated within the Bank's traditional country-lending model.
- Second, the Bank's lending operations must be driven by knowledge of the binding constraints on poverty reduction in specific country contexts and its analytic capabilities must be brought more systematically into its operations from the outset. The Bank's knowledge generation efforts must inform the nature of its lending and be informed by that lending—rather than simply serving lending when called upon. This requires quite fundamental changes in staff and managerial incentives and resource allocation within the current structure.
- Third, the Bank's present country-based model needs to be supplemented by a model with greater capacity for supporting the provision of global public goods. If one was to sit down today to design a mechanism to support the cross-country coordination needed to address shared threats it is unlikely that one would come up with the Bank's current country-lending model. A new model, or possibly a new institution, is called for.

Ravallion, Martin, 2015, "*The World Bank: Why it is Still Needed and Why it Still Disappoints*," Center for Global Development, Working Paper 400, Washington DC.