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MULTILATERAL ECONOMIC INSTITUTIONS AND U.S. FOREIGN POLICY

HEARING

BEFORE THE

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

OF THE

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MULTILATERAL ECONOMIC INSTITUTIONS AND U.S. FOREIGN POLICY

TUESDAY, NOVEMBER 27, 2018

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

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

Present: Senators Young [presiding] and Merkley.

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

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

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

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

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

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

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

In July of 1944, delegates from 44 nations met in Bretton Woods, New Hampshire to establish new rules and institutions for the post-World War II international economic system. These nations, led by the United States and informed by lessons regarding the causes of World War II, sought to create institutions that would catalyze economic growth, reduce poverty, expand trade, and promote financial stability. The primary result of these negotiations were the International Monetary Fund and the International Bank for Reconstruction and Development, which is now part of the World Bank group.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Senator YOUNG. Thank you, Secretary Malpass.

Secretary de Marcellus?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PREPARED STATEMENT OF HON. ROLAND DE MARCELLUS

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

Enhancing U.S. Leadership

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

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

Getting Bang for the Buck

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

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

Enhancing American National Security

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

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

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

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

Expanding Markets for U.S. Exports

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

Improving Business Climate and Standards

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

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

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

Protecting People and the Environment

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

Confronting Global Health Threats

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Senator YOUNG. Very good.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Mr. MALPASS. Thank you.

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

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

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

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

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

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

Senator YOUNG. Thank you much.

Senator Merkley?

Senator MERKLEY. Thank you both very much.

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

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

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

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

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

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

Mr. MALPASS. In some cases, both. So they are not made public. They are not available to the international community, but sometimes they are not even available to certain parts inside the government itself. And that is an issue because China may make a loan, but not really want the terms of the loan to be disclosed even within the government that it is lending to.

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

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

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

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

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

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

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

Senator MERKLEY. Please go ahead, yes.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

So within the transparency initiative that I mentioned in my remarks, we are working in the IMF and the World Bank to encourage them to include terms in loans, so when they do make a loan to a country, say that the country is expected to make transparent all of the lending that it gets. Otherwise, you would be the lender into a situation where someone else has better terms than you do.

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

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

Senator MERKLEY. Thank you.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Mr. DE MARCELLUS. Correct.

Senator YOUNG. Mr. Malpass?

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

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

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

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

Yes, sir, Senator?

Senator YOUNG. Well, so this is instructive.

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

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

Mr. MALPASS. Yes, sir.

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

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

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

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

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

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

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

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

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

Should we still be sending development loans to China?

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

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

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

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

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

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

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

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

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

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

Mr. MALPASS. Thank you, sir.

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

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

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

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

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

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

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

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

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

I welcome each of you. Thank you again for being here. Your full written statements will be included in the record. I would ask each of you to summarize your written statement within 5 minutes so we can engage in an extended Q&A and conclude the hearing around 4:30. So that is roughly 45 minutes from now.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Thank you. I am happy to field any questions.

[Mr. Lowery's prepared statement follows:]

PREPARED STATEMENT OF HON. CLAY LOWERY

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

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

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

My testimony today, however, reflects my own views.

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

The U.S. Role in the Multilateral Economic Institutions

The United States and its allies established the IMF, the World Bank, and the GATT—the predecessor of the World Trade Organization—at the Bretton Woods conference of 1944. The idea at the time—one that is still true today—was that international cooperation on key economic, financial and trade issues and maintaining an open, rules-based economic order are important for global stability and prosperity. Since then, the U.S. has also been a founding member, a substantial contributor, and a leader of the key regional development banks: the Asian, African, Inter-American, and European development banks.

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

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

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

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

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

How does this all relate to China?

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

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

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

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

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

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

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

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

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

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

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

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

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

What Can Congress Do?

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

Congress, particularly this committee, deserves a lot of credit for its bipartisan leadership in modernizing and expanding our own development finance institution through the BUILD act. The new IDFC could demonstrate that there are preferable alternatives to China's international economic development model, while also helping meet U.S. foreign policy goals and promoting development around the world.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Senator YOUNG. Thank you, Ms. Hillman.

Ms. Lee?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[The prepared statement of Ms. Lee follows:]

PREPARED STATEMENT OF THEA MEI LEE

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

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

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

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

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

Critique of current trade policy

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

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

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

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

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

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

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

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

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

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

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

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

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

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

What we should be doing on trade policy

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

The key elements of reform include the following:

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

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

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

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

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

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

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

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

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

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

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

Senator YOUNG. Thank you, Ms. Lee.

Mr. Morris?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Thank you.

[Mr. Morris's prepared statement follows:]

PREPARED STATEMENT OF SCOTT A. MORRIS

Chairman Young, Senator Merkley, thank you for the opportunity to testify today. My name is Scott Morris and I am a senior fellow and director of the U.S. development policy program at the Center for Global Development, a non-partisan think tank in Washington, DC. I previously served as the Deputy Assistant Secretary for Development Finance and Debt at the U.S. Treasury from 2009 through 2012.

You have raised a critical set of issues and challenges in this hearing, and I will try to do justice to at least some of them. I will focus my remarks on the importance of the International Financial Institutions (IFIs) for U.S. interests, the role that China is playing today in development finance, and the U.S. response to China's emergence as a leading development actor.

The Value of the IFIs

All the IFIs, which includes the IMF as well as the leading multilateral development banks (MDBs),[1] have been key partners for the United States since the creation of the World Bank and IMF over seven decades ago. This is not coincidental. The United States has been the leading architect and remains the largest shareholder or "owner" across the IFIs.

But even if they were of our making, how do they continue to serve our interests? Let me try to answer that question by focusing on the multilateral development banks.

- First, the MDBs amplify U.S. assistance, both by drawing in other countries' money and by their own AAA-rated borrowing on capital markets. In 2017, the United States contributed $1.8 billion to MDB programs (just 5 percent of the U.S. foreign assistance budget). In doing so, we directly leveraged over $120 billion in MDB on-the-ground assistance that year. That's three and half times as much as the U.S. spends directly on foreign assistance globally.
- Second, by virtue of their lending model, the MDBs can operate at a scale and across a range of sectors (infrastructure in particular), that the United States alone cannot, given our reliance on grant financing in our bilateral programs. This includes a presence in a wide range of developing countries and settings, including places where we have U.S. troops on the ground. This is why U.S. military leadership past and present has been among the leading advocates for the MDBs.
- Finally, the MDBs have been rated as the most effective development institutions by multiple systematic reviews of aid and development finance. More so than any other financing mechanism, this means that U.S. taxpayers stand a greater chance of getting the results that they pay for and not paying more than they should when it comes to MDB-financed projects. Surveys of developing country officials also reveal a strong preference for working with the MDBs compared to other sources of aid, suggesting that when we pursue our development objectives through these institutions, we stand a good chance of having committed partners on the other side of the transaction.

Continued U.S. leadership in these institutions depends on our willingness to provide financial support, and on this point the Trump administration's record is mixed. Last spring, Treasury Secretary Mnuchin announced U.S. support for a capital increase at the World Bank, a positive move that will enable the bank to continue to operate in a large group of developing countries, the so-called "middle income countries." These World Bank borrowers are not among the poorest but include countries like India and the Philippines where the United States has important ties and interests. I hope this committee will give timely consideration to the capital increase when the administration brings it forward next year.

At the same time, the administration's support for the MDBs when it comes to the poorest countries has not been as strong. The administration has scaled back commitments for the World Bank's low-income country financing arm, the International Development Association (IDA), as well as those of the other MDBs. This has been a mistake. It diminishes U.S. standing and limits the potential to fully engage in poorest countries where they are needed the most.

Looking ahead, given the administration's overall posture on the foreign assistance budget, there's a risk that the U.S. contribution for the World Bank's capital increase will come at the expense of our other multilateral contributions, and particularly IDA. But if there is to be a trade off in the budget to make room for the capital increase, this is not the right one. It will mean that the poorest countries will shoulder the burden of more financing for middle income countries at the World Bank. Surely there must be room in the remaining 95 percent of the foreign assistance budget to absorb this important and modest funding commitment.

China's Borrowing from the World Bank and ADB

Let me turn now to the question of China's relationship with the MDBs, particularly the World Bank and Asian Development Bank (ADB). In both cases, China re-

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

mains one of the largest borrowers, something that has attracted criticism from the Trump administration and the Obama administration before it. Yet, neither administration has succeeded in halting MDB lending to China by fiat, and I want to encourage a different way of thinking about this issue.

First, we should recognize that much of the value of the IFIs for the United States derives from their multilateral character. It greatly oversimplifies things to suggest they are strictly a U.S. tool, available to do our bidding no matter what the issue. The reality is that when we want to get something done in these multilateral institutions, we need to work with other countries. In turn, these institutions are most effective when they have the buy-in of the largest number of their member countries. And when the United States is seeking something from them that doesn't have broad-based support, it can be a tough road.

China's borrowing from the World Bank and ADB is such a case. I think it's misguided to push too hard on this issue, particularly when there is a better alternative with broader support, one that the Trump administration has already had some success in pursuing. Our objectives here ought to be twofold: to make the most of MDB engagement in China in terms of U.S. interests and to extract the most from China in return.

Making the most of China's borrowing means recognizing the value of some areas of this engagement and ensuring that the MDBs are appropriately focused on these areas. In some forthcoming research, I look in detail at World Bank projects in China. A significant share of the bank's China portfolio is aimed at reducing the country's massive carbon emissions, which is essential if we are to reduce the pace of climate change and its harmful effects, detailed just last week in the government's report on climate change. We know well that the damaging effects from climate change are not contained within national borders, and positive action taken in one country ultimately benefits other countries. From an economist's perspective, this aspect of the MDBs' work in China is a classic global public good and something that ultimately benefits us, even as we sit here 7,000 miles away.

There are other areas of World Bank lending that aren't nearly as compelling, and by my estimates, one-third to nearly half of the bank's lending in China is not appropriately focused. The capital increase agreement negotiated by the U.S. Treasury rightly seeks to reign in these areas of financing by laying out what sorts of activities are appropriate for the bank's relatively wealthier borrowers.

More importantly, the agreement also asks more of China and other relatively wealthier borrowers in the form of higher prices on their World Bank loans. Through higher loan charges, the bank will increase revenues, which eases the financing burden on shareholders, and will also create better incentives for the bank's borrowers. I think there is more scope over time to further differentiate the lending terms for China and other borrowers to a degree that their borrowing can genuinely be viewed as financially profitable for the institution.

Responding to China's Global Financing

Let me turn to what China is doing outside of the multilateral institutions and how the United States is responding. Over the course of a decade, China has become the leading bilateral source of development assistance globally, slightly surpassing the United States. Of course, the two countries look very different in the composition of their assistance. The United States mostly provides grant support in the health and humanitarian sectors, while China mostly provides loans to support infrastructure projects.

In some respects, China's lending is like that of the MDBs in that it is providing development country governments access to capital to invest in roads, bridges, and energy infrastructure, all of which are sorely needed to spur economic growth. But it's also increasingly clear that China's lending lacks important constraints, and the evidence suggests that Chinese development finance is pushing some countries into over-indebtedness with all the problems that come with unsustainable debt burdens.

In research earlier this year at the Center for Global Development, my colleagues and I detailed the debt problems facing China's Belt and Road initiative and pointed to the failures in China's approach that are pushing some countries into debt crises. Within the Belt and Road, this includes countries like Djibouti, which is host to ports and military bases for multiple countries, as well as China's neighbors Pakistan, Mongolia, and Laos.

While I am skeptical about overuse of the term "debt trap diplomacy" to characterize China's lending program, we don't have to have a clear understanding of China's motivations in every instance in order to recognize that policy failures on China's part are contributing to debt problems when they arise. As a result, a key priority for U.S. policy should be to affect a change in behavior by bringing China into the norms and disciplines of other major creditor countries, something we describe in detail in our research paper.

But we can also respond to the problematic aspects of China's lending by offering developing countries better alternatives. That should start with strong support for the MDBs, which are ready made to lend at scale and with high standards.

But we can also do more bilaterally, and one response from the administration, spurred by leadership in this committee, holds promise. The expansion of OPIC's lending authority and other reforms contained in the BUILD Act have the potential to bring more U.S.-led development finance to bear globally, expanding the mix of financing tools on offer in the U.S. assistance portfolio. The new U.S. Development Finance Corporation should better enable the United States to go beyond traditional assistance in the health and humanitarian sectors to provide larger scale financing in infrastructure and other growth-oriented sectors.

As much as I think the BUILD Act is a positive step forward, my optimism comes with some caveats. First, the U.S. DFC should be additional and not a substitute for traditional assistance. U.S. leadership through long-standing programs like PEPFAR is highly valued in developing countries and is doing vital worked measured in lives saved. And as I noted earlier, strong U.S. contributions to multilateral funds like IDA are critical in maintaining our leadership in these institutions. It would be a fundamental mistake to allow the aid budget to be gutted on the heels of the BUILD Act.

When it comes to the new DFC itself, it is important to recognize its essential value, particularly vis-a-vis Chinese finance. Yes, more financing overall is a good thing. But it is in the standards attached to that financing that will distinguish the DFC. The legislation lays important markers on project effectiveness and social and environmental safeguards. But it will take diligence and hard work to make these things a reality and to sustain them over time.

Too often, the experience of other development finance institutions suggests, for example, that time and resource-intensive environmental impact assessments are viewed as red tape in the face of competitive pressures. Positioning the new DFC so prominently as a competitor to China only heightens my concern on this point. I encourage this committee in its oversight to adhere to a strong sense of what ought to distinguish U.S. finance from the worst characteristics of Chinese finance-things like ensuring that local communities are consulted and fully compensated when they are negatively affected by a road project, or ensuring that a negative environmental impact assessment carries enough weight to alter or even halt a potential project.

Finally, I'll close by highlighting the risk of going too far when it comes to using development finance to compete with China. Yes, we should offer developing countries a "clear choice" by distinguishing our approach to assistance from the problematic features of Chinese finance. Here, we can and should do a better job with our developing country partners—both by clearly identifying problems such as non-competitive procurement and by supporting their efforts to be smarter borrowers when China is the creditor.

But there's a difference between offering choices and forcing countries to choose. It would be a costly mistake to seek to carve up the developing world in Cold War fashion between clients of the United States and clients of China. Chinese development finance is a reality, and even with its problematic features, it is undoubtedly delivering something of value to a wide range of developing countries. Where that is the case, we will not convince these countries otherwise.

Where Chinese finance is causing problems, the U.S. objective should be to change Chinese behavior, working with key allies in the G7, India, and Australia, and through multilateral settings like the IMF and World Bank. Chinese officials are showing signs of feeling the pressure of a backlash on the debt issue. Now is the time to exploit that by seeking change: not by drawing battle lines in the developing world that are unlikely to hold, but by pressuring Chinese officials in settings that matter to them, settings like the G20, the IMF, and the World Bank.

Thank you.

Senator YOUNG. Thank you, Mr. Morris.

Ms. Segal?

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

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

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

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

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

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

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

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

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

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

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

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

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

[Ms. Segal's prepared statement follows:]

PREPARED STATEMENT OF STEPHANIE SEGAL

Introduction

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

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

The International Monetary Fund

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

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

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

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

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

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

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

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

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

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

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

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

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

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

An Evolving International System

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

What Can the United States Do?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Ms. Hillman, thoughts.

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

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

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

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

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

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

Senator YOUNG. Excellent.

Ms. Lee?

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

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

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

Senator YOUNG. Thank you.

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

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

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

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

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

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

As I mentioned, in the past, there has been really a reluctance because China retaliates and retaliates so quickly and immediately against countries that do take actions against China. And they retaliate very clearly in this trade sphere and even for fairly innocuous actions.

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

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

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

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

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

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

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

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

Senator YOUNG. Okay. Thank you.

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

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

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

Senator YOUNG. Thank you.

Senator Merkley?

Senator MERKLEY. Thank you.

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

Mr. MORRIS. Absolutely I do.

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

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

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

Senator MERKLEY. Ms. Lee?

Ms. LEE. Yes, absolutely.

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

Senator MERKLEY. Ms. Hillman?

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

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

But the answer is unequivocally yes.

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

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

Senator MERKLEY. Thank you.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Senator MERKLEY. Yes, Scott?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Senator YOUNG. Well, thank you, Senator Merkley.

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

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

Senator MERKLEY. Absolutely.

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

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

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

Yes?

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

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

[The information referred to above follows:]

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

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

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

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

This hearing is now adjourned.

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

Additional Material Submitted for the Record

PREPARED STATEMENT OF HON. DAVID MALPASS

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

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

Major Policy Developments in 2018

In 2018, we worked to orient better the G20, G7, International Monetary Fund (IMF) and multilateral development banks (MDBs) toward growth and accountability. With engagement by the World Bank, IMF, and other partners, Secretary Mnuchin has pushed forward an initiative on debt transparency that will, in the near term, significantly increase public disclosure and broaden the existing definition of international debt beyond traditional bonds and loans. This will reduce the frequency and severity of developing country crises and help push back on China's over-lending to fragile developing nations, including those with weak governance. The World Bank and IMF have focused on more comprehensive and transparent reporting of public sector liabilities of borrowers to assist with our initiative.

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

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

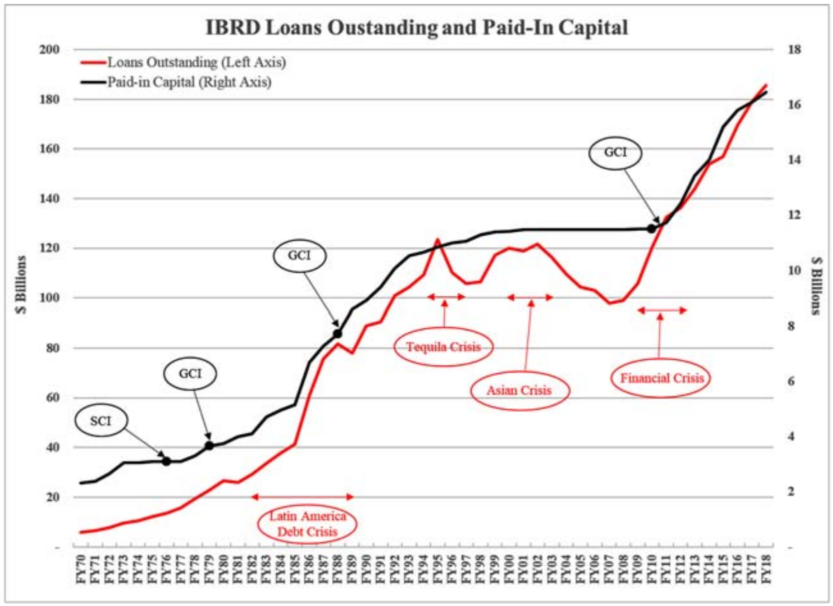
We have worked multilaterally to forge a new currency consensus in the G20 and International Monetary and Financial Committee recognizing the growth and investment benefits of currency stability. The administration recently concluded the U.S.-Mexico-Canada Agreement (USMCA), which included the first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

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

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

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

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



Policy Direction for 2019

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

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

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

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

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

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

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

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

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

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

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

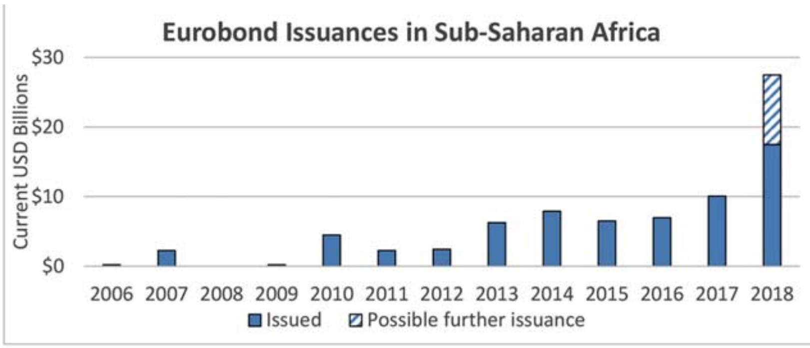
We have been in discussions on the World Bank's request for a capital increase. We are seeking to improve the quality of IMF programs through existing cases and upcoming conditionality reviews. We will be notifying Congress of negotiations related to the IMF's request for a quota increase under the 15th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

Seismic Shifts in Global Finance

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

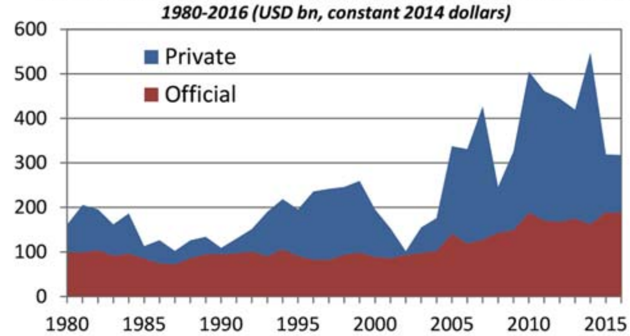
But these inflows have presented challenges, including renewed debt sustainability risks in more vulnerable countries with weaker institutions and macroeconomic policies. Consequently, the availability of increased financing must be accompanied by a dramatically increased level of debt transparency,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

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



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

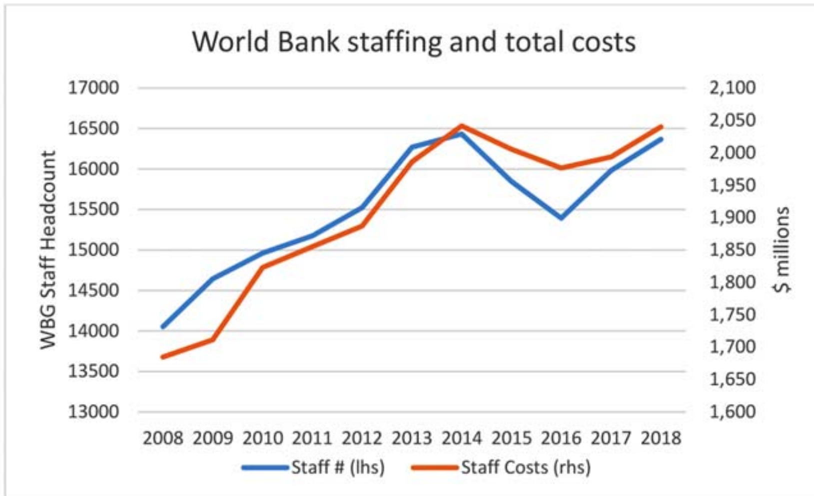
Total Official and Private Flows from Donor to Developing Countries
1980-2016 (USD bn, constant 2014 dollars)

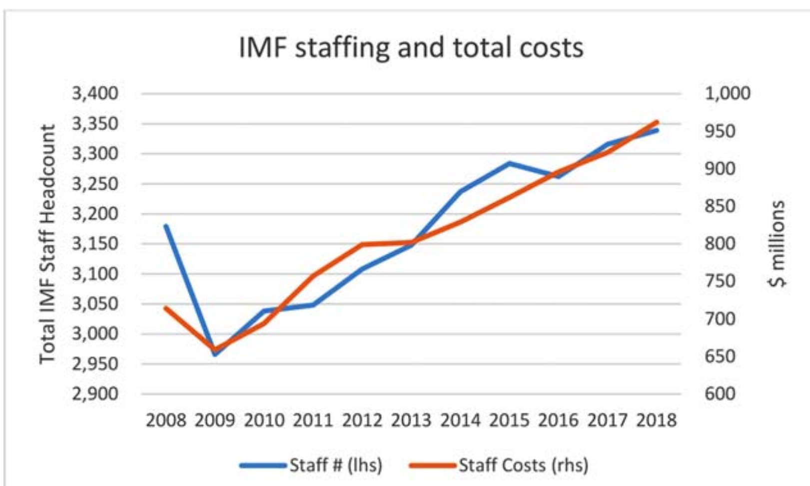


Note: Chart depicts flows from OECD Development Assistance Committee countries to developing countries in constant 2014 U.S. dollars.
Source: OECD

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

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





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

Role of MDBs

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

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

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

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

World Bank Capital Increase

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

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

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

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

The IBRD capital increase is packaged with an increase in the capitalization of the International Finance Corporation (IFC), the part of the World Bank Group that focuses on lending to and investing in the private sector in developing countries. We declined to participate in the IFC capital increase based on our assessment that the IFC did not need more capital to be impactful. Other countries wanted to expand the IFC on their own, and packaged their support for the IBRD reforms to an IFC expansion. Our voting power will be diluted to 16.4 percent from 21.0 percent, but we maintained our veto through a reduction in the IFC's veto threshold, which will be adjusted from 20 percent to 15 percent. However, we succeeded in negotiating that shareholders will, in parallel, seek an amendment to the IFC Articles of Agreement to reduce the threshold that allows the United States to maintain our veto over any future IFC capital increases from 20 percent to 15 percent. We will also be seeking Congressional authorization to vote for such an amendment.

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

IMF's Role in Growth

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

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

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

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

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

IMF Quota Review

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

CURRENT IMF RESOURCES

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

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

MDB Authorization Topics and Specific MDB Objectives

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

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

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

As with IDA, replenishment negotiations for the African Development Fund (AfDF), the AfDB's concessional arm, will occur in 2019. We intend to notify Congress of the launch of this negotiation in 2019. We are seeking many of the same improvements that are needed for the AfDB. In particular, given its relatively small scale, we want the AfDF to increase the selectivity of the areas it works in, with an emphasis on regional transport and trade facilitation, electricity access, and water and sanitation. As a majority of AfDF recipient countries are now classified as fragile, heavily affected by conflict in neighboring countries, or otherwise at high risk of debt distress, we also expect the AfDF to maintain a strong emphasis on addressing fragility, conflict, and violence and helping countries improve their debt management.

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

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

Mandates Can Complicate the Goal of High-quality MDB Programs

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

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

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

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

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

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

Debt Transparency Initiative

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

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

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

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

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

In conclusion, while U.S. growth has accelerated, growth in many other countries has slowed. This gives rise to new challenges in international economic policy that we are working to meet through new initiatives. I appreciate the opportunity to present this Committee with a description of our major activities in 2018 and policy direction for 2019 and beyond, and I invite your views and questions.

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

Debt Transparency

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

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

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

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

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

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

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

Multilateral Development Banks

Regarding your testimony on Multilateral Development Banks (MDBs),

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

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

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

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

International Monetary Fund Quota Review

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

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

Answer. There are many ways to estimate future demand for IMF resources, including by looking at the size of members' economies and their trade and capital flows, estimates of demand based on historical IMF programs, and data from past global crises. In addition, demand for IMF resources also relates to the availability of other sources of support, such as regional financial arrangements. Moreover, it is not feasible to assume that the IMF resources will cover every tail risk scenario. Therefore, Treasury constructed several crisis scenarios. These include a mild crisis scenario in which a set of emerging markets face financial difficulties and request assistance of about 3.5 percent of their Gross Domestic Product (GDP), with resulting demand for IMF resources of about $300 billion; a moderate crisis scenario in which the same set of emerging markets requests assistance at 6 percent of GDP, with resulting demand of about $500 billion; and a severe shock scenario in which the set of emerging markets require assistance at amounts of 9 percent of GDP, with demand of about $700 billion.

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

PREPARED STATEMENT OF JENNIFER HILLMAN

A. INTRODUCTION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

B. THE CRISIS AT THE WTO

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

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

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

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

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

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

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

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

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

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

Possible Fixes?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The concerns are further laid out in two recent documents:

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

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

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

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

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

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

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

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

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

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

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

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

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

D. A BIG, BOLD WTO CASE IS THE BEST WAY TO ADDRESS THE DEEP, SYSTEMIC CHINA PROBLEMS. WHY?

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

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

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

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

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

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

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

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

E. THE TIME IS RIPE FOR A WTO CASE NOW

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

Among the reasons may be the following:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1. Technology Transfer

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

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

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

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

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

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

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

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

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

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

2. Discriminatorv Licensing Restrictions

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

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

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

3. Outbound Investment and Made in China 2025

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

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

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

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

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

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

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

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

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

4. Theft of Trade Secrets and Other Intelelectual Property

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

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

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

5. Investment Restrictions

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

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

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

[36] Marrakesh Declaration of 15 April 1994.

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

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

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

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

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

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

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

6. Lack of An Independent Judiciary

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

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

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

7. Subsidies

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

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

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

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

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

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

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

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

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

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

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

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

8. Export Restraints

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

9. Standards

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

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

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

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

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

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

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

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

10. Services

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

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

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

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

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

11. Agriculture

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

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

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

Transparency[57]

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

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

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

13. Non-violation

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

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

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

[58] Article XXIII provides:

Nullification or Impairment

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

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

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

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

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

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

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

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

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

G. Objectives of Such a WTO Case

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

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

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

H. Conclusion

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

[62] Mark Wu at 284.
[63] Harry G. Broadman, "The Coalition-Based Trade Strategy Trump Should Pursue Toward China," Forbes, April 9, 2018.

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

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

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

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JENNIFER HILLMAN
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STRENGTHENING TRANSATLANTIC COOPERATION

[1] Jennifer Hillman is a Professor from Practice at the Georgetown University Law Center. She is a former member of the WTO Appellate Body and also served as a Commissioner at the U.S. International Trade Commission and as an Ambassador and General Counsel in the Office of the United States Trade Representative.

The German Marshall Fund of the United States
1744 R Street, NW
Washington, DC 20009
T 1 202 683 2650
F 1 202 265 1662
E info@gmfus.org

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Jennifer Hillman*
The German Marshall Fund of the United States

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*Jennifer Hillman is a senior transatlantic fellow at the German Marshall Fund of the United States and a current member of the World Trade Organization's Appellate Body. Previously, she served as commissioner at the U.S. International Trade Commission and general counsel and chief textiles negotiator at the Office of the U.S. Trade Representative. The author would like to thank Joe Guinan, Roman Balin, Dan Price, Peter Sparding, Debra Steger, and Kati Suominen for their help with this paper.

1 Introduction: Coping with Complexity

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

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

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

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

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

At the macro-level, this led to shifting trade flows and patterns of foreign direct investment, a rise in the number and size of multinational companies and financial institutions, and surging global demand. It also meant a corresponding increase in the speed with which goods, money, and technology traverse the globe. At the micro-level, the "great doubling" of the global workforce has had a direct effect on wages, income levels, and employment in the advanced industrial countries, in some instances prompting fears of economic insecurity and a public backlash against "globalization."[1]

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

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

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

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

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

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

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

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

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

2 Solid Foundations: The Architecture of Global Economic Governance

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

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

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

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

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

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

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

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

Table 1. The architecture of global economic governance

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

Source: IMF, World Bank, WTO websites

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

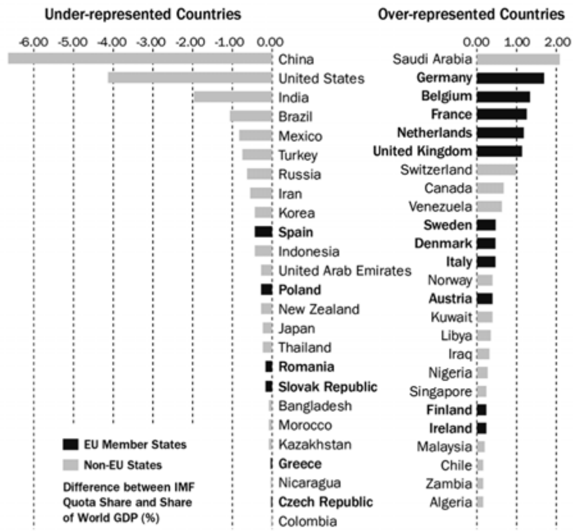
Communism. But it also served U.S. economic self-interest: a significant portion of Marshall Plan aid effectively went to boost European demand for goods from the United States, helping stave off domestic fears of a postwar slump or renewal of the Great Depression. Over the medium term, the Bretton Woods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

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

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

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

Figure 1. Under- and over-representation at the International Monetary Fund



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

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

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

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

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

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

This Great Recession of 2008–2009 has tested the international economic institutions as never before. In response, the IMF has stepped up its role as a lender of last resort, providing financial support packages to (among others) Iceland, Ukraine, Hungary, Pakistan, Belarus, Serbia, Armenia, El Salvador, and Latvia, and has also extended credit to Mexico, Poland, and Colombia under a new flexible credit line. In order to better equip the Fund for this task, G20 leaders at their London summit in April 2009 pledged to triple the IMF's lending capacity to $750 billion. Additionally, they urged the Fund to intensify its economic surveillance and early warning systems.

The World Bank has also moved to expand and speed up lending, assistance, and advice to developing countries, committing a record high of nearly $60 billion to countries hit by the financial crisis in fiscal year 2009—an increase of 54 percent over the previous year. An additional $8.3 billion was mobilized as part of the World Bank's global crisis response initiative to lessen the impact of the crisis on the most vulnerable, especially in low-income countries. These initiatives focus on safety net programs to protect the most vulnerable, maintaining long-term infrastructure investment programs, and on sustaining the potential for private sector-led economic growth and employment creation, particularly through the support of small and medium-size enterprises.

The WTO for its part began a new monitoring and reporting mechanism on protectionist actions taken by WTO members and worked to ensure that markets remained open and that countries adhered to their WTO commitments. The WTO also pushed G20 members to keep their pledges of support for Aid for Trade initiatives and worked to ensure that trade finance remained available and affordable.

The second major systemic response to the Great Recession has been the transformation of the little-known G20 gatherings of finance ministers and central bankers into an affair involving heads of state, declared by these leaders to be "the premier forum for international economic cooperation."[5] The G20 started in 1999 in the wake of the 1997 Asian financial crisis as a forum that brought together finance ministers from

[5] The Pittsburg Summit: Leaders' Statement, paragraph 19. "We designated the G20 to be the premier forum for our international economic cooperation."

major advanced and emerging economies with the goal of stabilizing global financial markets. With its ascendancy as part of the response to the Great Recession, it has now supplanted the G7/G8 meetings as the "chief steering committee of the world economy."[6] The inclusion in the G20 of a number of countries beyond the historical G7/G8 grouping no doubt stemmed, at least in part, from a recognition of the growing power of the emerging market and developing countries, who now account for more than 40 percent of the world economy. To have any sense of legitimacy throughout the world and particularly among the emerging market economies, expansion of the leadership circle was critical.

However, the initial G20 Leaders Summit, held in Washington in November 2008, was something of an EU-U.S. joint venture. British Prime Minister Gordon Brown had been calling for a "Bretton Woods II" to completely revise global economic governance, and the United States responded by promoting the idea of a G20 gathering, elevated to the level of heads of state, and extended the invitation for an initial meeting in Washington. European leaders at first exhibited differences of viewpoint on this approach, with French President Nicolas Sarkozy needing to be convinced of the appropriateness of the G20 as a venue, given that EU member states hold four of the seven seats (57 percent) at the G7 but only those same four seats plus one for the European Union (25 percent) at the G20. But in the end there was acceptance of the G20 as the only available forum with the scope of membership required to develop ideas, reach consensus on their desirability, and work to implement them.

[6] C. Fred Bergsten, Peterson Institute for International Economics, "A Blueprint for Global Leadership in the Twenty-First Century," Keynote Speech at the Global Human Resources Forum, Seoul, Korea, Nov. 4, 2009.

The evolution of the G20 also caused an evolution in the European approach to such summits. Efforts were made prior to and after each meeting to come to a Europe-wide position, with the European Council adopting a number of principles for action where agreements could be reached—principally in the area of enhancing sound regulation and reforming the international financial institutions. The European Commission was given the task of developing proposals for comprehensive reform of the financial system, which were then endorsed by the European Council and urged upon the rest of the G20 leaders by European heads of state. Throughout these efforts, Europe needed to find common ground among competing positions, with the United Kingdom arguing for more stimulus from other governments, Germany emphasizing the need to avoid major budget deficits, and France pushing for a major clampdown on executive compensation and a general tightening of financial regulation. The United States joined the United Kingdom and Japan in pushing for more stimulus from others while initially resisting any shift of financial regulatory policy out of the hands of national regulators.

What emerged from these G20 summits is fairly remarkable—both in terms of the substance of the consensus that was reached and in terms of the process. Despite starkly differing views on how to stimulate economic growth and recovery, agreement was reached to pump more than $1 trillion into the global economy—albeit through the IMF, rather than individual countries—in the form of $500 billion in new lending capacity, $250 billion in new Special Drawing Rights, and $250 billion in trade finance. Separately, the G20 asserted that commitments by individual countries for fiscal expansion would total $5 trillion over two years. Demands from some European countries for a major toughening of the regulation and oversight of financial institutions were met through the creation

The inclusion in the G20 of a number of countries beyond the historical G7/G8 grouping partly stems from a recognition of the growing power of the emerging market and developing countries, who now account for more than 40 percent of the world economy.

Table 2. Numbers count: From the G7/G8 to the G20

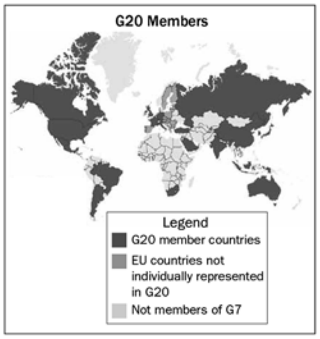
G7 Members

Source: G20 website; www.g20.org

EU G8: France, Germany, Italy, United Kingdom.

G7/G8		
Country	**GDP (millions of dollars)***	**% of world GDP**
Canada	1,499,551	2.46%
France	2,866,951	4.71%
Germany	3,673,105	6.03%
Italy	2,313,893	3.80%
Japan	4,910,692	8.06%
United Kingdom	2,680,000	4.40%
United States	14,441,425	23.71%
G7	32,385,617	**53.16%**
Russia	1,676,586	2.75%
G8	34,062,203	**55.92%**
EU countries in G8	11,533,949	**18.93%**

G20 Members



Source: G20 website; www.g20.org

[1] EU 27: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

[2] Non-G8 EU members: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden.

G20/G20 + non G8 EU		
Country	**GDP (millions of dollars)***	**% of world GDP**
Argentina	324,767	0.53%
Australia	1,013,461	1.66%
Brazil	1,572,839	2.58%
China	4,327,448	7.10%
India	1,206,684	1.98%
Indonesia	511,765	0.84%
Mexico	1,088,128	1.79%
Saudi Arabia	469,426	0.77%
South Africa	276,764	0.45%
South Korea	929,124	1.53%
Turkey	729,983	1.20%
Subtotal	12,450,389	**20.44%**
G20 total	46,512,592	**76.35%**
EU (27)[1]	18,387,785	**30.18%**
G20 + non-G8 EU countries[2]	53,366,428	**87.60%**

* 2008 GDP

Source: IMF World Economic Outlook Database (Oct. 2009) of a Financial Stability Board (FSB).[7] The FSB was designed to bring about greater coordination and coverage of regulatory systems to include hedge funds, principles on pay and compensation, controls on excessive bank leverage and bank secrecy, and oversight of accounting standards and credit rating agencies. Those calling for a "Bretton Woods II" and a revamping of the institutions of multilateral economic governance were met at least halfway: there was eventual agreement on the U.S. proposal to increase the IMF quota share of the emerging market countries by five percentage points, along with an increase in the voting power of developing and transition countries at the World Bank of at least three percent and a commitment to reform the "mandates, scope and governance" of the financial institutions, while Europe's desire to keep the number of seats on the Executive Boards of the IMF and the World Bank at 24 was met. The WTO was included in the later G20 meetings, and was given the task of monitoring G20 pledges not to take any protectionist action and to complete the Doha Round of trade negotiations.[8]

A pattern began to emerge from the G20 summits whereby the heads of state would assign tasks to the multilateral economic institutions related to specific issues, with instructions to report back to the next meeting of G20 leaders. While the response to the initial Washington summit was not impressive, with markets around the world falling significantly after its conclusion, as the actions by the multilateral institutions and governments to carry out their assigned tasks started to take shape, the reaction to the subsequent summits was much more positive. Also of interest is the emerging process by which disagreements among, for example, major European players like Germany, France, and the United Kingdom, or between Europe and the United States, were brokered by other G20 members, with India or China or Brazil serving this role of referee and conciliator.

[7] The Financial Stability Board was established at the London G20 Summit as a successor to the Financial Stability Forum, which was created in 1999 by the G7 finance ministers and central bankers as a forum to promote coordination and information exchange among those responsible for financial stability. The FSF was made up of financial regulators from the G7 countries, Australia, Hong Kong, Netherlands, Singapore, and Switzerland, as well as international financial institutions, international regulatory and supervisory groupings, committees of central bank experts and the European Central Bank. When the G20 leaders transformed the FSF into the FSB, they expanded its membership to include 64 participants—all G20 countries, plus Hong Kong SAR, the Netherlands, Singapore, Spain, Switzerland, the European Central Bank, and the European Commission. They also significantly expanded its mandate to include assessments of vulnerabilities in the financial system, monitoring market developments, advising on best practices in meeting regulatory standards and the establishment of guidelines and support for supervisory colleges. U.S. Treasury Secretary Timothy Geithner described the FSB as "a fourth pillar to the architecture of cooperation established after the second world war" referring to the IMF, the World Bank and the WTO, noting his expectation that the FSB will set high global financial standards and hold all FSB members accountable to those standards.

[8] The WTO's scarce resources and prescribed impartiality places strong constraints on its ability to effectively name and shame members for adopting protectionist measures. A number of independent monitors, most prominently Global Trade Alert (GTA), www.globaltradealert.org, have stepped in to analyze protectionist measures using a much broader definition of what constitutes a protectionist action. With regard to the G20 pledge to "refrain from raising new barriers to investment or to trade in goods and services," GTA found that, "on average, a G20 member had broken the no-protectionism pledge every three days" in the year following the Washington Leaders Summit.

Table 3. G20 leaders summits: Pledges and commitments

G20 Leaders Summits	Pledges/Commitments
Washington, November 2008	• Adopted 5 principles for reform relating to transparency, accountability, and enhanced regulation of financial markets, products, and participants, including credit rating agencies, with an action plan for their implementation • Pledged to coordinate regulatory reforms internationally • Committed to reform Bretton Woods Institutions to reflect changed economic weights in the world economy, but no specifics • Pledged to use expansionary macroeconomic policies, both fiscal and monetary, to stimulate aggregate demand and encourage economic growth • Committed to refrain from protectionist trade policies and to "strive" to reach agreement on the Doha Round of WTO talks.
London, April 2009	• Reiterated commitments of 2008 • Creation of Financial Stability Board (FSB) as successor to Financial Stability Forum with all G20 countries, FSF members, Spain and the European Commission as FSB members, set up to establish and enforce high global standards for financial regulation and monitoring • IMF: Pledge to increase funding for the IMF and MDBs by $ 1.1 trillion, including a tripling of the IMF's lending capacity by restocking the IMF with $500 billion and creating $250 billion of new Special Drawing Rights. • World Bank: support for increase in lending of at least $100 billion and implementation of 2008 reforms • Commitment to conclude an "ambitious" Doha Round and to avoid protectionist measures
Pittsburgh, September 2009	• Agreed on a "Framework for Strong, Sustainable and Balanced Growth" to coordinate and monitor national economic policies to correct the current global imbalances and prevent future such imbalances, with some peer review and some IMF oversight of this macroeconomic policy coordination • Specific plans to increase the representation of emerging-market countries at the IMF by increasing their quota by five percentage points to 43% of the total and similar initiatives at the World Bank • Commitment to crack down on financial institution excesses, including raising capital standards, implementing international compensation standards and adopting frameworks for cross-border resolutions of failed institutions • Commitment to conclude the Doha Round by the end of 2010
Participants	**Washington:** Argentina, Australia, Brazil, Canada, China, France[1], Germany, India, Indonesia, Italy, Japan, Mexico, the Netherlands[2], Rep. of Korea, Russia, Saudi Arabia, South Africa, Spain[2], Turkey, United Kingdom, United States Ex-officio participants: European Commission (President), World Bank (President), Secretary General of the UN, IMF (Managing Director), Financial Stability Forum (Chairman) **London:** All Washington participants plus Czech Republic[3] and ex-officio participants: Chair of New Partnership for Africa's Development (NEPAD), Chair of Association of Southeast Asian Nations (ASEAN), WTO (Director-General) **Pittsburgh:** All participants from London with Sweden[3] representing the EU Council rather than the Czech Republic

[1] Representing EU Council and themselves
[2] Permitted extraordinary presence
[3] Representing the EU Council

Source: G20 website, www.g20.org

4 The IMF, World Bank, and WTO: From Crisis to Reform

With each successive wave of economic crisis to hit the world—from the Asian meltdowns in 1997 to Russia's ruble crisis in 1998 to the collapse of Argentina in 1999 and 2000—there has been a subsequent torrent of hand-wringing, post-mortem analysis, and calls for reforms to the architecture of global economic governance in order to speed recovery and prevent such crises from reoccurring. Equally compelling has been a wave of tragedies—from the tsunami in the Indian Ocean to Hurricane Katrina in 2005 to the enduring poverty throughout much of Africa—that have tested the world's ability to respond, accompanied by calls for a better approach to development contained in many a bestselling book or prominent commission report. On the trade front, the WTO took center stage not long after its creation, when protestors outnumbered delegates at its Ministerial meeting in Seattle in 1999, setting a precedent for civil disturbances at meetings of the WTO, IMF, and World Bank ever since. Overall, the clamoring for reform reached a crescendo with the Great Recession of 2008-2009, which has prompted a number of pledges from political leaders to learn from the mistakes of the past and to reform the global economic architecture to meet the challenges of the 21st century.

The various calls for reform have pin-pointed problems of relevance, effectiveness, and legitimacy. Waning *relevance* in the case of the IMF has been detected as a result of the ascendance of private capital markets; at the World Bank, as a result of the rise of China and other new economic powers engaging in infrastructure development; and at the WTO as a result of the proliferation of regional trade agreements. Waning *effectiveness* at the IMF is a claim directed at the Fund's inability to tackle global imbalances and its "mission creep" into bailouts; at the World Bank it has been identified in relation to the inability substantially to improve poverty rates, particularly in Africa, or adequately address environmental, human rights or corruption concerns, along with a perceived "mission creep;" and at the WTO it has arisen from the inability to conclude the Doha Round despite the nine years that have lapsed since talks began in November 2001. Finally, waning *legitimacy* has been diagnosed at both the IMF and the World Bank as a result of the lack of voting power or quota levels held by emerging and developing countries and the perception that the institutions are controlled by a handful of wealthy countries that impose conditionality on others but not themselves; at the WTO, it arises from a perceived lack of transparency in its operations combined with concerns that the consensus-only decision making process may be getting in way of reaching conclusions, and from a longstanding failure to ensure that the benefits of free trade are more evenly distributed.[9]

The various calls for reform have focused on a perceived lack of relevance, effectiveness, and legitimacy at the IMF, the World Bank, and the WTO.

[9] Much work on reform proposals had been done well before the G20 Summits. See, for example, World Trade Organization (2004), *The Future of the WTO: Addressing Institutional Challenges in the New Millennium: Report of the Consultation Board to the Director-General Supachia Pantichpakdi* (the"Sutherland Report"); and the report of the IMF's Independent Evaluation Office, *Governance of the IMF: An Evaluation*, 2008. In addition to the work of such commissions, there have been countless books and articles written, many of which are noted in the bibliography at the end of this article. Key among them would be *Losing the Global Development War*, John W. Heard, 2008; *Reforming the IMF for the 21st Century*, Edwin M. Truman, 2006; *Redesigning the World Trade Organization for the 21st Century*, Debra P. Steger (2010); *Studies of IMF Governance*, Ruben Lamdany and Leonardo Diaz Martinez (2009); *The IMF and its Critics*, (2004) and *The World Bank: Structure and Policies* (2000) David Vines and Christopher Gilbert; "Reforming the World Bank," Jessica Einhorn, *Foreign Affairs*, Jan./Feb. 2006, Vol. 85, Issue 1, and *The IMF, World Bank and Policy Reform*, Alberto Paloni and Maurizio Zanardi, Routledge Studies in Development Economics, 2006. In addition, a number of groups have been formed devoted to reform of these institutions, including The Bretton Woods Project (www.brettonwoodsproject.org), New Rules for Global Finance Coalition (www.new-rules.org) and The Fourth Pillar (www.fourthpillar.org).

It is in the face of these challenges that G20 leaders have called for reforms to the international financial institutions. These reforms will primarily focus on changes to their mandates, scope, and governance to reflect the increasing complexity in the world and changes in the economic weight of the various players. In addition, the reforms will also involve greater coordination and coherence among the three economic institutions, along with the newly created Financial Stability Board.

Implicit in various calls for reform is a reaffirmation of support by the G20 leaders for a multilateral approach to economic problems and for increased reliance on the multilateral economic institutions to help solve them. Such increases will necessarily also involve finding a way to "multilateralize" many of the existing regional agreements that cut into the scope of the work of these institutions. Equally implicit in the G20 leaders' statements is support for the ongoing work of these existing institutions of global economic governance.

In the wake of the Second World War, it was America that largely built a system of international institutions that carried us through the Cold War. Leaders like Harry Truman and George Marshall knew that instead of constraining our power, these institutions magnified it.

Today it's become fashionable to disparage the United Nations, the World Bank, and other international organizations. In fact, reform of these bodies is urgently needed if they are to keep pace with the fast-moving threats we face. Such real reform will not come, however, by dismissing the value of these institutions, or by bullying other countries to ratify changes we have drafted in isolation. Real reform will come because we convince others that they too have a stake in change—that such reforms will make their world, and not just ours, more secure.

Then-presidential candidate Barack Obama
The Chicago Council on Global Affairs
April 23, 2007

5 Guardian of Global Finance: The International Monetary Fund

Mission

The principal international institution involved in financial stability and finance matters is the International Monetary Fund. The Fund has evolved considerably from its original role, which focused on management of the par value system of fixed exchange rates. When the United States eliminated adherence to the gold standard and the system of pegged exchange rates in 1971, countries were left free to choose their exchange rate regimes and the IMF's charter was radically amended, pushing it to focus heavily on member countries with persistent balance-of-payment problems and on responding to crises that threaten the international monetary system as a whole. The Fund's scope was also fundamentally altered by the emergence of newly independent nations in Africa and elsewhere beginning in the late 1950s, followed by another wave of new entrants after the end of the Cold War, both of which required a change in financing and policy advice to support growth-oriented structural reforms and transitions from centrally-planned to market economies. The IMF currently carries out its mission through a combination of financing (typically done through stand-by arrangements or special loans), surveillance of countries' economic and financial policies, technical assistance, and policy endorsements.

Governance

Both the IMF and the World Bank have a Board of Governors made up of a representative of all 186 countries which meets twice a year. The IMF's Board of Governors is advised by two ministerial committees, the International Monetary and Financial Committee (IMFC), and the Development Committee. While some specific powers reside with the Board, the real management of the IMF is done by its Executive Board of 24 members, five of whom are appointed (the United States, Japan, Germany, France, and the United Kingdom), three of whom are elected by a single country (China, Russia, and Saudi Arabia), and 16 of whom are elected to represent a group of countries, along with the managing director of the IMF, who serves as the chairman of the Executive Board.[10] Over and above the appointees of Germany, France, and the United Kingdom, the remaining members of the European Union are all represented on the Executive Board in one of seven different country groupings. Each member of the Executive Board controls a share of the total vote at the IMF, depending on the size and level of participation of those countries in his or her group. The United States has the largest single voting share with 16.77 percent, followed by Japan (6.02 percent), Germany (5.88 percent), France (4.85 percent), and the United Kingdom (4.85 percent). While many decisions at the Executive Board are made on the basis of majority rule, some key decisions require a super-majority vote of 85 percent, which gives the United States, with its 16.77 percent share, the ability to block such decisions. If the three appointed European representatives voted together, they too would have more than 15 percent of the vote and would have, like the United States, enough power to "veto" any action that required a supermajority vote of 85 percent. While the IMF's quota shares are automatically updated, these updates have not resulted in a substantial shift in power away from overrepresented Europe to underrepresented emerging market economies.

With respect to recent governance reform efforts at the Fund, Managing Director Dominique Strauss-Kahn created a "four pillar" approach to reform, calling for a report from the IMF's Independent Evaluation Office, from an internal Working Group

[10] Including the managing director, there are currently 10 Europeans (40 percent of the total) serving on the IMF's Executive Board.

Dissatisfaction with Fund governance well pre-dates the crisis, reflecting a sense of declining relevance (given ascendant private capital markets), effectiveness (demonstrated by the Fund's inability to tackle global imbalances), and legitimacy (with institutional structures described as outmoded and feudalistic).

on IMF Corporate Governance, from civil society organizations, and lastly from the Committee on IMF Governance Reform headed by South African Finance Minister Trevor Manuel. As the Fund's internal report noted, "dissatisfaction with Fund governance well pre-dates the crisis," reflecting a sense of waning relevance (given ascendant private capital markets), effectiveness (demonstrated by the Fund's inability to tackle global imbalances), and legitimacy (with institutional structures described as "outmoded and feudalistic").[11]

In attempting to address at least the concerns about relevance and legitimacy, the Manuel Committee was established in September 2008 and issued its report on March 25, 2009, in advance of the spring meeting of the IMF. The Committee's report called for:

- The creation of a high-level ministerial council (IMF Council) to foster political engagement in strategic and critical decisions;
- An acceleration of the quota and voice reform begun in 2009 by shifting to a 70 to 75 percent majority for decisions, which would have the effect of removing the U.S. veto power while giving low income countries the ability to band together to veto activities they do not like;
- A broader mandate for surveillance to include macroeconomic policies, prudential issues, and financial spillovers;
- Clearer lines of responsibility and accountability among various decision-making entities in the Fund with more authority for member-specific surveillance given to management and greater strategic and supervisory roles for the Executive Board; and
- The introduction of an open, transparent, and independent-of-nationality selection process for the Managing Director, thereby eliminating the unwritten rule that the Managing Director must be a European.

For its part, the Independent Evaluation Office report, *Governance of the IMF*, recommended:

- Clarification and alteration of the roles and responsibilities within the IMF governance structure to minimize overlaps and close gaps;
- Active and systematic ministerial-level involvement in setting strategic goals and overseeing performance;
- Reorientation of the Board away from executive functions to a supervisory role focused on formulating strategy, monitoring policy implementation, and exercising executive oversight; and
- Establishment of a framework to hold management accountable for its performance.

Civil society organizations, for their part, emphasized through their "fourth pillar" process a greater need for transparency and communication, particularly with the executive directors, along with strong calls for changes to the distribution of voting power and quotas and increased accountability for the executive board. They also insisted that the selection of the managing director and the deputies should be conducted via a merit-based, transparent process without any restrictions as to the nationality of the candidates.

Mandate

With respect to the mandate of the IMF, the current economic crisis has pointed to the need for a number of substantial changes to the mandate of the IMF. These include the establishment of a

[11] International Monetary Fund, "IMF Governance—Summary of Issues and Reform Options", Strategy Policy, and Review Department and the Legal Department, Jul. 1, 2009.

sound early warning system for macroeconomic and financial risks, broader surveillance of all members' macroeconomic policies (including the United States and European Union member states), tougher oversight of exchange rate imbalances, and broad-based support for growth in developing countries by helping finance counter-cyclical spending, bank recapitalization, infrastructure, trade finance, balance of payments support, debt rollover, and social support.

6 From Reconstruction to Development: The World Bank

Europe has long favored a World Bank focused almost exclusively on poverty alleviation, while the U.S. wants additional emphasis placed on private sector engagement and development.

Mission

Among the multilateral institutions, the task of promoting global development and poverty alleviation primarily falls to the World Bank. The World Bank has evolved from its inception as an institution with 44 member countries and a focus on postwar reconstruction to a development services organization with more than 10,000 employees and an administrative budget of $1.6 billion. Last year, its loan commitments totaled $46.9 billion. Over the years, its core focus has shifted from growth through trade and investment in partnership with middle-income countries to an organization set on alleviating poverty and promoting development in poor countries.

In the main, the United States and Europe have had shared goals for and commitment to the work of the World Bank Group. However, historically there have been some differences in approach. At its inception, the United States saw the Bank as responsible for building a strong middle-class and overall economic prosperity in middle-income countries, in part to provide markets for U.S. exports. As the Bank moved from reconstruction to a focus on development, the United States has typically favored a mission that continues to place strong emphasis on the pursuit of economic growth and productive investment that leans heavily on the private sector. Europe was initially on the receiving end of the Bank's reconstruction efforts, until much of that work was taken over by the Marshall Plan. Once fully recovered, Europe began to push for the Bank to work almost exclusively with the poorest countries and the poorest pockets of the middle-income countries, and the Europeans remain strong proponents of this primary focus on poverty alleviation.

Governance

The governance structure of the World Bank largely mirrors the structure of the IMF, with a Board of Governors that meets twice a year and the real management of the Bank done by its Executive Boards, which are also composed of 24 directors who are appointed or elected by the same member countries or groups of countries as the IMF along with the president of the Bank, who serves as its chairman.[12] The voting weight of each country is made up of both basic votes (whose value has eroded over time) and votes that are dependent on a country's shareholding in the Bank. Unlike at the IMF, which has automatic quota reviews every five years, shareholding adjustments are made through periodic—and generally very political—processes. With 16.4 percent, the United States has by far the largest voting weight at the Executive Board of the International Bank for Reconstruction and Development, followed by Japan (7.87 percent), Germany (4.49 percent), France (4.31 percent), and the United Kingdom (4.31 percent). These five countries have the right to appoint their own representatives to all four Executive Boards. Three other countries elect a single representative to each of the Executive Boards (China, Russia and Saudi Arabia), while the remaining 16 directors are elected to represent a group of countries. As with the IMF, all of the other members of the European Union participate as part of a group of countries represented by one of seven other elected representatives on the Executive Board.

Decisions at the Bank are made by simple majority vote for ordinary decisions and by supermajority (85 percent) for one type of decision—amendments to the Article of Agreement. As at the IMF, because

[12] Technically the World Bank Group has four boards (IBRD, IDA, IFC, and MIGA) of executive directors with slightly different voting percentages for each, but as a practical matter, the same individual typically serves as the executive director on all four.

Table 4. The World Bank Group today				
World Bank Group	**Est.**	**Areas of specialization**	**Cumulative Lending/ commitments (billions)**	**Fiscal 2009 Lending/ commitments (billions)**
International Bank for Reconstruction and Development	1944	Focuses on lending to public sector entities in poor to middle income countries.	$479 (effective FY 2005, includes guarantees)	$32.9 for 126 new operations in 42 countries
International Development Association	1960	IDA lends to world's poorest countries. Provides interest-free loans and grants to public sector to boost growth and reduce inequality. Major source of financing for infrastructure.	$207 (effective FY 2005, includes guarantees)	$14 for 176 new operations in 63 countries
International Finance Corporation	1956	Finances private sector investment, mobilizing capital in financial markets, and providing advisory services to businesses. IFC invests in enterprises majority-owned by the private sector. Aims to address constraints to private sector investment in infrastructure, health, and education.	$34.4 (plus $8 in syndicated loans)	$10.5 committed and $4 mobilized for 447 projects in 103 countries
Multilateral Investment Guarantee Agency	1988	Promotes FDI into developing countries by providing political risk insurance (guarantees) to the private sector. Insures investment against losses related to expropriation, currency transfer restrictions, civil disturbance/war, breach of contract, non-honoring of sovereign financial obligations.	$20.9 (includes amounts leveraged through the Cooperative Underwriting Program)	$1.4 in guarantees issued for 26 projects
International Centre for Settlement of Investment Disputes	1966	Autonomous international institution aims to provide facilities for conciliation and arbitration of international investment disputes.	292 cases registered	24 cases registered in 2009

The term "World Bank" typically refers only to the IBRD and IDA. The World Bank Group also encompasses the IFC, MIGA, and ICSID.

Source: World Bank Annual Report 2009.

In October 2008, World Bank President Zoellick established a high-level commission to focus on the modernization of World Bank Group governance so the World Bank Group can operate more dynamically, effectively, efficiently, and legitimately in a transformed global political economy.

the United States controls more than 15 percent of the vote, it alone has an effective "veto" power to block any such changes to the Article, and a mythology has ballooned around the perceived reach of this veto power.

Many proposals for governance reform at the World Bank have been made over the years, primarily aimed at addressing the various imbalances that result from the appointed seats held by the "big three" European countries, or from the U.S. "veto" power. Most recently, in October 2008, World Bank President Robert Zoellick established a high-level commission, headed by former Mexican President Ernesto Zedillo, to "focus on the modernization of World Bank Group governance so the World Bank Group can operate more dynamically, effectively, efficiently, and legitimately in a transformed global political economy."

At the outset, the Commission on Modernization of World Bank Group Governance noted significant weaknesses in three key areas of the Bank's decision making and governance processes: strategy formulation, voice and participation, and accountability.

On *strategy formulation*, the Commission found that the Bank lacks an effective means to formulate a clear strategy that can be used to set priorities, balance tradeoffs, and align operations and resources with strategic goals. In part, this is due to the advisory nature of the Development Committee and the insufficient time available to—and seniority among—the members of the Bank's current Executive Board.

On *voice and participation*, the Commission noted that the decision-making process is widely seen as too exclusive and that a number of conventions and practices create the perception that the Bank is accountable and responsive to at best only a handful of shareholders. Contributing to this perception is the significant gap between the voting shares of developing versus developed countries, an allocation of voting power and special majority rules that gives rise to the "U.S. veto" and the considerable overrepresentation of European countries on the Bank's Executive Boards.

On *accountability*, the Commission cited in particular the ambiguous relationship between the Board and management, the conflict of interest from the president of the Bank also serving as the chairman of the Executive Boards, the difficulty in holding the president accountable for performance, and the non-transparent process for the selection of the president, with its unwritten convention that the president of the Bank must be a U.S. citizen (just as the managing director of the IMF must be a European).

The Zedillo Commission issued its report in October 2009, which included five recommendations that the Commission noted need to be adopted and implemented as a single package:

- *Enhancing voice and participation* by consolidating the board to 20 chairs from the current 24, composing the board entirely of elected chairs that represent multi-country constituencies, and eliminating the link between the IMF quotas and the World Bank voting powers;
- *Restructuring the World Bank's governing bodies* by elevating the Board to ministerial level with responsibility for overall strategy and direction, major policy decisions, oversight and selection of the President, delegating to management the approval of financing operations and creating an advisory council of representatives;
- *Reforming the leadership selection process* by creating a rules-based, inclusive, competitive process for selecting the President that does

away with the current un-written rule that reserves the Bank presidency to a U.S. citizen;

- *Strengthening management accountability* by creating a performance review process for the Bank president, increasing use of external evaluations and increasing reviews of those providing safety nets for the poorest; and
- *Strengthen the Bank's resource base* through increases to its capital base.

Mandate

With respect to the mandate of the World Bank, significant change has already occurred. However, as the many calls for reform indicate, much remains to be done. With four branches in addition to the original International Bank for Reconstruction and Development and the establishment of regional development banks, the World Bank has moved far beyond its initial role of lending to public-sector entities for reconstruction. Much of the World Bank's current support is provided through equity investments, financial services, and political risk insurance, in addition to traditional lending and project financing.

In today's world, it is clear that more needs to be done to broaden and deepen the role of the Bank, particularly in its relationships with non-state actors, be they private business, NGOs, or bilateral aid donors, as central components of its development strategy and to ensure that it is not trying to be all things to all people. Global leaders and scholars alike have noted that the path to economic recovery is one that will be primarily paved by the private sector, be it small and large businesses, entrepreneurs, microfinance lending groups, or risk-takers and financiers from around the world.

Private sector growth has been the engine that allowed hundreds of millions of people to lift themselves out of poverty in China and India in recent decades. From Dambisa Moyo's notion, in *Dead Aid*, that development assistance to governments is "easy money" that furthers poor governance and adds to the poverty of Africa rather than helping it, to R. Glenn Hubbard and William Duggan's call, in *The Aid Trap*, for a new Marshall Plan of lending directly to private enterprises in the world's poorest nations, to the inclusion of a global partnership for development with the private sector as part of the Millennium Development Goals, there are growing calls for more resources to be directly granted to private and local business in order to both cultivate a middle class and to place market incentives and disciplines on more economic activity. In addition, the Bank needs to adjust its approach to address the considerable competition it now faces in the development of infrastructure from countries, particularly China, who are willing to invest directly in large-scale projects without many of the policy strings ("conditionality") normally attached by the Bank to those activities. It also needs to ensure that the Bank is playing as big a role as possible in the effort to ensure that development and sustainable economic activity go hand in hand. Moreover, the G20 has conferred on the Bank a leading role in responding to problems requiring "globally coordinated action, such as climate change and food security."[13]

[13] Pittsburgh Summit, Leaders' Statement, September 24-25, 2009, paragraph 21.

7 Negotiating the Rules: The World Trade Organization

Mission

As with the IMF and the World Bank, the principal governing institution of the global trading system—first the General Agreement on Tariffs and Trade, then its successor, the World Trade Organization—has undergone major changes since it was first conceived in the 1940s. Following the failure of the United States to ratify the Havana Charter that would have created the International Trade Organization, a smaller group of 23 countries joined together in a looser arrangement to provide reciprocal tariff reductions and to agree to certain codes governing their trading relationships. The GATT provided the forum in which eight rounds of multilateral trade negotiations were completed, substantially lowering tariffs on industrial goods among industrial countries (although not yet in agricultural products or the labor-intensive manufactured goods of export interest to many developing countries). Through its system of tariff bindings, transparency, and adherence to rules—especially the principle of nondiscrimination expressed in the *most favored nation* (MFN) and *national treatment* provisions—the GATT also provided an underpinning of institutional stability and predictability in international trade that served as a guarantor against the threat of 1930s-style protectionism throughout the second half of the 20th century.

With the increasing complexity of global commerce came the recognition among GATT members of the need for an organization that could provide more comprehensive regulation of international trade. The ITO as it was originally envisioned would have held a wide remit beyond trade in goods, with the ability to negotiate rules governing labor standards, commodity agreements, restrictive business practices, international investment, and trade in services. With the conclusion of the Uruguay Round negotiations, the GATT membership agreed to the launch, in 1995, of a full-fledged international organization, the World Trade Organization, which now has a membership of 153 countries. As with the original ITO, the WTO is concerned with disciplines on trade beyond just goods, and covers trade in agriculture and services as well as rules on intellectual property, subsidies, investment, and trade facilitation. The WTO also boasts a binding dispute settlement mechanism.

Governance

Unlike the Bank and the Fund, the WTO does not have a formal governance structure with a governing or executive board. Instead, the WTO is a member-driven institution, run by its members with a relatively small secretariat that has very limited power to propose, much less to impose, solutions to problems. It is organized through a series of councils—primarily the General Council, the Dispute Settlement Body, and the Trade Policy Review Body, along with the Council for Trade in Goods, the Council for Trade in Services, and the Council for Trade-Related Aspects of Intellectual Property Rights—which are chaired by a Geneva representative of a WTO member country with an annual rotation of the chairs. In addition, there are numerous committees and working parties on particular issues that are open to all members. While the agreement establishing the WTO set forth a number of procedures by which votes could be taken on certain issues, in practice the WTO has continued to operate on a consensus basis.

Cries for reform of the WTO began in earnest following the huge protests and failure to reach agreement at the WTO's infamous 1999 Ministerial Conference in Seattle, Washington. Four years later, shortly before another less-than-successful Ministerial Conference in Cancún, the then-Director General of the WTO, Supachai Panitchpakdi, established a consultative board to address the future of the WTO and the institutional challenges it faced. That group, led by former WTO

Director General Peter Sutherland, issued its report in December 2005, on the tenth anniversary of the creation of WTO.

Among other things, the Sutherland Report focused on the consensus-based decision-making process. It recommended that more onus be placed on any member blocking a measure that otherwise enjoys strong consensus, and that the WTO re-examine the principle of plurilateral approaches to negotiations and the possibility of approving decisions by a critical mass of members. Also recommended were regular annual ministerial meetings, a WTO Summit of world leaders every five years, and the establishment of a consultative body for senior officials that would meet on a quarterly basis. It urged the development of a set of objectives for the WTO's relations with civil society and the public at large. The report also expressed deep concerns about the spread of regional *preferential trade agreements* and called for such agreements to be subject to meaningful review and effective disciplines at the WTO.

Two years later, Warwick University in the United Kingdom established its first Warwick Commission with a broad mandate to examine the governance of the multilateral trading system in light of growing challenges. The Commission looked at ways to counter growing opposition to further trade liberalization in industrialized countries and to ensure that the end of the dual domination of the trade regime by the United States and Europe does not give way to long-term stalemate or disengagement. It sought ways to forge a broad-based agreement about the WTO's objectives and functions and to ensure that the WTO's many agreements result in benefits for its weakest members. Finally, as with the Sutherland Report, it looked at ways to ensure that the proliferation of regional preferential trade agreements does not undermine the WTO principles of nondiscrimination and transparency in international commerce. Among other things, the Warwick Commission recommended a *critical mass* approach to decision-making and urged that the industrialized countries refrain from negotiating preferential agreements with each other as well as the development of WTO disciplines and review mechanisms for such agreements. At its most recent Ministerial Conference in December 2009, in the face of the continued inability to conclude the Doha Development Round of trade talks, more than 20 countries endorsed a proposal to establish a process to review the WTO's "functioning, efficiency, and transparency, and consider possible improvements" in light of the "rapid change in the global economic environment" and the need for the WTO to be "agile and responsive." To date, none of these calls for reform have resulted in any changes in the WTO's governance structure.

Mandate

The WTO is still wrestling with the new mandate it was given in the transition from the GATT to an institution with a scope that was closer to that of the original ITO. Already a chorus of voices—including that of the European Union—is calling for a still-further broadening of the WTO's mandate, with some attributing the failure to conclude the Doha Round in part on its narrow agenda of "yesterday's issues"—namely, market access in agriculture, in goods, and in services.[14] Other WTO members like Brazil and South Africa are more resistant, refusing to move on to new issues until developed country members make good on a promise that was made at the end of

Already a chorus of voices—including that of the European Union—is calling for a still-further broadening of the WTO's mandate, with some attributing the failure to conclude the Doha Round in part on its narrow agenda of "yesterday's issues"—namely, market access in agriculture, in goods, and in services.

[14] See for example, Aaditya Mattoo and Arvind Subramanian, "From Doha to the Next Bretton Woods, A New Multilateral Trade Agenda," *Foreign Affairs*, Jan./Feb. 2009, contending that a new round of talks is needed to develop a more ambitious agenda than Doha, involving a broader set of institutions than just the WTO and focusing on a wider array of issues, including food security (export bans on agriculture, biofuels policies, etc), cartels, energy trade, exchange rates, regulation of sovereign wealth funds, and climate change.

the Uruguay Round—that, after a half-century of resistance, liberalization would be extended to trade in farm products and in light manufactures of export interest to developing countries. This long-running standoff is at the heart of the present deadlock in the Doha Round.

However these issues find resolution, it is clear that if the WTO is to remain relevant it will need to be engaged in the trade issues, broadly defined, of the twenty-first century. These include competition policy, investment policy, energy policy, food security, global health services, technology, environmental goods and services, and a host of additional issues that are both contentious and at the core of business concerns—including corruption, corporate social responsibility, exchange rates, immigration, and cyber security.

8 Renovating the House of Global Economic Governance for the 21st Century

A number of obvious commonalities and themes stand out from these various calls for reform of the Bretton Woods architecture:

- All recognize that the institutions of global economic governance were created at a very different time and under very different circumstances but have failed to change, particularly with respect to the changing distribution of economic weight and power among nations;
- All recognize that the imperative for change must come from political leaders who are above any particular institution in recognition of the fact that it is virtually impossible to change governance structures from within, particularly when such changes involve shifting power away from some to others;
- All call for increased and active involvement at higher political levels in the governance of the institutions, particularly in setting strategic direction; and
- All support a broadening or deepening of the range of activities and mandates of the existing institutions.

It remains to be seen whether the sheer imperative for a coordinated global response to the financial crisis and the emergence of a broader and stronger consensus among the G20 leaders will provide the needed catalyst for change, or whether these blueprints for reform will join a long line of well-thought-out proposals issued with varying degrees of fanfare only to sink without trace in the ocean of well-meaning but failed ideas, swept away by many of the same forces that make it harder to reach international consensus on anything. However this may be, in the meantime it is a source of hope that the change that is most needed is not impossible to achieve. For the multilateral economic institutions do not need to be completely reconstructed from the ground up. That would be unrealistic. The current crisis is unlikely to be either deep enough or of sufficient duration to create a "1944 moment"—a constitution-making moment when major new institutions and institutional relationships can be built anew or created out of whole cloth. Instead, what is most needed is more akin to a *renovation* and not a rebuilding.

This renovation of the house of global economic governance would involve: a rebalancing of power, a broadening of mandates, a deepening of coordination, and a commitment to bring regional agreements into the fold.

This renovation of the house of global economic governance would involve a rebalancing of power within the existing institutions away from Europe and the United States and toward the rest of the world. It would involve a broadening of the mandates of these institutions to enable them to address the new issues of the day. It would mean a deepening of the coordination among the institutions, including the WTO, to ensure that pressing issues do not fall between the cracks. Finally, it would mean a new commitment on the part of the major players to work to bring the proliferation of regional agreements on the sidelines into their folds.

How can this be done?

9 The Harbinger of Global Governance: Political Leadership and the G20

Use of the G20 as a "Council of Governors" would give the emerging market countries a permanent and significant voice in global economic governance, getting them more engaged in addressing problems at the multilateral level and allowing them to play an important brokering role when differences between the United States and Europe threaten to cause global gridlock.

The simplest way to achieve these goals is to transform the G20 into a "Council of Governors" for the three established international economic institutions plus the new Financial Stability Board. While the G20 may not be perfect—and debate will doubtless continue as to whether the current configuration is the optimal one—the fact is that it has defied its doubters in reaching consensus on specific approaches to a number of critical and controversial issues. Both the United States and Europe emerged from the three summits with a good deal of confidence in the grouping. "When we are talking about reform of the international system…the G20 was seen as the right body for these decisions to be made at," noted British Prime Minister Gordon Brown. U.S. President Barack Obama noted that "the G20 will take the lead in building a new approach to cooperation." This augurs well for the G20 becoming—as Nicolas Sarkozy stated at the World Economic Forum this January, "the harbinger of global governance in the 21st century." The G20 Council of Governors would establish strategic goals and then give the various institutions the job of carrying them out.

This G20 "Council of Governors" would focus on three main tasks:

- Setting the strategic direction of the international institutions (IMF, World Bank, WTO, and FSB) to ensure their mandates are broad enough to cover the many issues that are now falling between the cracks yet tailored enough to ensure that inefficient overlaps or mission creep are avoided;
- Pushing through the necessary changes in the voting and power structures at the IMF and World Bank to ensure that those institutions' governance structures reflect changes in economic weight, while at the same time infusing the WTO with direction and support from a smaller group of higher level officials; and
- Holding the international institutions accountable for implementing the directives that come from the G20 summits and giving the international institutions a forum to hold the G20 leaders accountable for their commitments to the institutions.

Providing the G20 with such a role would allow the group to set strategic direction and then use the considerable expertise and qualified personnel at each of the institutions to carry out its instructions. By giving the G20 the continuing role of coming together at least once or twice a year to perform the fiduciary duty of direction-setting and oversight for these institutions, the G20 would be assured of a consistent and on-going role in setting the course of global economic activity. Use of the G20 for this role would also give the emerging market countries a permanent and significant voice in global economic governance, getting them more engaged in addressing problems at the multilateral level and allowing them to play an important brokering role when differences between the United States and Europe threaten to cause global gridlock.

A G20 Council of Governors could also ensure that any country putting up roadblocks to the implementation of agreed-upon changes can be singled out and pressured in the "court of international opinion" to permit necessary changes to move ahead. This increased accountability would move in both directions, with the institutions themselves having access to a high-level political body to which to take concerns about failures to follow through with prior commitments. Playing this strategic leadership role would also allow the G20 to fill an oft-cited need for high-level political engagement in the international institutions, albeit at an even higher level than initially envisaged by the reformers. Finally, inclusion of the World Trade Organization within the ambit of responsibility of this "Council of Governors" would ensure that the WTO takes its rightful place among the international institutions, in recognition of the critical link between finance, development, and trade, and the imperative of using the expertise and rules of the WTO to ensure that private enterprise can be fully engaged in worldwide economic recovery and future prosperity. In addition to this new role for the G20, it will also be necessary to reaffirm support for the multilateral institutions at the highest political levels, and to address the explosion of regional agreements.

10 Reaffirming Multilateralism in a World of Regionalism

The multilateral institutions have economies of scale, depth of expertise, greater staying power and a longer-term, broader-based approach to resolving global economic problems than any bilateral or regional agreement does.

On the one hand, the international organizations have been taken somewhat for granted as a widely-accepted commonplace on the global scene. On the other hand, they have become the source of virulent protests and stinging political rebukes from many quarters. Those on the right, particularly in the United States, deeply resent the United Nations and see it as a sinister instrument of foreign domination. On the other side of the ideological spectrum, those on the left frequently get out the placards and line the protest routes for most meetings of the WTO or IMF and World Bank, objecting to what they see as the role of these institutions in exacerbating the worst of globalization—growing inequality that funnels wealth to the multinational corporations while leaving the poorest countries ever farther behind.

Particularly at this time of crisis, it is essential that those who understand and appreciate the critical work of these institutions stand up for them and for the broad multilateralism that they represent. Failure to do so will only undermine trust in the institutions and in the belief that global economic problems can and should be addressed globally. If nothing else, the international institutions bring both economies of scale and deep expertise that cannot be readily replaced. As the world and its problems grow more complex, this knowledge—accumulated in many countries and over a long period of time—can only be put to good use if the institutions themselves are properly maintained. The institutions also have greater staying power and a longer-term, broader-based approach to resolving global economic problems than any bilateral or regional arrangement does. They have been bringing together people and ideas from around the world for more than 60 years in countless forums, meetings, project planning sessions, and more.

Away from all the teargas and the ideological smokescreens, it is in the mundane day-to-day meetings, reports, and projects being conducted within these institutions that multilateralism is most often advanced. Countries get in the habit of working together and come to important understandings about both the substance and the procedures for their collective action. A steady stream of information is exchanged, understandings reached, and norms established through these institutional gatherings. For example, despite the inability of the WTO to reach consensus on completion of the Doha Round, much agreement and common understanding has been achieved through the ongoing work of the various WTO committees, particularly the Council for Trade in Services and the Committee on Sanitary and Phytosanitary Measures.[15] While these practices don't rise to the level of formal rulemaking, they do form much of the bread-and-butter of multilateral activity that is critical if countries are going to a come together in times of crisis.

The statements of G20 leaders and others supporting these multilateral institutions and their work in particular—and the principles of multilateral cooperation in general—are to be commended, and will need to be repeated over and over as the institutions continue to grapple with the often-contentious issues of the 21st century. At the same time, a number of threats to multilateralism must be acknowledged and addressed. Most importantly among these is the rapid growth of regionalism and regional alliances and trade arrangements.

[15] For example, the WTO Committee on Sanitary and Phytosanitary Measures has adopted a decision on the implementation of Article 4 of the SPS Agreement regarding recognition of "equivalence" of different standards, procedures to enhance transparency, and guidelines to further the implementation of the SPS provisions on regional and pest-free areas. See Andrew Lang and Joanne Scott, "The Hidden World of WTO Governance," *The European Journal of International Law*, Vol. 20, Issue 3, 2009, pp. 575-614, citing WTO Doc S/C/M18 and WTO Doc S/CSC/M/17.

The debate over whether regional agreements—and regional trade agreements in particular—contribute to or detract from the multilateral system has grown in intensity as the number of new agreements, most recently in Asia, has skyrocketed. Indeed, in the first 45 years of the GATT—the period between 1948 and the creation of the WTO at the conclusion of the Uruguay Round—124 regional trade agreements were notified, less than three a year. By contrast, the last 15 years saw 333 new notifications of such agreements, more than 22 a year. As of October 15, 2009, 457 regional trade agreements had been notified to the WTO, 266 of which are currently in force.[16] The most recent is the Association of South East Asian Nations (ASEAN)-China Free Trade Area (ACFTA), launched on January 1, 2010. This is the largest free-trade area in the world by population (1.9 billion), with a combined GDP of $6 trillion, making it the third largest (behind the European Union and NAFTA) by economic value. The ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA) also went into effect on January 1, covering 600 million people and a combined GDP of $2.8 trillion.

Nor is trade the only area in which a spaghetti bowl of regional alliances are coming into force. The Chiang Mai Initiative Multilaterization (CMIM), a regional financial mechanism in Asia, encompassing the ASEANs, Japan, Korea, and China, set up a $120 billion facility designed to strengthen the region's capacity to safeguard against increased risks and challenges in the global economy. The core objectives of this "Asian Monetary Fund" are (i) to address balance-of-payments and short-term liquidity difficulties in the region, and (ii) to supplement the existing international financial arrangements. As such, it represents regional competition to the IMF, albeit with a low enough total capital base for now that the IMF will likely remain the lender of last resort even within the CMIM region.

In the development arena, the World Bank has seen an explosion in the use of trust funds, which are bilateral or regional development funds masquerading as multilateral ones. The World Bank may administer them, but the funds must be spent where and how the often sole donor designates. Over a thousand such trust funds have been established in recent years. Last year, disbursements from such trust funds equaled half of the World Bank's total disbursements. Together with bilateral development assistance, such trust funds allow donors to impose their own goals and strategy, which can bring in bilateral political pressures or a short-term or narrow focus that may not be in the best interests of a country as a whole. China, for example, has put billions of dollars into infrastructure projects in Africa while contributing only $30 million to the International Development Association (IDA), the World Bank arm designed to help the poorest countries.

This turn to regional or bilateral arrangements in lieu of multilateral ones is huge, with approximately 50 percent of all trade occurring under such agreements and about 65 percent of all aid currently coming from trust funds, bilateral aid funds, or "vertical" loans or grants focused on a particular issue.

All in all, this turn to regional or bilateral arrangements in lieu of multilateral ones is huge, with approximately 50 percent of all trade occurring under such agreements and about 65 percent of all aid currently coming from trust funds, bilateral aid funds, or "vertical" loans or grants focused on a particular issue. Why such a dramatic shift? Many countries around the world have turned away from multilateralism and the multilateral institutions for a number of reasons. First, there are non-institutional alternatives to the multilateral system—ranging from a broad array of private investment tools that supplant the IMF to huge infrastructure projects that are financed by foreign governments or other aid funds, often undermining the role of the World Bank. Second, many developing countries are skeptical about institutions set up by the transatlantic powers in

[16] World Trade Organization, "Report of the Committee on Regional Trade Agreements", WT/Reg/20, 16 Oct. 2009.

The multilateral institutions need to recognize that the regional agreements are massive in magnitude and add enormous complexity to the system, but they are here to stay and need to be accommodated and incorporated into the multilateral system.

which they don't have a significant voice or any great confidence that the institutions will address their needs. Third, they have found regional agreements easier to reach, either because they don't require solving some of the hardest problems on the table in multilateral negotiations—for example, agricultural subsidy issues at the WTO—or simply because reaching an agreement on a bilateral or regional basis is easier than trying to reach an agreement among the multitude of parties to any agreement at the multilateral level.

The downsides of this rush to regionalism are many. The time, energy, and resources required to negotiate bilateral or regional agreements are considerable, and by necessity take away valuable time, resources, and political capital available to countries to devote to multilateral agreements. At the same time, bilateral or regional agreements are much more subject to the vagaries of domestic politics—indeed, they are often initiated in response to particularistic commercial or foreign policy pressures. Then, once they are in force, most of these agreements have weak or non-existent dispute settlement mechanisms, making commitments under such agreements harder to enforce. Bilateral and regional agreements often have unique rules and provisions, which increases overall transaction costs in the system and makes it difficult for developing countries to understand what they need to do to comply with a wide array of differing sets of rules. On the trade side, such agreements often exclude particular products or don't allow for cumulation of inputs or resources from countries outside of the particular agreement, which can lead to inefficiencies and to hub-and-spoke systems of trade in which power-based arrangements begin to erode the protection of a rules-based non-discriminatory multilateral trading system.[17] Finally—and most importantly—proliferating preferential agreements by their very existence send a strong signal of a growing lack of faith in multilateral institutions and the multilateral system.

As such, it is imperative that the multilateral system work to fix problems that act as a deterrent to deeper engagement by developing countries while at the same time working to bring the various bilateral and regional arrangements within their systems. The multilateral institutions need to recognize that the regional agreements are massive in magnitude and scope and have added enormous complexity to the system, but that at the same time they are here to stay. Most urgently needed from the multilateral institutions are clear guidelines for any such agreements to ensure that they are stepping stones to multilateralism rather than barriers to entry for anyone outside any given regional or bilateral arrangement.

[17] The potential for regional trade agreements to undermine the multilateral system have been widely discussed. See for example Jagdish Bhagwati, *Termites in the Trading System: How Preferential Agreements Undermine Free Trade*, Council on Foreign Relations (2008).

11 Transatlantic Multilateralism for the 21st Century

During the critical period of the Bretton Woods conference of 1944 and in the months that followed, a large part of the world picked itself up from the ruins of depression and war and rallied around the vision—largely set forth by the United States and Great Britain—to create institutions and accords that would prevent a repetition of the disasters of the 1930s by allowing for global economic cooperation and multilateral governance. Then-U.S. President Franklin Delano Roosevelt, in his last address to the U.S. Congress, declared that "the world will either move toward unity and widely shared prosperity, or it will move apart," noting that the then-emerging plans for the Bretton Woods institutions and the global trading system represented the chance "to lay the economic basis for the secure and peaceful world we all desire."

The present global economic crisis has not been of the same order of magnitude of the events of the 1930s. But it does represent another transformative moment in world history. In particular, it presents the United States and Europe with another opportunity to exercise shared transatlantic leadership to ensure that the vision of their past leaders can be preserved, updated, and carried forward into the 21st century with all the challenges it brings. What do Europe and the United States need to do to meet this challenge?

First, they need to commit to not give up on the multilateral economic institutions, but to reform them instead. Together, the United States and Europe created these multilateral institutions and they have as much to gain as ever in keeping them at the core of the global economic architecture. However, ensuring that these institutions remain relevant, legitimate, and effective will mean some significant changes in the manner in which both the United States and Europe participate in their operations. These changes are an opportunity to show real leadership on the world stage at the cost of some concessions in the formal power structure.

Agreeing to make these concessions would also send a powerful signal to the rest of the world that they can have faith that these institutions are changing to accommodate shifting relationships in the global economy and an equally powerful affirmation by the transatlantic powers of their continuing reliance on multilateral institutions.

For its part, the United States should give up on both the unwritten rule that the head of the World Bank must be an American and the insistence that it retain veto power over matters requiring a supermajority. In addition, the United States should support the use of the G20 as a strategic steering group or "Council of Governors" for the World Bank, IMF, and WTO to ensure a strong G20 role in strategy formulation and coordination that would also give greater voice to the emerging market economies.

In the same vein, the member states of the European Union should give up on the unwritten rule that the head of the IMF must be a European, and work to consolidate European votes and seats at the IMF and World Bank either into a single European seat (which would give Europe the single largest voting share) or at least consolidate its seven partial seats with the bigger European economies so that Europe ends up with no more than four seats. As with the United States, the European Union and its member states should also lend their support to the G20 as the "steering committee of the global economy."

For Europe, the form of European participation in the Bretton Woods institutions presents a challenge and an opportunity to resolve the best way to ensure the strongest collective European voice in global economic governance. The coming into force of the Lisbon Treaty gives the European Union a formal international legal personality, and all around the world the EU is reorganizing its representation, a process that will continue with the

In order to save the institutions they started, the U.S. and Europe need to give up some of their formal power in order to allow more legitimate and more relevant institutions to emerge.

formation of the External Action Service. A reform of the governance structure of the international economic institutions would give Europe another opportunity to put this new status into operation.

Today, at the WTO, Europe speaks with one voice, through sole representation by the European Commission. The opposite is the case at the Bretton Woods institutions.

Today, at the WTO, Europe speaks with one voice, through sole representation by the European Commission. The opposite is the case at the Bretton Woods institutions, where the European Union has no formal place and can only act through the voice of certain member states. Nor does the Eurozone have a formal place at the IMF. At the G20, the European Union and the European Commission have been present—but so, too, have been individual member states (France, Germany, Italy, and the United Kingdom, later joined by Spain and the Netherlands), with some of these member states overshadowing the European Union. Reforming the manner of European participation in the Bretton Woods institutions could be a win-win for Europe. It would allow Europe to show leadership and a commitment to the modernization of the multilateral institutions while at the same time consolidating European power in a single but larger voting share. But it will not be easy. The three member states with permanent seats—France, Germany, and the United Kingdom—will no doubt resist giving up their exclusive rights. Many of the issues related to financial regulation and reform are still carried out at the national level, even within Europe and within the Eurozone. However, the opportunity to obtain more influence by acting collectively in this one arena of international economic institutional governance ought to be compelling for Europe. These institutions do not raise the same political problems of European consolidation that would be present at the UN or in other fora. Participating as one Europe could be seen as furtherance of the process of a coordinated European approach that was begun in preparation for the G20 Leaders Summits and of the Lisbon Treaty's goal of making the European voice in the world stronger.

Nonetheless, on paper, all of this could be seen as a dramatic loss of power on both sides of the Atlantic. But as a practical matter, a diminution in sway over the institutions of global economic governance could result in longer-term gains that would stem from stronger, more legitimate, and more effective institutions that operate to the continuing benefit of the United States and Europe and the kind of stable, open, rules-based global economy they both support. If the process and criteria for selecting the heads of the IMF and World Bank were solely merit-based, and if the United States and European Union nominated highly-qualified candidates, they would likely continue to take their turn in having their nationals serve in leadership roles. Moreover, while the exact voting share of countries is an important symbol of their power, few if any formal votes are taken in practice. In the process of finding sufficient support for any given proposal short of a formal vote, the consolidation of Europe into a single voice may result in more, not less, influence. Moreover, some diminution in the voting share of the United States or Europe would still leave both powers with the ability to block objectionable changes simply by finding a small handful of other countries to join them.

At the WTO, the concerns over and need for transatlantic leadership are somewhat different, while the challenges of effectiveness, legitimacy, and relevance are the same. Unlike the IMF and the World Bank, the WTO does not have an executive board or a management board, nor does the WTO Secretariat have the power to set priorities or propose new rules or formal structures to approve new rules other than through consensus—and traditionally only through rounds of negotiations. This means that the WTO does not need to engage in any formal rebalancing—certainly not in the direction of a further devolution or redistribution of power. However, the WTO membership does need to form new alliances and groups that would create the basis for decision-making in the absence of complete consensus. It is in putting together these alliances that the United States and the European Union should play a leadership role by taking seriously the recommendations of the Sutherland Report, the Warwick Commission, and other contributions to put in place alternatives to the single undertaking—an "all-for-one and one-for-all" consensus only process. U.S. and European leaders should ensure that a serious debate about the WTO's governance structure and its place in the global economic architecture takes place now, while leaders from around the world are focused on all three pillars of the system and should make it clear that this examination can be conducted without detriment to the ongoing attempts to conclude the Doha Round negotiations—and in fact could even contribute to their successful conclusion. This is the moment for the WTO to take its rightful place as an equal partner with the IMF and the World Bank in the global economic system.

Second, the United States and Europe should use the G20 as the most efficient mechanism to insert high-level involvement in the governance of these institutions, particularly their strategic direction setting and the coherence among them. They need to ensure that the mandates of these institutions are modernized to cover the many issues that are currently going unaddressed—including food security, energy policy, climate change, competition policy, and corruption—while protecting against duplication among them. They also must take seriously the commitment to allow their own macroeconomic policies to be subject to real scrutiny by the G20 and the IMF for consistency with the G20 Framework for Strong, Sustainable, and Balanced Growth. Moreover, both the United States and the EU need to take seriously the proposals for reform of these institutions and to stick with the reform process until the necessary renovations of the institutions are completed.

Third, the United States and the European Union should reaffirm their commitment to multilateralism by working to multilateralize the tangle of their own regional agreements and to adopt a set of guidelines for any further agreements that ensure that they do not detract from or undermine the multilateral system.[18] As in many other areas, the European Union and the United States have been at the forefront of regionalism. The European Union itself is a regional agreement—the largest economic free trade area in the world, followed by the North American Free Trade Agreement, linking the United States, Canada, and Mexico. Given their leadership roles in both multilateral and regional growth, the United States and Europe should also lead the way in finding a way to multilateralize these agreements, particularly the agreements they each have in common with other countries, in a manner which brings them closer to multilateralism. Currently, the United States and the EU remain each other's largest trading partners—far exceeding their trade with any other country. For example, U.S. two-way trade in goods with the EU totaled $988 billion in 2009, while its two-way trade with China was $366 billion. However, high on the list of significant trading partners for both the US and the EU are a number of countries with whom both have negotiated a free trade agreement, most notably Canada (the United States' second largest partner and Europe's fifth), South Korea (the sixth largest trading partner for both the United States and the EU) and Mexico (the fourth largest partner for the United States and tenth for the EU). If these common agreements alone could be reshaped into multilateral agreements, the United States and the EU will have done much to bring a substantial amount of trade back into the multilateral fold.

[18] The concept of "multilaterlizing" regional agreements has been much discussed in academic and other forums, including at the September 10-12 2007, conference at the WTO, "Multilateralizing Regionalism: Challenges for the Global Trading System." See in particular, Richard Baldwin's "Multilateralising Regionalism: Spaghetti Bowl as Building Blocks on the Path to Global Free Trade," *The World Economy 29* (2006).

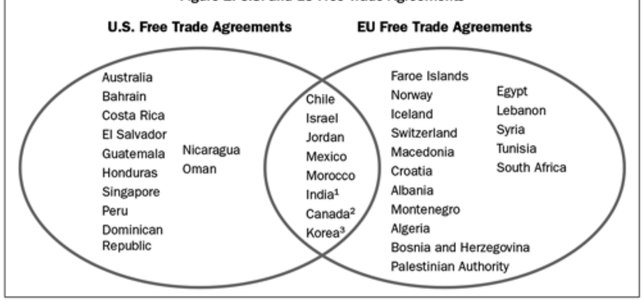
The most important contribution to be made is to agree upon principles to guide such efforts as a way of distinguishing those agreements that are acceptable within a multilateral system and those that are not. "Acceptable" agreements would include those that:

- Do not create conflicts with members' obligations under multilateral agreements, such as the WTO Agreement or the IMF's Articles of Agreement.
- Are at least as transparent as multilateral agreements.
- Require full disclosure of all the details to the multilateral institutions and subject the regional agreement to potential assessment by the relevant multilateral institution for significant inconsistencies with multilateral obligations.

With respect to trade agreements, much work has already been done in many forums on the specifics of harmonizing rules of origin, or providing opportunities to cumulate inputs into the manufacture of goods, resolving conflicts between dispute settlement provisions, mutually recognizing regulatory approvals and more.[19] The European Union and the United States need to agree to undertake this work now in order to show others that their own regional agreements can put them on the path to greater multilateral integration.

[19] See Richard Baldwin and Patrick Low, *Multilateralizing Regionalism*. Antoni Estevadeordal and Kati Suominen "Bridging Regional Trade Agreements in the Americas," Special Report on Integration and Trade, Inter-American Development Bank.

Figure 2. U.S. and EU Free Trade Agreements



Source: USTR

The United States has signed free trade agreements (FTAs) with Colombia, Korea, and Panama, but Congress must enact legislation to approve and implement each agreement in order for them to go into effect.

Source: EU Trade-European Commission (Jan. 11, 2010)

[1] Both the United States and the EU are in the process of negotiating an agreement with India.

[2] The United States and Canada have an FTA in effect. The EC and Canada negotiated a common working document in Dec. 2009; final confirmation of an FTA is pending further consultation.

[3] While the U.S. has already signed a free trade agreement with Korea, Congress has yet to enact legislation to approve it. The EC's FTA with Korea was initialed in Oct. 2009. The text of the FTA must be translated into all EU languages before the ratification process can proceed.

12 Conclusion

The way forward—for the international community as a whole, and for the transatlantic partners in particular—is now clear. To cope with the increasing complexity of world affairs, in which the challenges themselves are growing more difficult and reaching agreement among the large number of players is ever more like a huge multidimensional chess game, the institutions of global economic governance are in urgent need of renovation. The status quo is not an option—let alone the status quo ante, before the economic crisis struck. Failure to modernize the international economic institutions in all likelihood will mean watching them atrophy and decay. The end result would be even greater fragmentation of global economic governance into a patchwork of overlapping, competing, and conflicting regional and bilateral arrangements that would reduce the ability of both individual countries and the international community as a whole to act and to find solutions to the most urgent problems of the day.

This need not be the case. In spite of Copenhagen, in spite of the eight years of crisis and stalemate in the Doha Round negotiations, in spite of proliferating regionalism, it is still possible to save multilateralism and to preserve the architecture that has served the international community well. Reforms can be made to our existing institutions that both preserve the strong role and voice of the United States and European Union while simultaneously encouraging stronger participation and commitment from the emerging market countries. By acting responsibly and showing leadership in the redistribution of power, giving emerging market countries more say over the strategic direction of the existing global economic institutions, the United States and Europe can lead the way in preserving and extending the benefits of the multilateral economic order they created. By working with the emerging market countries through the mechanism of the G20 Leaders Summit, they can provide a "Council of Governors" for the global economic institutions. In this manner, the United States and the European Union can continue to provide the kind of stewardship and direction of the global economy they showed in the second half of the 20th century and that is so sorely needed amid the increasing complexities and growing challenges of the 21st.

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ANNEXES B AND C

ANNEX B

DISCLAIMER: The U.S. delegation is providing the below draft framework solely to help facilitate candid and constructive exchanges between the two sides. The current text is not a proposed international agreement and remains subject to ongoing review. In the interest of time and out of respect for the seriousness of the issues that the two sides will discuss, this document is being provided in advance of the visit and while this review is ongoing.

The U.S. delegation looks forward to discussing this draft and related issues later this week in Beijing.

BALANCING THE TRADE RELATIONSHIP

between

THE UNITED STATES OF AMERICA AND THE PEOPLE'S REPUBLIC OF CHINA

The Government of the United States of America ("United States") and the Government of the People's Republic of China ("China") have strong overlapping interests as the world's two largest economies and the major drivers of global growth. At present, the United States-China trade relationship is significantly imbalanced. United States investment and the sale of services into China remain severely constrained. China's industrial policies now targeting U.S. technologies and intellectual property pose significant economic and security concerns to the United States.

There is an immediate need for the United States and China to reduce the U.S. trade deficit with China by ensuring that China's market is open to United States traders and investors on a fair and non-discriminatory basis. China therefore undertakes to (a) eliminate improper tariff and non-tariff barriers to United States exports to China, (b) address China's policies and practices related to technology transfer and intellectual property, (c) treat United States service providers in China on terms equal to those provided to Chinese service providers in the United States, and (d) record China's agreement not to target United States farmers and agricultural products. To address these issues and restore balance in the United States–China trade relationship, there is an immediate need for the United States and China to agree on a set of concrete and verifiable actions.

SECTION 1

TRADE DEFICIT REDUCTION

China commits to work with Chinese importers to engage in trade transactions to achieve targets to which the Parties agree. These transactions are specifically designed to reduce the United States-China trade deficit by $100 billion in the twelve (12) months beginning June 1, 2018, and an additional $100 billion in the twelve (12) months beginning June 1, 2019, such that the U.S. trade deficit with China will have decreased compared to 2018 by at least $200 billion by the end of 2020. China's purchase of U.S. goods will represent at least 75% of China's commitment to a $100 billion increase in purchases of U.S. exports for the twelve months beginning June 1, 2018, and at least 50% of China's commitment to an additional $100 billion increase in purchases of U.S. exports in the twelve (12) months beginning June 1, 2019.

SECTION 2

PROTECTION OF AMERICAN TECHNOLOGY AND INTELLECTUAL PROPERTY

In order to address China's policies, laws, regulations, practices and actions that are harming United States intellectual property rights, innovation and technology development, China commits as follows:

(a) China immediately will cease providing market-distorting subsidies and other types of government support that can contribute to the creation or maintenance of excess capacity in the industries targeted by the Made in China 2025 industrial plan;

(b) by January 1, 2019, China will eliminate specified policies and practices with respect to technology transfer;

(c) China will take immediate, verifiable steps to ensure the cessation of Chinese government-conducted, Chinese government-sponsored, and Chinese government-tolerated cyber intrusions into U.S. commercial networks and cyber-enabled theft targeting intellectual property, trade secrets and confidential business information held by U.S. companies;

(d) China will strengthen specified intellectual property rights protection and enforcement;

(e) by January 1, 2019, China will eliminate the provisions of the Regulations on the Administration of the Import and Export of Technologies and the Regulations on the Implementation of the Law on Chinese-Foreign Equity Joint Ventures identified in the U.S. request for WTO consultations in *China – Certain Measures Concerning the Protection of Intellectual Property Rights* (DS542); and

(f) by July 1, 2018, China will withdraw its request for WTO consultations in *United States – Tariff Measures on Certain Goods from China* (DS543) and will take no further action related to this matter under the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU").

In addition, China will not take any retaliatory action, whether in the form of tariffs on imports of U.S. products or in any other form, including unwarranted sanitary and phytosanitary ("SPS") measures, unwarranted technical barriers to trade ("TBT") measures, antidumping and countervailing duties, and discriminatory inspection, quarantine and testing practices directed at imports of U.S. agricultural products, in response to actions taken or to be taken by the United States, including any new U.S. restrictions on investments or imports. China immediately will cease all retaliatory actions currently being pursued.

China agrees to immediately cease the targeting of American technology and intellectual property through cyber operations, economic espionage, counterfeiting, and piracy. China also agrees to abide by U.S. export control laws.

SECTION 3

RESTRICTIONS ON INVESTMENT IN SENSITIVE TECHNOLOGY

In light of China's prevailing investment restrictions and state-directed investment in sensitive U.S. technology sectors, including industrial plans such as Made in China 2025, China confirms that it will not oppose, challenge, or otherwise retaliate against the United States' imposition of restrictions on investments from China in sensitive U.S. technology sectors or sectors critical to U.S. national security.

SECTION 4

UNITED STATES INVESTMENT IN CHINA

China recognizes that China should not distort trade through investment restrictions, and that any investment restrictions or conditions imposed by China must be narrow and transparent. U.S. investors in China must be afforded fair, effective and non-discriminatory market access and treatment, including removal of the application of foreign investment restrictions and foreign ownership/shareholding requirements. In furtherance of these principles, China will issue an improved nationwide negative list for foreign investment by July 1, 2018. Within ninety (90) days of the date on which China issues this negative list, the United States will identify existing investment restrictions that deny U.S. investors fair, effective and non-discriminatory market access and treatment. Following receipt of the U.S. list of identified restrictions, China is to act expeditiously to remove all identified investment restrictions on a timetable to be decided by the United States and China.

SECTION 5

TARIFF AND NON-TARIFF BARRIERS

China's tariffs and non-tariff barriers are significantly higher than those of the United States for most tradable goods. China commits to address U.S. concerns relating to tariffs and non-tariff barriers as follows:

(a) by July 1, 2020, China will reduce its tariffs on all products in non-critical sectors to levels that are no higher than the levels of the United States' corresponding tariffs; and

(b) China will remove specified non-tariff barriers.

China also recognizes that the United States may impose import restrictions and tariffs on products in critical sectors, including sectors identified in the Made in China 2025 industrial plan.

SECTION 6

UNITED STATES SERVICES AND SERVICES SUPPLIERS

In order to achieve fair treatment with respect to U.S. services and services suppliers, China commits to improve access to its market in specified ways.

SECTION 7

UNITED STATES AGRICULTURAL PRODUCTS

In order to achieve fair treatment with respect to U.S. agricultural products, China commits to improve access to its market in specified ways.

SECTION 8

IMPLEMENTATION

China and the United States will meet quarterly to review progress in meeting agreed targets and reforms.

In the event that the United States considers that China fails to comply with any of China's commitments in this Framework, including deficit targets, China acknowledges the likelihood that the United States will impose additional tariffs or other import restrictions on Chinese products, or on the supply of services or investment, to such extent as the United States deems appropriate. China also understands that it will not oppose, challenge or take any form of action against the United States' imposition of additional tariffs or restrictions pursuant to this paragraph, including action pursuant to the DSU.

China will withdraw its WTO complaints regarding designations of China as a non-market economy by the United States and European Union (*United States – Measures Related to Price Comparison Methodologies* (DS515), *European Union – Measures Related to Price Comparison Methodologies* (DS516)) and will refrain from challenging the treatment of China as a non-market economy under the DSU in the future.

Additionally, within 15 days of receiving written notice of a prohibited product that may have been transshipped through one or more countries, with or without modification, China will provide full details of every such shipment to the suspected destination or destinations. If China fails to do so, or the information reveals that transshipping is occuring, the United States will impose tariffs equal to the amount of suspected transshipments.

China understands that if it fails to uphold any commitment under this Framework for Discussion, it is likely that the United States will impose tariffs on imports from China, and, where appropriate in the case of China's commitments under subsection (c) of Section 2 or the last paragraph in Section 2, U.S. Customs and Border Protection will confiscate counterfeit and pirated goods or levy tariffs to compensate the United States for its lost technologies and intellectual property. China commits to not take any retaliatory action in response to the imposition of tariffs or confiscations by the United States pursuant to this Section.

ANNEX C

WTO Disputes Filed Against China

1. **China — Certain Measures Concerning the Protection of Intellectual Property Rights (DS 542)**
    - Status: In consultations on 23 March 2018
    - Complainant and third parties: U.S
    - Relevant Agreements and Provisions: (TRIPS): Art. 3, 28.1(a), 28.1(b), 28.2
    - Summary: On 23 March 2018, the United States requested consultations with China concerning certain measures pertaining to the protection of intellectual property rights. Japan, the EU, Ukraine, Saudi Arabia and Taipei have requested to join the consultations.

2. **China — Subsidies to Producers of Primary Aluminum (DS 519)**
    - Status: In consultations on 12 January 2017
    - Complainant and third parties: U.S
    - Relevant Agreements and Provisions: GATT 1994: Art. XVI:1; Subsidies and Countervailing Measures: Art. 2.1(a), 2.1(c), 2.2, 5(c), 6.3(a), 6.3(b), 6.3(c), 6.3(d).
    - Summary: On 12 January 2017, the United States requested consultations with China concerning alleged subsidies that China provides to its producers of primary aluminum. Japan, Canada, Russia and the EU have requested to join the consultations as well.

3. **China — Tariff Rate Quotas for Certain Agricultural Products (DS517)**
    - Status: Panel composed 12 February 2018
    - Complainant and third parties: U.S; Australia; Brazil; Canada; Ecuador; European Union; Guatemala; India; Indonesia; Japan; Kazakhstan; Korea, Republic of; Norway; Russian Federation; Singapore; Chinese Taipei; Ukraine; Viet Nam
    - Relevant Agreements and Provisions: Protocol of Accession: Part I, para. 1.2
    - GATT 1994: Art. X:3(a), XI:1, XIII:3(b).
    - Summary: On 15 December 2016, the United States requested consultations with China concerning China's administration of its tariff rate quotas, including those for wheat, short- and medium- grain rice, long grain rice, and corn.

4. **China — Domestic Support for Agricultural Producers (DS511)**
    - Status: Panel composed on 24 June 2017
    - Complainant and third parties: U.S; Australia; Brazil; Canada; Colombia; Ecuador; Egypt; El Salvador; European Union; Guatemala; India; Indonesia;

Israel; Japan; Kazakhstan; Korea, Republic of; Norway; Pakistan; Paraguay; Philippines; Russian Federation; Saudi Arabia, Kingdom of; Singapore; Chinese Taipei; Thailand; Turkey; Ukraine; Viet Nam

- Relevant Agreements and Provisions: Agriculture: Art. 3.2, 6.3, 7.2(b).
- Summary: On 13 September 2016, the United States requested consultations with China regarding certain measures through which China appears to provide domestic support in favour of agricultural producers, in particular, to those producing wheat, India rice, Japonica rice and corn. On 22 February 2018, the Chair of the panel informed the DSB that the panel expected to issue its final report to the parties no earlier than the third-quarter of 2018, in accordance with the timetable adopted after consultation with the parties.

5. China — Duties and other Measures concerning the Exportation of Certain Raw Materials (DS 509)

- Status: Panel established, but not yet composed on 23 November 2016
- Complainant and third parties: EU; Brazil; Canada; Chile; Colombia; India; Indonesia; Japan; Korea, Republic of; Mexico; Oman; Chinese Taipei; Viet Nam; United States; Russian Federation; Norway; Kazakhstan; Singapore
- Relevant Agreements and Provisions: Protocol of Accession: , Part I, para. 5.1, Part I, para. 5.2, Part I, para. 11.3; GATT 1994: Art. X:3(a), XI:1.
- Summary: On 19 July 2016, the European Union requested consultations with China regarding China's duties and other alleged restrictions on the export of various forms of antimony, chromium, cobalt, copper, graphite, indium, lead, magnesia, talc, tantalum and tin. The European Union also considers that the measures also appear to nullify or impair the benefits accruing to the European Union directly or indirectly under the cited agreements.

6. China — Export Duties on Certain Raw Materials (DS 508)

- Status: Panel established, but not yet composed on 8 November 2016
- Complainant and third parties: U.S; Brazil; Canada; Chile; European Union; India; Indonesia; Japan; Kazakhstan; Korea, Republic of; Mexico; Norway; Russian Federation; Singapore; Chinese Taipei; Viet Nam
- Relevant Agreements and Provisions: Protocol of Accession: Part I, para. 11.3, Part I, para. 1.2, GATT 1994: Art. X:3(a), XI:1.
- Summary and key findings: On 13 July 2016, the United States requested consultations with China regarding China's export duties on various forms of antimony, cobalt, copper, graphite, lead, magnesia, talc, tantalum, and tin. The United States claims that the alleged restrictions appear to be inconsistent with Paragraphs 2(A)(2), 5.1, 11.3 of Part I of China's Accession Protocol, as well as paragraph 1.2 of the Accession Protocol (to the extent that it incorporates paragraphs 83, 84, 162 and 165 of the Report of the Working Party on the Accession of China), and Articles X:3(a) and XI:1 of the GATT 1994.

7. **China — Tax Measures Concerning Certain Domestically Produced Aircraft (DS 501)**
   - Status: In consultations on 08 December 2015
   - Complainant and third parties: U.S
   - Relevant Agreements and Provisions: GATT 1994: Art. III:2, III:4, X:1, Protocol of Accession: Part I, para. 1.2, para 2(C)(1) and 2(C)(2).
   - Summary: On 8 December 2015, the United States requested consultations with China regarding tax measures in relation to the sale of certain domestically produced aircraft in China.

8. **China — Measures Related to Demonstration Bases and common Service Platforms Programs (DS489)**
   - Status: Panel established, but not yet composed on 22 April 2015
   - Complainant and third parties: U.S; European Union; Australia; Canada; India; Korea, Republic of; Brazil; Japan; Russian Federation; Colombia; Singapore; Chinese Taipei; Saudi Arabia, Kingdom of; Dominican Republic.
   - Relevant Agreements and Provisions: Subsidies and Countervailing Measures: Art. 3.1(a), 3.2.
   - Summary: On 11 February 2015, the United States requested consultations with China with regard to certain measures providing subsidies contingent upon export performance to enterprises in several industries in China. On 14 April 2016, China and the United States informed the DSB that they had reached an agreement in relation to this dispute in the form of a Memorandum of Understanding.

9. **China - Anti-Dumping Measures on Imports of Cellulose Pulp from Canada (DS483)**
   - Status: decided in favor of the complainant, Panel decision adopted by the DSB on May 22, 2017; implementation notified by respondent on 11 January 2018
   - Complainant and third parties: Canada; Brazil, Chile, EU, Japan, Korea, Norway, Singapore, Uruguay, U.S
   - Relevant Agreements and Provisions: Anti-dumping (Article VI of GATT 1994): Art. 1, 2.1, 2.2, 2.2.1.1, 2.2.2, 2.4, 3.1, 3.2, 3.4, 3.5, 4.1, 6.2, 6.8, 6.9, 6.10, 6.10.2, 8.1, 8.3, 12.2, 12.2.2, 9.4, Annex II; GATT 1994: Art. VI
   - Summary and key findings: This dispute concerned the anti-dumping measure imposed by China on imports of cellulose pulp originating from Canada. Canada challenged MOFCOM's determination of injury in the anti-dumping investigation at issue. Canada requested that the Panel find that the measure at issue is inconsistent with China's obligations under Articles 3.1, 3.2, 3.4, and 3.5 of the Anti-Dumping Agreement, and as a consequence also inconsistent with Article 1 of the Anti-Dumping Agreement and Article VI of the GATT 1994. The Panel upheld some of Canada's claims and rejected others, ruling in a number of

instances that MOFCOM has failed to adequately explain its anti-dumping findings.The Panel also upheld Canada's consequential claims that China acted inconsistently with Article 1 of the Anti-Dumping Agreement and Article VI of the GATT 1994.

10. China — Measures Imposing Anti-Dumping Duties on High-Performance Stainless Steel Seamless Tubes ("HP-SSST") from the European Union (DS460, DS 454)

- Status: Report(s) adopted, with recommendation to bring measure(s) into conformity on 28 October 2015
- Complainant and third parties: EU; Japan; Korea, Republic of; India; Turkey; United States
- Relevant Agreements and Provisions: Anti-dumping (Article VI of GATT 1994): Art. 1, 2.2, 2.4, 2.4.2, 3.1, 3.2, 3.4, 3.5, 6.4, 6.5, 6.5.1, 6.7, 6.9, 7.4, 12.2, 12.2.2, Annex I, Annex II; GATT 1994: Art. VI
- Summary and key findings:
  ADA Arts. 2.2.1 and 2.2.2—the Appellate Body upheld much of the Panel's finding in that China had acted inconsistently with ADA and in one instance, completed the legal analysis and found that China acted inconsistently with the ADA's injury provisions and its requirement to disclose the essential facts underlying MOFCOM's dumping determination.
  The Panel also made findings of inconsistency with ADA Arts. 1, 2.4, 7.4, 12.2, 12.2.2, 6.8 and Paragraph 1 of Annex II that were not appealed.

11. China — Measures Relating to the Production and Exportation of Apparel and Textile Products (DS451)

- Status: In consultations on 15 October 2012
- Complainant and third parties: Mexico
- Relevant Agreements and Provisions: Agriculture: Art. 3, 9, 10; GATT 1994: Art. III:4, XVI; Subsidies and Countervailing Measures: Art. 1, 1.1(a), 1.1(b), 2, 2.1, 2.2, 2.3, 3.1(a), 3.1(b), 4.2, 5(c), 6.3(b), 6.3(c), 6.4, 6.5, 7.2; Protocol of Accession: Part I, para. 1.2
- Summary: On 15 October 2012, Mexico requested consultations with China concerning measures that allegedly support producers and exporters of apparel and textile products. Measures cited include tax exemptions for certain enterprises, reduction of import duties and VAT for purchase of equipment by certain groups of enterprises and those located in certain regions, measures contingent on use of Chinese goods and contingent on export performance, low cost loans by state-owned banks to certain industries, preferential land use rights, discounted electricity rates, support for production, sale and transportation provided to cotton farmers and the Chinese petrochemical industry, and cash payments from government agencies.

12. China — Certain Measures Affecting the Automobile and Automobile-Parts Industries (DS 450)

- Status: In consultations on 17 September 2012
- Complainant and third parties: U.S
- Relevant Agreements and Provisions: GATT 1994: Art. XVI:1; Subsidies and Countervailing Measures: Art. 25.1, 25.2, 25.3, 25.4; Protocol of Accession: Part I, para. 1.2
- Summary: On 17 September 2012, the United States requested consultations with China concerning certain measures providing subsidies in the form of grants, loans, forgone government revenue, the provision of goods and services, and other incentives contingent upon export performance to automobile and automobile-parts enterprises in China.

13. China — Anti-Dumping and Countervailing Duties on Certain Automobiles from the United States (DS440)

- Status: Report(s) adopted, no further action required on 18 June 2014
- Complainant and third parties: U.S; Colombia; European Union; India; Japan; Korea, Republic of; Oman; Turkey; Saudi Arabia
- Relevant Agreements and Provisions: Anti-dumping (Article VI of GATT 1994): Art. 1, 3.1, 3.2, 3.4, 3.5, 4.1, 5.3, 5.4, 6.2, 6.5.1, 6.8, 6.9, Annex II; GATT 1994: Art. VI; Subsidies and Countervailing Measures: Art. 10, 11.3, 11.4, 12.4.1, 12.7, 12.8, 15.1, 15.2, 15.4, 15.5, 16.1, 22.3, 22.5
- Summary and key findings:
  ADA Art. 6—the Panel found a variety of violations for failures with respect to non-confidential information and failures to disclose essential facts. The Panel also found that MOFCOM had failed to give public notice of the findings and conclusions and had failed to base its price effects and causation analyses on an objective examination based on positive evidence, inconsistently with these provisions.

14. China — Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum (DS 433, DS 432, DS 431)

- Status: Implementation notified by respondent on 20 May 2015
- Complainant and third parties: Japan; Brazil; Canada; Colombia; European Union; India; Korea, Republic of; Norway; Oman; Saudi Arabia, Kingdom of; Chinese Taipei; United States; Viet Nam; Argentina; Australia; Indonesia; Turkey; Peru; Russian Federation
- Relevant Agreements and Provisions: GATT 1994: Art. VII, VIII, X, XI, XI:1, X:3(a); Protocol of Accession: Part I, para. 5.2, Part I, para. 5.1, Part I, para. 8.2, , Part I, para. 1.2, Part I, para. 7.2, Part I, para. 11.3
- Summary and key findings:

Accession Protocol/Marrakesh Agreement/GATT Art. XX—the Panel found that China's export duties on rare earths, tungsten, and molybdenum were inconsistent with its Accession Protocol.
The Panel also found that China's export quotas on rare earths, tungsten, and molybdenum were inconsistent with GATT Art. XI but concluded that the export quotas were not justified under the exception in GATT Art. XX(g), which allows WTO Members to implement GATT-inconsistent measures "relating to the conservation of exhaustible natural resources". The Panel found that China maintained restrictions (minimum registered capital, prior export experience and export performance) on the trading rights of enterprises exporting rare earths and molybdenum contrary to paras. 83 and 84 of China's Working Party Report. The Panel also found that China was entitled to seek to justify these breaches pursuant to Art. XX(g). However, China failed to make a prima facie case that such requirements were justified pursuant to Art. XX(g).

15. China — China — Anti-Dumping and Countervailing Duty Measures on Broiler Products from the United States (DS 427)

- Status: Compliance proceedings completed with finding(s) of non-compliance on 28 February 2018
- Complainant and third parties: U.S; European Union; Japan; Norway; Thailand; Saudi Arabia, Kingdom of; Chile; Mexico
- Relevant Agreements and Provisions: Anti-dumping (Article VI of GATT 1994): Art. 1, 2.2, 2.2.1.1, 2.4, 3.1, 3.2, 3.4, 3.5, 4.1, 5.1, 6.2, 6.4, 6.5.1, 6.8, 6.9, 12.2, 12.2.1, 12.2.2, 12.7, Annex II; GATT 1994: Art. VI, VI:3; Subsidies and Countervailing Measures: Art. 10, 11.1, 12.3, 12.4.1, 12.7, 12.8, 15.1, 15.2, 15.4, 15.5, 16.1, 19.4, 22.3, 22.4, 22.5
- Summary and key findings:
  ADA Art. 6—the Panel found that China's Ministry of Commerce (MOFCOM) had failed to provide an opportunity for interested parties with adverse interests to meet and present their views, that the non-confidential summaries of the information redacted from the confidential version of the Petition did not provide a reasonable understanding of the information submitted in confidence, and that MOFCOM had failed to disclose certain essential facts.
  ADA Art. 2.2.1.1—the Panel found that MOFCOM had improperly rejected the cost allocations in the normal books and records of two of the respondents as it did not explain its reasons for doing so.
  ADA Art. 6.8 and ASCM Art. 12.7—the Panel concluded that the United States made a prima facie case that the rates applied were in contravention of Arts. 6.8 and 12.7.
  ASCM Art. 19.4 and GATT Art. VI:3—the Panel found that MOFCOM improperly calculated the amount of per unit subsidization.

ADA Art. 3/ASCM Art. 15—the Panel determined that MOFCOM acted inconsistently with ADA Arts. 3.1/15.1 and 3.2/15.2 when it compared domestic and import prices with a different product mix in its price effects analysis. ADA Arts. 12.2 and 12.2.2 and ASCM Arts. 22.3 and 22.5—the Panel found that MOFCOM had failed to disclose "in sufficient detail the findings and conclusions reached on all issues of fact and law considered material" or "all relevant information on matters of fact" in its determinations with respect to the "all others" rate; and failed to explain in its final determinations its reasons for rejecting certain arguments made by US interested parties before MOFCOM.

16. China — Definitive Anti-Dumping Duties on X-Ray Security Inspection Equipment from the European Union (DS 425)

- Status: Implementation notified by respondent on 26 February 2014
- Complainant and third parties: EU; Japan; United States; Thailand; Norway; India; Chile
- Relevant Agreements and Provisions: Anti-dumping (Article VI of GATT 1994): Art. 2.4, 2.6, 3.1, 3.2, 3.4, 3.5, 6.1, 6.2, 6.4, 6.5, 6.5.1, 6.9, 12.2.1, 12.2.2
- GATT 1994: Art. VI:1, VI:6
- Summary and key findings:
  ADA Art. 3—the Panel held that MOFCOM's price undercutting and price suppression analyses were inconsistent with Arts. 3.1 and 3.2.; that the price effects analysis was not based on an objective examination of positive evidence, as MOFCOM had failed to ensure that the prices it was comparing as part of its price effects analysis were comparable; and that MOFCOM acted inconsistently with Arts. 3.1 and 3.4 because of its failure to consider all relevant economic factors.
  ADA Art. 6.5.1—the Panel upheld the majority of the European Union's claims that the non-confidential summaries were inadequate to permit a reasonable understanding of the substance of the information submitted in confidence and that MOFCOM had failed to disclose certain essential facts to interested parties.
  ADA Art. 12.2.2—the Panel found that MOFCOM's failure to include in its public notice relevant information regarding its price effects analysis and the factual basis for the determination of the residual rate was contrary to the first sentence of Art. 12.2.2, also that MOFCOM's public notice violated the second sentence of Art. 12.2.2 as it failed to explain why it had rejected certain arguments regarding the treatment of domestic sales to affiliated distributors. Other aspects of the European Union's claim under Art. 12.2.2 were not upheld by the Panel.

17. China — Measures concerning wind power equipment (DS 419)

- Status: In consultations on 22 December 2010
- Complainant and third parties: U.S

- Relevant Agreements and Provisions: GATT 1994: Art. XVI:1; Subsidies and Countervailing Measures: Art. 3, 25.1, 25.2, 25.3, 25.4; Protocol of Accession: Part I, para. 1.2
- Summary and key findings: On 22 December 2010, the United States requested consultations with China concerning certain measures providing grants, funds, or awards to enterprises manufacturing wind power equipment (including the overall unit, and parts thereof) in China. The United States indicated that the measures appear to provide grants, funds, or awards that are contingent on the use of domestic over imported goods. In addition, the United States considered that, as China has not notified these measures, it appears to have failed to comply with Article XVI:1 of the GATT 1994 and Article 25.1, 25.2, 25.3 and 25.4 of the SCM Agreement. The United States also alleged that, as China has not made available a translation of these measures into one or more of the official languages of the WTO, it also appears to have failed to comply with its obligation under Part I, Paragraph 1.2, of its Protocol of Accession (to the extent that it incorporates paragraph 334 of the Report of the Working Party on the Accession of China).

18. China — Countervailing and Anti-Dumping Duties on Grain Oriented Flat-rolled Electrical Steel from the United States (GOES) (DS 414)

- Status: Report(s) adopted, with recommendation to bring measure(s) into conformity on 12 November 2012
- Complainant and third parties: U.S; Argentina; European Union; Honduras; India; Japan; Korea, Republic of; Saudi Arabia, Kingdom of; Viet Nam; Russian Federation
- Relevant Agreements and Provisions: Anti-dumping (Article VI of GATT 1994): Art. 1, 3.1, 3.2, 3.5, 6.5.1, 6.8, 6.9, 12.2, 12.2.2, Annex II; GATT 1994: Art. VI; Subsidies and Countervailing Measures: Art. 10, 11.2, 11.3, 12.4.1, 12.7, 12.8, 15.1, 15.2, 15.5, 22.3, 22.5
- Summary and key findings: The measure at issue was China's imposition of anti-dumping and countervailing duties on grain oriented flat-rolled electrical steel from the United States
  ASCM Arts. 11.2 and 11.3—the Panel concluded MOFCOM initiated countervailing duty investigations into 11 programs without sufficient evidence to justify it, contrary to Art. 11.3.
  ADA Art. 6.8 and Annex II para. 1/ASCM Art. 12.7—the Panel found that MOFCOM improperly resorted to facts available to calculate the "all others" dumping margin and subsidies rate for unknown exporters.
  ADA Art. 3/ASCM Art. 15—the Appellate Body upheld the Panel's finding that MOFCOM wrongly relied on the "low price" of subject imports relative to domestic prices in reaching its price effects finding, as the evidence available could not have allowed an objective and impartial investigating authority to determine that subject imports were priced lower than domestic products.

ADA Art. 6/ASCM Art. 12—the Panel found deficiencies in MOFCOM's essential facts disclosure in connection with the resort of facts available, the price effects analysis and the causation analysis with respect to non-subject imports, contrary to ADA Art. 6.9 and ASCM Art. 12.8. The Appellate Body upheld the finding with respect to price effects. The Panel also found that MOFCOM failed to require the applicants to furnish non-confidential summaries in sufficient detail to permit a reasonable understanding of the substance of the information submitted in confidence, contrary to ADA Art. 6.5.1 and ASCM Art. 12.4.1.

19. China — Countervailing and Anti-Dumping Duties on Grain Oriented Flat-rolled Electrical Steel from the United States (GOES) (Art. 21.5) (DS 414)

- Status: Report(s) adopted, with recommendation to bring measure(s) into conformity on 31 August 2015
- Complainant and third parties: U.S; Argentina; European Union; Honduras; India; Japan; Korea, Republic of; Saudi Arabia, Kingdom of; Viet Nam; Russian Federation
- Relevant Agreements and Provisions: Anti-dumping (Article VI of GATT 1994): Art. 3.1, 3.2, 3.4, 3.5, 6.9, 12.2, 12.2.2; Subsidies and Countervailing Measures: Art. 12.8, 15.1, 15.2, 15.4, 15.5, 22.3, 22.5
- Summary and key findings: Measure at issue: Measures taken by China to implement the DSB recommendations and rulings in China – GOES, as set forth in MOFCOM's Redetermination issued on 31 July 2013. The key findings were as follows:
  ADA Art.3/ASCM Art.15—the Panel found this claim was not properly before it as it pertained to a matter that could have been raised in the original proceedings but was not, and it could not now be raised in compliance proceedings. The Panel found several aspects of MOFCOM's causation determination to be inconsistent with these provisions.
  ADA Art.6.9/ASCM Art.12/Art. 22—the Panel upheld some claims raised by the United States while rejecting others. The Panel also found that the claims regarding inadequate public notice related to aspects of MOFCOM's Redetermination on which the Panel had already found a substantive violation. Thus, the Panel exercised judicial economy on these claims.

20. China — Certain Measures Affecting Electronic Payment Services (DS 413)

- Status: Implementation notified by the Respondent on 23 July 2013
- Complainant and third parties: U.S; Australia; Ecuador; European Union; Guatemala; Japan; Korea, Republic of; India
- Relevant Agreements and Provisions: Services (GATS): Art. XVI, XVI:1, XVI:2(a), XVII
- Summary and key findings:
  The United States alleged that China permits only a Chinese entity (China UnionPay) to supply electronic payment services for payment card transactions

denominated and paid in renminbi and also requires all payment card processing devices to be compatible with that entity's system and bear that company's logo. It further argued that the Chinese entity has guaranteed access to all merchants while foreign services suppliers must negotiate for access to merchants.
Classification of the services at issue: The Panel found that electronic payment services for payment card transactions are classifiable under Subsector 7.B(d) of China's Services Schedule, which reads "[a]ll payment and money transmission services, including credit, charge, and debit cards, travellers cheques and bankers drafts (including import and export settlement)".
Scope of China's GATS commitments: The Panel rejected the United States' view that China's Schedule includes a cross-border (mode 1) market access commitment to allow the supply of EPS into China by foreign EPS suppliers. The Panel found, however, that China's Schedule includes a market access commitment that allows foreign EPS suppliers to supply their services through commercial presence (mode 3) in China, so long as a supplier meets certain qualifications requirements related to local currency business. The Panel further found that China's Schedule contains a full national treatment commitment for the cross-border supply of EPS (mode 1) as well as a commitment under mode 3 (commercial presence) that is subject to certain qualifications requirements related to local currency business.
GATS Art. XVI—the Panel rejected on the basis of lack of evidence that China maintains China UnionPay (CUP) as an across-the-board monopoly supplier for the processing of all domestic RMB payment card transactions. The Panel found, however, that China acted inconsistently with GATS Art. XVI:2(a) in view of its mode 3 market access commitment by granting CUP a monopoly for the clearing of certain RMB payment card transactions
GATS Art. XVII of the GATS—the Panel found that some of the relevant requirements, namely the requirements that all bank cards issued in China must bear the Yin Lian/UnionPay logo, that all terminal equipment in China must be capable of accepting Yin Lian/UnionPay logo cards, and that acquirers of transactions for payment card companies post the Yin Lian/UnionPay logo and be capable of accepting payment cards bearing that logo, are each inconsistent with China's national treatment obligations under Art. XVII.

21. China — Measures Related to the Exportation of Various Raw Materials (DS 398, DS 395, DS 394)

- Status: Implementation notified by the Respondent on 28 January 2013
- Complainant and third parties: Mexico; EU; U.S; Argentina; Brazil; Canada; Chile; Colombia; Ecuador; India; Japan; Korea, Republic of; Norway; Chinese Taipei; Turkey; Saudi Arabia, Kingdom of
- Relevant Agreements and Provisions: GATT 1994: Art. VIII, VIII:1, VIII:4, X, X:1, X:3, XI, XI:1; Protocol of Accession: Part I, para. 1.2, Part I, para. 5.1, Part I, para. 5.2, Part I, para. 8.2, Part I, para. 11.3.

- Summary and key findings: On 21 August 2009, Mexico requested consultations with China with respect to China's restraints on the export from China of various forms of raw materials. Mexico cites 32 measures through which China allegedly imposes restraints on the exports in question and note that there appear to be additional unpublished restrictive measures.
  DSU Art. 6.2—Based on these procedural grounds, the Appellate Body declared a number of the Panel's findings with respect to the additional restrictions "moot and of no legal effect"
  China's Accession Protocol, para. 11.3—the Appellate Body upheld the Panel's recommendation that China bring its export duty and export quota measures into conformity with its WTO obligations such that the "series of measures" did not operate to bring about a WTO-inconsistent result.
  GATT Art. XX—the Appellate Body upheld the Panel's finding that there is no basis in China's Accession Protocol to allow the application of Art. XX to China's obligations under para.11.3 of the Protocol. The Panel had concluded that China's export restraints were not justified pursuant to Arts. XX(b) and (g). These findings were not appealed.
  GATT Art. XI—the Appellate Body upheld the Panel's conclusion that China had not demonstrated that its export quota on refractory-grade bauxite was "temporarily applied" to either prevent or relieve a "critical shortage", within the meaning of Art. XI:2(a). The Panel concluded that the failure by China to publish promptly the decision not to authorize an export quota for zinc was inconsistent with Art. X:1. This conclusion was not appealed.

22. China — Grants, Loans and Other Incentives (DS 390)

- Status: In consultations on 19 January 2009
- Complainant and third parties: Guatemala
- Relevant Agreements and Provisions: Agriculture: Art. 3, 8, 9, 10; GATT 1994: Art. III:4; Subsidies and Countervailing Measures: Art. 3; Protocol of Accession: Part I, para. 1.2, Part I, para. 12.1.
- Summary and key findings: In 2009, Guatemala requested consultations with China with regard to certain measures offering grants, loans and other incentives to enterprises in China that are contingent upon export performance. Additionally, to the extent that these measures provide subsidies for agricultural products, they appear to be inconsistent with Articles 3, 8, 9, and 10 of the Agreement on Agriculture. Finally, the grants, loans, and other incentives appear to be inconsistent with Article III:4 of the GATT 1994 to the extent that the measures benefit products of Chinese origin but not imported products.

23. China — Grants, Loans and Other Incentives (DS 388, DS 387)

- Status: In consultations on 19 December 2008
- Complainant and third parties: Mexico, U.S

- Relevant Agreements and Provisions: Agriculture: Art. 3, 8, 9, 10; GATT 1994: Art. III:4; Subsidies and Countervailing Measures: Art. 3; Protocol of Accession: Part I, para. 1.2, Part I, para. 12.1.
- Summary and key findings: same as above, different dates and complainant. Guatemala among others also requested to join the consultations in 2009. China informed the DSB that it had accepted the requests of Australia, Canada, Colombia, Ecuador, the European Communities, Guatemala, New Zealand, Turkey and the United States to join the consultations.

24. China — Measures Affecting Financial Information Services and Foreign Financial Information Suppliers (DS 378)

- Status: Settled or terminated (withdrawn, mutually agreed solution) on 20 June 2008
- Complainant and third parties: Canada
- Relevant Agreements and Provisions: Services (GATS): Art. XVI, XVII, XVIII; Protocol of Accession: Part I, para. 1.2
- Summary and key findings: Canada makes claims against a number of Chinese measures affecting financial information services and foreign financial information service suppliers in China. Such measures include no fewer than a dozen legal and administrative instruments which require foreign financial information suppliers to supply their services through an entity designated by Xinhua News Agency (Xinhua). Xinhua has designated only one such agent, China Economic Information Service (CEIS), one of Xinhua's commercial enterprises.
- Canada also claims that China is preventing foreign financial information service suppliers from establishing any commercial presence in China other than limited representative offices. Canada therefore considers that the measures at issue are inconsistent with Articles XVI, XVII and XVIII of the GATS, the horizontal standstill commitment contained in China's Schedule of obligations under the GATS, and China's Accession Protocol.

  On 4 December 2008, China and Canada informed the DSB that they had reached an agreement in relation to this dispute in the form of a Memorandum of Understanding:

  China confirms that the State Council will, by 31 January 2009, authorize a new regulator of financial information services (the "new regulator") and that the new regulator will be a governmental entity separate from, and not accountable to, any supplier of financial information services. The new regulator, within its mandate, will have the authority to require that suppliers of financial information services comply with all relevant Chinese laws, regulations, and departmental rules.

  China confirms that a legal instrument (the "new measures") will be promulgated by 30 April 2009 to replace the 2006 Measures, effective no later than 1 June 2009.

China confirms that under the new measures, a new licensing system will be applied to foreign suppliers of financial information services. China further confirms that this new licensing system will conform to the commitments that China made in paragraph 308 of the Working Party Report to the Protocol of Accession.
China confirms that it will accord foreign financial information services and foreign suppliers no less favorable treatment than that accorded to Chinese financial information services and service suppliers.
China clarifies that Chinese laws, regulations, and departmental rules do not impose any prohibitions on the supply, through commercial presence, of financial information services.

25. China — Measures Affecting Financial Information Services and Foreign Financial Information Suppliers (DS 373)

- Status: Settled or terminated (withdrawn, mutually agreed solution) on 4 December 2008
- Complainant and third parties: U.S
- Relevant Agreements and Provisions: Services (GATS): Art. XVI, XVII, XVIII; Protocol of Accession: Part I, para. 1.2
- Summary and key findings: same as above.

26. China — Measures Affecting Financial Information Services and Foreign Financial Information Suppliers (DS 372)

- Status: Settled or terminated (withdrawn, mutually agreed solution) on 4 December 2008
- Complainant and third parties: EU
- Relevant Agreements and Provisions: Services (GATS): Art. XVI: 2(a), XVI:2(b), XVII, XVIII; Protocol of Accession: Part I, para. 1.2
- Summary and key findings: same as above.

27. China — Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products (DS 363)

- Status: Implementation notified by Respondent on 24 May 2012
- Complainant and third parties: U.S; Australia; European Communities; Japan; Korea, Republic of; Chinese Taipei
- Relevant Agreements and Provisions: Services (GATS): Art. XVI, XVII; GATT 1994: Art. III:4, XI:1; Protocol of Accession: Part I, para. 1.2, Part I, para. 5.1, Part I, para. 5.2
- Summary and key findings: On 10 April 2007, the United States requested consultations with China concerning: (1) certain measures that restrict trading rights with respect to imported films for theatrical release, audiovisual home entertainment products (e.g. video cassettes and DVDs), sound recordings and

publications (e.g. books, magazines, newspapers and electronic publications); and (2) certain measures that restrict market access for, or discriminate against, foreign suppliers of distribution services for publications and foreign suppliers of audiovisual services (including distribution services) for audiovisual home entertainment products.

- Regarding trading rights, on various Chinese measures that reserve, to certain Chinese state-designated and wholly or partially state-owned enterprises, the right to import films for theatrical release, audiovisual home entertainment products, sound recordings and publications;
- Regarding distribution services, on various Chinese measures that impose market access restrictions or discriminatory limitations on foreign service providers seeking to engage in the distribution of publications and certain audiovisual home entertainment products.

China's Accession Protocol—the Panel found that provisions in China's measures that either limit to wholly State-owned enterprises importation rights regarding, or prohibit foreign-invested enterprises in China from importing, reading materials, AVHE products, sound recordings, and films, were inconsistent with China's obligation, under paras. 1.2 and 5.1 of China's Accession Protocol and paras. The Appellate Body upheld the Panel's findings that the relevant provisions of the measures were subject to, and inconsistent with, China's trading rights commitments.

GATT Art. XX(a)—the Appellate Body found that, by virtue of the introductory clause of para. 5.1 of China's Accession Protocol, China could, in this dispute, invoke Art. XX(a) to justify provisions found to be inconsistent with China's trading rights commitments under its Accession Protocol and Working Party Report.The Appellate Body upheld the Panel's conclusion that China had not demonstrated that the relevant provisions were "necessary" to protect public morals, and that, as a result, China had not established that these provisions were justified under Art. XX(a).

GATS Arts. XVI and XVII—the Panel concluded that China's measures regarding distribution services for reading materials and AVHE products, as well as electronic sound recordings, were inconsistent with China's market access or national treatment commitments in respect of Arts. XVI and XVII, respectively. The Appellate Body upheld the Panel's finding that China's measures prohibiting foreign-invested entities from engaging in the distribution of sound recordings in electronic form were inconsistent with the national treatment obligation in Art. XVII.

GATT Art. III:4—the Panel found that certain Chinese measures affecting the distribution of imported reading materials were inconsistent with Art. III:4. These findings were not appealed.

On 9 May 2012, China and the United States informed the DSB of key elements relating to films for theatrical release as set forth in the Memorandum of Understanding mentioned at the DSB meeting on 22 February 2012. At the DSB meeting on 24 May

2012, China said that it had taken all necessary steps and had thus complied with the DSB recommendations. The United States said that the Memorandum of Understanding represented significant progress but not a final resolution.

28. China — Measures Affecting the Protection and Enforcement of Intellectual Property Rights (DS 362)

- Status: Implementation notified by Respondent on 19 March 2010
- Complainant and third parties: U.S; Argentina; Australia; Brazil; Canada; European Communities; India; Japan; Korea, Republic of; Mexico; Chinese Taipei; Thailand; Turkey
- Relevant Agreements and Provisions: TRIPS: Art. 3.1, 9.1, 14, 41.1, 46, 59, 61
- Summary and key findings: The four matters on which the United States requests consultations are:
    - the thresholds that must be met in order for certain acts of trademark counterfeiting and copyright piracy to be subject to criminal procedures and penalties;
    - goods that infringe intellectual property rights that are confiscated by Chinese customs authorities, in particular the disposal of such goods following removal of their infringing features;
    - the scope of coverage of criminal procedures and penalties for unauthorized reproduction or unauthorized distribution of copyrighted works; and
    - the denial of copyright and related rights protection and enforcement to creative works of authorship, sound recordings and performances that have not been authorized for publication or distribution within China.

  TRIPS Art. 61—the Panel found that while China's criminal measures exclude some copyright and trademark infringements from criminal liability where the infringement falls below numerical thresholds fixed in terms of the amount of turnover, profit, sales or copies of infringing goods.

  TRIPS Art. 59—the Panel found that the customs measures were not subject to Trips Agreement Arts. 51 to 60 to the extent that they apply to exports. The Panel concluded that the way in which China's customs auctions these goods was inconsistent with Art. 59.

  TRIPS Art. 9.1/ TRIPS Art. 41.1—the Panel found that while China has the right to prohibit the circulation and exhibition of works, this does not justify the denial of all copyright protection in any work. China's failure to protect copyright in prohibited works (i.e. that are banned because of their illegal content) is therefore inconsistent with Art. 5(1) of the Berne Convention as incorporated in Art. 9.1, as well as with Art. 41.1, as the copyright in such prohibited works cannot be enforced.

29. China — Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments (DS 359)

- Status: Settled or terminated (withdrawn, mutually agreed solution) on 7 February 2008
- Complainant and third parties: Mexico; Argentina; Australia; Canada; Chile; Colombia; Egypt; European Union; Japan; Chinese Taipei
- Relevant Agreements and Provisions: GATT 1994: Art. III:4; Subsidies and Countervailing Measures: Art. 3, 3.1(b), 3.2; Trade-Related Investment Measures (TRIMs): Art. 2, 2.1, Annex 1; Protocol of Accession: Part I, para. 1.2, Part I, para. 7.2, Part I, para. 7.3, Part I, para. 10.3
- Summary and key findings: The request for consultations identifies various measures, including any amendments and any related or implementing measures. There were several clarifications and affirmations made in the memorandum of understanding, although there were no new commitments: China has explained that legal instruments of at least equal legal stature to the circulars identified in the complaints will contain provisions stating that these circulars are repealed, and will be issued by the competent authorities, by 31 December 2007, effective no later than 1 January 2008. China confirms that the tax preferences under the circulars identified will not be reinstated.
  Article 3 provided an exemption for certain foreign-invested enterprises from payments to the State for worker allowances. China has explained that, at the time the State Council promulgated the State Council Provisions, Article 11 of the State Council Regulations on Labor Management in Sino-Foreign Joint Ventures, GuoFa [1980] No. 199 (26 July 1980), required foreign-invested enterprises to make such payments to the State. China has confirmed, however, that because this requirement was eliminated by the State Council Decision on Abolition of Certain Administrative Regulations Promulgated Prior to the End of 2000, Order [2001] No. 319 (6 October 2001), the exemption provided under Article 3 of the State Council Provisions is no longer operative. China confirms that Article 3 of the State Council Provisions may no longer serve as a legal basis to exempt foreign-invested enterprises from making payments required by Chinese law, regulation, or other official measure.
  WTO-consistency of value-added tax (VAT) refunds: China has stated that these circulars do not create a preference, either in law or on a de facto basis, for the use of domestic over imported goods in connection with purchases of domestically-produced equipment. China also confirmed that it will ensure that imported equipment receives VAT treatment under terms and conditions no less favorable than those applicable to domestically-produced equipment.

30. China — Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments (DS 359)

- Status: Settled or terminated (withdrawn, mutually agreed solution) on 19 December 2007
- Complainant and third parties: U.S; Argentina; Australia; Canada; Chile; Colombia; Egypt; European Union; Japan; Chinese Taipei

- Relevant Agreements and Provisions: GATT 1994: Art. III:4; Subsidies and Countervailing Measures: Art. 3, 3.1(b), 3.2; Trade-Related Investment Measures (TRIMs): Art. 2, 2.1, Annex 1; Protocol of Accession: Part I, para. 1.2, Part I, para. 7.2, Part I, para. 7.3, Part I, para. 10.3
- Summary and key findings: same as DS 359

31. China — Measures Affecting Imports of Automobile Parts (DS 342, DS 340, DS 339)

- Status: Implementation notified by respondent on 31 August 2009
- Complainant and third parties: Canada; Argentina; Australia; Brazil; Japan; Mexico; Chinese Taipei; Thailand
- Relevant Agreements and Provisions: GATT 1994: Art. II, II:1, III, III:1, III:2, III:4, III:5, X:1, X:3; Rules of Origin: Art. 2; Subsidies and Countervailing Measures: Art. 3, 3.1(b), 3.2; Trade-Related Investment Measures (TRIMs): Art. 2, 2.1; Protocol of Accession: Part I, para. 1.2, Part I, para. 7.2, Part I, para. 7.3
- Summary and key findings: Measure at issue: Three legal instruments enacted by China which impose a 25 per cent "charge" 3 on imported auto parts "characterized as complete motor vehicles" based on specified criteria.
- Key findings: The Appellate Body upheld the Panel's characterization of the charge as an "internal charge" (Art. III:2), rather than as an "ordinary customs duty" (first sentence, Art. II:1(b)

  GATT Arts. III—the Appellate Body upheld the Panel's findings that the measures violated: (i) Arts. III:2 because they imposed an internal charge on imported auto parts that was not imposed on like domestic auto parts; and (ii) Art. III:4 because they accorded imported parts less favorable treatment than like domestic auto parts by, inter alia, subjecting only imported parts to additional administrative procedures.

  GATT Arts. II—the Panel found that, even if the "charge" were an ordinary customs duty, it was still inconsistent with Art. II:1(a) and (b) because it corresponded to the tariff rate for motor vehicles (25 per cent), in excess of the applicable tariff rate for auto parts (10 per cent) under China's Schedule. The Panel rejected China's argument that a rule under the HS would allow auto parts to be classified as complete motor vehicles.

  GATT Arts. XX—the Panel rejected China's defense of its measures under Art. XX(d) because China had not proven that the measures were "necessary to secure compliance" with its Schedule.

32. China — Value-Added Tax on Integrated Circuits

- Status: Settled or terminated (withdrawn, mutually agreed solution) on 5 October 2005
- Complainant and third parties: U.S
- Relevant Agreements and Provisions: Services (GATS): Art. XVII; GATT 1994: Art. I, III

- <u>Summary and key findings:</u> On 18 March 2004, the United States requested consultations with China concerning China's preferential value-added tax ("VAT") for domestically-produced or designed integrated circuits ("IC").
  The United States claims that, although China provides for a 17 percent VAT on ICs, enterprises in China are entitled to a partial refund of the VAT on ICs that they have produced, resulting in a lower VAT rate on their products. China also allows for a partial refund of VAT for domestically-designed ICs that, because of technological limitations, are manufactured outside of China. China thus appears to be subjecting imported ICs to higher taxes than applied to domestically produced ICs and to be according less favorable treatment to imported ICs.
  According to the notification to the DSB on 14 July 2004, China agreed to amend or revoke the measures at issue to eliminate the availability of VAT refunds on ICs produced and sold in China and on ICs designed in China but manufactured abroad by 1 November 2004 and 1 September 2004 respectively.
  On 5 October 2005, China and the United States informed the DSB that they were in agreement that the terms of the agreement had been successfully implemented.

Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective

John Hurley, Scott Morris, and Gailyn Portelance

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Abstract

China's Belt and Road Initiative (BRI) hopes to deliver trillions of dollars in infrastructure financing to Asia, Europe, and Africa. If the initiative follows Chinese practices to date for infrastructure financing, which often entail lending to sovereign borrowers, then BRI raises the risk of debt distress in some borrower countries. This paper assesses the likelihood of debt problems in the 68 countries identified as potential BRI borrowers. We conclude that eight countries are at particular risk of debt distress based on an identified pipeline of project lending associated with BRI.

Because this indebtedness also suggests a higher concentration in debt owed to official and quasi-official Chinese creditors, we examine Chinese policies and practices related to sustainable financing and the management of debt problems in borrower countries. Based on this evidence, we offer recommendations to improve Chinese policy in these areas. The recommendations are offered to Chinese policymakers directly, as well as to BRI's bilateral and multilateral partners, including the IMF and World Bank.

Center for Global Development
2055 L Street NW
Fifth Floor
Washington DC 20036
202-416-4000
www.cgdev.org

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1. Introduction

During the 19th National Party Congress in 2017, China's Communist Party formally adopted the Belt and Road Initiative (BRI) under its Party Constitution as part of a resolution to achieve "shared growth through discussion and collaboration." As a result, President Xi Jinping entered his second term with a strategy of international engagement defined by BRI, signaling a sustained commitment to an initiative that has already been heavily invoked by China's leadership. The Party Congress may mark the point at which ambitious rhetoric shifted to an operational program.

As envisioned, BRI spans at least 68 countries with an announced investment as high as $8 trillion for a vast network of transportation, energy, and telecommunications infrastructure linking Europe, Africa, and Asia.[1] It is an infrastructure financing initiative for a large part of the global economy that will also serve key economic, foreign policy, and security objectives for the Chinese government.

Yet, important questions arise on sustainable financing of the initiative within BRI countries, and how the Chinese government will position itself on debt sustainability. Infrastructure financing, which often entails lending to sovereigns or the use of a sovereign guarantee, can create challenges for sovereign debt sustainability. And when the creditor itself is a sovereign, or has official ties to a sovereign as do China's policy banks—China Development Bank (CDB), the Export-Import Bank of China (China Exim Bank), and the Agricultural Development Bank of China (ADBC)—these challenges often affect the bilateral relationship between the two governments. They are also, to varying degrees, guided by standards determined by multilateral institutions like the World Bank and International Monetary Fund (IMF), or by multilateral mechanisms like the Paris Club.

It remains unclear the degree to which BRI, a Chinese-led bilateral initiative that seeks to employ some multilateral mechanisms to achieve its financing goals, will be guided by multilateral standards on debt sustainability. This paper will explore the policy considerations facing China and possible multilateral partners in BRI like the World Bank, Asian Infrastructure Investment Bank (AIIB), and Asian Development Bank (ADB) when it comes to sustainable financing and when debt problems arise.

As a starting point, the paper assesses the current debt vulnerabilities of all likely BRI prospect countries. In a subset of 23 countries that we determine to be significantly or highly vulnerable to debt distress, we construct a BRI project lending pipeline based on publicly reported sources. Integrating this financing data into a country's debt as of end-2016, we consider the movement in a country's overall public debt-to-GDP ratio, as well as the concentration of that debt with China as creditor. Along these two dimensions, we identify eight countries where BRI appears to create the potential for debt sustainability problems, and where China is a dominant creditor in the key position to address those problems. We next describe the credit risk that China faces in each of the eight countries. Finally, we

[1] The highest estimate we've identified in media reports. See Balding, 2017; Moser, 2017; Wo-lap, 2016.

examine China's experience as a creditor facing debt problems with a borrowing sovereign country. We consider the degree to which China has participated in multilateral approaches to managing these problems, and highlight cases where China has managed a debt problem strictly through the bilateral relationship and with ad hoc outcomes that do not follow the practices of other leading creditor countries.

Based on this assessment, we offer conclusions and recommendations about how BRI, and the Chinese government as its leading architect, should approach the question of debt sustainability in BRI countries.

We conclude that multilateral actors can, and should, encourage policies and procedures for BRI that would improve the initiative's development impact. To do so, they should obtain clear commitments from the Chinese architects of BRI about the applicability of multilateral standards that pertain to debt sustainability. For its part, this is an opportunity for China to embrace more sustainable lending practices in its bilateral engagements. By adhering to widely accepted "rules of the road" for sovereign creditors, this initiative could make great strides in spurring productivity growth through sound infrastructure investments in developing economies. The alternative will be an initiative that introduces new debt vulnerabilities in developing countries and risks growth setbacks in some of these countries.

2. Debt sustainability and BRI

Some public reporting has expressed alarm about the implications of BRI for debt sustainability.[2] The primary concern is that an $8 trillion-dollar initiative will leave countries with debt "overhangs" that will impede sound public investment and economic growth more generally (see Box 1). There is also concern that debt problems will create an unfavorable degree of dependency on China as a creditor. Increasing debt, and China's role in managing bilateral debt problems, has already exacerbated internal and bilateral tensions in some BRI countries, such as Sri Lanka, where citizens have regularly clashed with police over a new industrial zone surrounding Hambantota port,[3] and Pakistan, where Chinese officials openly appealed to opposition politicians to embrace the construction of the China-Pakistan Economic Corridor (CPEC), BRI's "flagship project" to bolster ties between Beijing and Islamabad.[4]

The sustainability of BRI financing will depend in part on the productivity of the BRI projects themselves. The developmental benefits of increased public infrastructure investment more broadly have been promoted by multilateral development institutions. For example, a widely quoted ADB study asserts that in Asia alone, $26 trillion in infrastructure investments are needed over the 2016-2030 period to maintain 3 to 7 percent economic growth, eliminate poverty, and respond to climate change.[5]

[2] Heydarian 2017; Krakowska 2017; Zhang 2017.
[3] Aneez 2017.
[4] The Economist, May 2017.
[5] ADB, 2017.

Box 1: Why debt sustainability matters

If infrastructure is a critical engine of growth in developing economies, then debt financing is the fuel for that engine. Public borrowing to support productive investment is central to the development narratives of today's wealthy countries and it continues to drive growth in emerging economies. However, there is also considerable evidence indicating significant negative impacts on countries and their people when governments incur too much debt.

When government borrowing is not accompanied by enough economic growth and revenue generation to fully service the debt, it can generate a downward spiral that inevitably ends in the need for debt restructuring or reduction.[6] Domestic spending on infrastructure and social services may be sacrificed in order to service the debt, with the problem compounded when governments borrow additional funds just to meet debt servicing needs.[7] This occurred from the 1970s into the 1990s, when developing countries' debt compounded at an annual average of roughly 20 percent, rising from $300 billion to $1.5 trillion. For the poorest countries, external public debt increased from slightly above 20 percent of GDP in 1970 to almost 140 percent of GDP by 1994. Between 1978 and 1988, interest payments alone on low-income countries' external debts jumped from $230 million to $1.3 billion.[8]

Doubts about a country's ability to service its debt as debt ratios worsen can increase the cost of capital as investors demand a higher return to compensate for increased risk, creating a self-fulfilling debt prophecy.[9] In Argentina, for example, prior to default the average interest rate of the total public debt went from 5.8 percent in 1996 to 9.4 percent in 2001, and bonds issued in 2001 required dollar interest rates of about 15 percent.[10] Imbalances in the external accounts due to negative shocks on the terms of trade or weak exports can result in a real exchange rate depreciation that increases the burden of payments in terms of local currency and enhances the probability of a sovereign default.[11]

The macroeconomic impacts of a rapidly increasing country-risk premium and, if it occurs, a sovereign default, result in significant damage to the economy and to citizen livelihoods. A sovereign default can lead to a banking crisis, as banks have to make write-downs on credits provided to the state; an economic crisis, as aggregate demand falls; and a currency crisis due to a sudden stop in foreign capital.[12] The negative effects can be relatively short-lived, depending on the nature of the workout, but the impacts on individuals who fall into poverty can be lasting. In the case of Argentina, for example, by the end of 2002, 58 percent of the population was living on incomes below the national poverty line and a quarter were considered destitute.[13]

There are also potential cross-border spillover effects from a sovereign default. For example, in the wake of the Latin American debt crisis, commercial creditors who were exposed to sovereign default risks, be it directly via their holdings of foreign government debt or indirectly via their exposure to the banking sector of the defaulting country, reduced their overseas exposure and/or raised the country-risk premiums.[14] While state-owned financial intermediaries such as CDB and China Exim Bank can operate in a riskier manner than purely private institutions, even they could apply a much more conservative business model on a portfolio-wide basis if borrowers exhibit financial stress.

Evidence in some countries appears to support the idea that debt-financed infrastructure investment can play a key role in catalyzing economic growth. For example, Ethiopia has achieved rapid economic growth in a large part due to a massive public investment program financed through loans and other credit instruments.[15] Public infrastructure investment in Ethiopia rose from about 5 percent of GDP in the early 1990s to 18.6 percent of GDP in 2011, and GDP growth averaged over 10 percent between 2010 and 2015. China's economic performance has also benefited from a massive infrastructure investment program, though Chinese authorities have also had to address the monetary expansion, instability in financial markets, economic fragility, and build-up of debt that resulted from these investments.

More generally, the evidence of a causal relationship between public investment and economic growth is mixed. One widely cited study concludes that there is only a weak and short-term positive association between investment spending and growth, with lagged impacts proving insignificant.[16] Another recent analysis finds that investment and infrastructure projects are less likely to be successful when they are undertaken during periods of higher-than-average public investment, which is particularly relevant in light of the BRI "big-push" approach to infrastructure investment.[17]

The sustainability of a country's debt depends not only on macroeconomic variables, but also on the structure of its debt portfolio. For low-income countries (LICs), access to concessional financing is critical for achieving the twin goals of debt sustainability and progress toward reaching development goals. The higher the concessionality, or grant element, of the loan, the less risk of default on the part of the borrower. For multilateral institutions such as the World Bank and the AIIB, the financing terms for loans to sovereign governments are publicly available. This practice is also followed by most bilateral development finance institutions. However, CDB and China Exim Bank do not disclose the terms of their loans, making it difficult, if not impossible, to accurately assess the present value of the debt owed by a country to China. Anecdotal evidence from media and IMF reports indicate that the terms of CDB and China Exim Bank loans vary widely, from interest-free loans in the case of some Pakistan projects to a fully commercial rate in the case

[6] Sturzenegger and Zettelmeyer, 2006.
[7] Shabir and Yassin, 2015.
[8] World Bank International Debt Statistics.
[9] Nicolini, 2016.
[10] Damill, Frankel, and Rapetti, 2006.
[11] Sturzenegger and Zettelmeyer, 2006.
[12] Borensztein and Panizza, 2008
[13] World Bank Argentina Poverty Assessment, 2003.
[14] Trebesch et al., 2012.
[15] Moller and Wacker, 2017.
[16] Warner, 2014.
[17] Presbitero, 2016.

of the Ethiopia-Djibouti railway.[18] Borrowers are also susceptible to exchange rate risks given that most CDB and China Exim loans are denominated in dollars or renminbi.

Other major country creditors may be particularly sensitive to the prospect of BRI investments leading to debt overhang problems and another round of debt relief on a multilateral basis, having already spent billions of dollars to relieve many countries of their debt burdens through Paris Club treatments, the Heavily Indebted Poor Country (HIPC) Initiative, and the Multilateral Debt Relief Initiative. For these reasons, it is appropriate to identify debt sustainability as a key variable in BRI (MDRI) and one that deserves scrutiny during the early stages of the initiative.

Our analysis finds that BRI is unlikely to cause a systemic debt problem in the regions of the initiative's focus. While the aggregate numbers look large, when assessed in the context of the size of the economies that are likely to benefit from BRI investments, the amounts are consistent with current levels of infrastructure investment. Over a 20-year span, an $8 trillion investment program for BRI countries would amount to less than 1.5 percent of GDP per annum, and about 2.5 percent excluding China. It is also likely that some of the China-sourced financing will merely substitute for other sources. These levels are modest in comparison to the ADB's estimated infrastructure financing "needs" in Asia, which are projected to be 5.1 percent of the region's GDP.

Nonetheless, we conclude that there are some countries, most of whom are small and relatively poor, that face a significantly increased risk of a sovereign debt default if planned BRI projects are implemented in an expeditious manner and financed with sovereign loans or guarantees.

Our methodology focuses on two factors: 1) the general risk of sovereign debt distress that individual BRI countries are facing today, and 2) the degree to which BRI financing will add to the risk of debt distress. Because of the policy implications, we center our attention on countries where debt to China, as a share of total public external debt, would be particularly high due to BRI-related projects.

In the following sections, we elaborate on each stage of our methodology (Figure 1):

1. We first **identify 23 BRI countries** at risk of debt distress today according to standard measures of debt sustainability.

2. For each of these countries we **construct a BRI lending pipeline** based on publicly available sources.

[18] See IMF, July 2016 for grant elements calculated for select Djibouti projects, and Mughal, 2017 for reporting on Pakistan. AidData also calculates grant elements for a variety of projects.

3. We **integrate the lending pipeline** into the countries' overall debt and debt to China as of end-2016.[19]

4. We determine **eight countries** for whom BRI creates the potential for debt sustainability problems.

There are clear limitations to this methodology, which are addressed in appendix A.

Figure 1: Methodology

3. Methodology

3.1 Debt vulnerability in BRI countries

We identify 68 countries that fall under the scope of BRI based on reports from Chinese quasi-official organizations and BRI's geographical representation. By region, these countries are grouped as follows:

- East and Southeast Asia (14): Brunei, China, Indonesia, Malaysia, Mongolia, Myanmar, Cambodia, Laos, Philippines, Singapore, South Korea, Thailand, Timor-Leste, and Vietnam;

- Central and South Asia (13): Afghanistan, Bangladesh, Bhutan, India, Kazakhstan, Kyrgyzstan, Maldives, Nepal, Pakistan, Sri Lanka, Tajikistan, Turkmenistan, and Uzbekistan;

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[19] This is the latest available statistic.

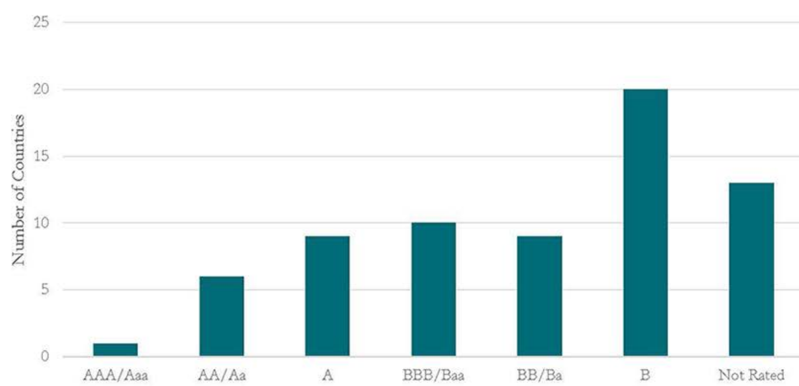
- Middle East and Africa (17): Bahrain, Djibouti, Egypt, Ethiopia, Iran, Iraq, Israel, Jordan, Kenya, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates, and Yemen;

- Europe and Eurasia (24): Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkey, and Ukraine.

The annual economic output of these 68 countries is roughly $25 trillion, with China itself accounting for some 45 percent of the total. They are heterogenous economies, small and large, developed and developing, commodity-dependent and more diversified exporters. To assess current levels of debt risk among these countries, we apply a series of filters.

We first look at the sovereign credit risk ratings issued by the three major credit rating agencies: Standard & Poor's, Moody's, and Fitch Ratings. Of the 68 BRI countries we identified, there are 35 countries at the time of publication that are rated investment grade or near investment grade, and therefore have a low risk of debt distress (Figure 2).[20] As a result, we believe the risk of debt distress from additional BRI-related financing in these countries is small.

Figure 2: Sovereign credit ratings for likely BRI countries



[20] These 35 countries have long-term foreign currency ratings of BB-/Ba3 or better from one of the three primary rating agencies (Standard & Poor's, Moody's, and Fitch Ratings). We use the highest rating from any of the three agencies.

We then focus on the risk of debt distress for the remaining 33 countries that are currently rated below investment grade. We draw primarily from the debt sustainability analyses (DSAs) conducted by the IMF and the World Bank. We remove from consideration Brunei, Iran, Moldova, Myanmar, Nepal, Timor-Leste, Turkmenistan, and Uzbekistan, all "not rated" countries that are at a low risk of debt distress. Moldova, Myanmar, and Nepal have a low risk of debt distress according to their most recent IMF/World Bank DSA, and the others have a public debt-to-GDP ratio below 25 percent. We also remove Syria and Yemen, both countries in conflict that are unlikely to be active BRI countries in the short to medium term. By region, this leaves the following 23 countries:

- East and Southeast Asia (3): Cambodia, Mongolia, and Laos;
- Central and South Asia (7): Afghanistan, Bhutan, Kyrgyzstan, Maldives, Pakistan, Sri Lanka, and Tajikistan;
- Middle East and Africa (7): Djibouti, Egypt, Ethiopia, Iraq, Jordan, Kenya, and Lebanon;
- Europe and Eurasia (6): Albania, Armenia, Belarus, Bosnia and Herzegovina, Montenegro, and Ukraine.

Given their current risk ratings, these 23 countries represent those for whom the risk of debt distress due to additional BRI-related financing could be quite high. To investigate this question in these countries, we next identify publicly reported projects under BRI, estimate a lending pipeline, and integrate this financing data into a country's debt.

3.2 Identifying BRI projects

China does not report cross-border project lending in a systematic or transparent manner. Beyond topline investment numbers that have been announced by Chinese officials, and the occasional projection on intended country-level investment under the initiative, BRI project information is not centrally reported.[21] Additionally, while Chinese policy and commercial banks will sometimes make public announcements about project investments, this is not done consistently and specific financing agreements are rarely published. It is also uncommon for the debtor countries to fully and completely disclose loan information. Given this reality, we identify BRI projects mainly through media publications, replicating the methods of other projects that have attempted to identify Chinese overseas lending (see Box 2).

We first identify publicly reported Chinese financed infrastructure projects starting from the first announcement of BRI by President Xi in Astana, Kazakhstan on September 7, 2013,

[21] One notable exception is for projects in CPEC. The Pakistan-China Institute and China Radio International have developed a CPEC portal that lists transportation, energy, and port infrastructure projects under the initiative, including varying levels of detail regarding progress and financing. CPEC, 2017.

through December 2017.[22] Consistent with the rhetoric of Chinese officials, we consider any Chinese infrastructure project in an identified BRI country since the announcement of the initiative to be a BRI project. Because we focus on the debt sustainability of countries implicated in BRI, we only identify infrastructure projects that we believe were or would be financed through sovereign or sovereign-guaranteed concessional and commercial loans or export credits.[23] This includes loans from Chinese policy banks to state-owned enterprises in BRI countries, even if the authorities might claim that there is no sovereign guarantee.[24] There may be some ambiguity about the degree to which there is a sovereign obligation or guarantee on the borrowing side of some of these transactions, but we err toward greater inclusion in order to identify debt risks. Experience shows that even in cases where there is no explicit sovereign guarantee, the obligations of state-owned or quasi-official entities are often implicitly guaranteed by the national government.

Box 2: Existing methods to identify Chinese overseas financing

The The College of William and Mary's AidData research lab hosts a global dataset on China's official development spending from 2000-2014. AidData has identified more than $350 billion in Chinese foreign aid and other forms of state financing using their Tracking Underreported Financial Flows (TUFF) methodology. Projects are identified through a comprehensive search of public official sources and verified by media and other additional sources. The Center for Strategic and International Studies' Reconnecting Asia project uses a similar method to catalogue Asian infrastructure projects. The Reconnecting Asia team collects project information from open primary sources, including national government agencies, international financial institutions, and project contracts. Information from these sources is supplemented and verified by other media publications. The United States Export Import Bank (US EXIM) conservatively estimates activities by Chinese export credit agencies by measuring export buyer's and seller's credits and concessional lending using media reporting. Johns Hopkins School of Advanced International Studies' China-Africa Research Initiative (SAIS-CARI) tracks loans to African governments from 2000-2015. SAIS-CARI applies a "forensic internet sleuthing" approach and identifies project loans through official websites of central banks, ministries of finance, Chinese contractors, and media reports. They supplement this data collection with in-country interviews and meetings with Chinese and African officials.

[22] Jinping, 2013.

[23] We recognize that loans to the private sector, particularly financial institutions, can have spillover effects on the sovereign, but we do not believe this will be the case with respect to BRI projects due to the focus on public infrastructure investments.

[24] One example is the Lao-China Railway Company set up to build and operate the Vientiane to China highspeed railway. The Lao Ministry of Finance asserts that no sovereign guarantee will be provided for the debt of the joint venture company, but ultimately the government would need to act if the company could not pay its debts.

We start with the databases referred to in box 2. For projects outside the scope of these databases,[25] we consult reporting by recipient country government agencies, reporting by the Chinese policy and commercial banks, and to a significantly lesser extent, project contracts released by BRI contractors, 89 percent of which are Chinese state-owned enterprises (SOEs).[26] Finally, and most prominently for projects announced in 2017, we rely on other media publications, ranging from Chinese state-owned news agencies, media in debtor countries, and other international media outlets.

3.3 Constructing the BRI lending pipeline in 23 countries

We next seek to identify the debt effects of adding a BRI project pipeline to our 23 target countries. Drawing from our estimated universe of BRI projects, we characterize a BRI pipeline project as any project whose financing may not be captured by a country's latest public debt figures, which we have through the end of 2016. In most cases, this includes: 1) a project announced in 2017, and 2) a project announced at any time since the beginning of the initiative, but with undisbursed loan commitments due to a delay in project implementation or other factors. Using these pipeline projects, we are able to estimate a lending pipeline value for each country by aggregating the debt component of each identified project.[27] A complete table of debt and lending pipeline statistics for these 23 countries can be found in appendix B.

We include the second group in the lending pipeline because these projects appear to reflect firm political commitments even though they have yet to move beyond the initial commitment phase. These projects may be a symptom of a broader trend—according to information available in the SAIS-CARI Loan Database on the three African countries in our elevated risk universe (Djibouti, Ethiopia, and Kenya), of the approximately $19 billion in Chinese loans of government origin between 2000-2015, over $5 billion have yet to be implemented.[28] For example, a coal power plant in Kenya, announced in 2015 and to be financed with an approximately $900 million loan from the Industrial and Commercial Bank of China (ICBC), is still in the proposal phase due to local protests over environmental and economic viability concerns. However, government officials continue to vocally support the project.[29]

[25] AidData: post 2014, SAIS-CARI: post 2015, US EXIM: post 2016.

[26] US Congress, 2018.

[27] We estimated, when the lending information for a project was unavailable, that China would finance roughly 80 percent of the total cost of a project. There are various unofficial sources that provide anecdotal evidence of an 80:20 debt-to-equity ratio for projects in CPEC, BRI's flagship project. Additionally, in our own review of media sources we identified a financing ratio between roughly 80:20 and 75:25 for projects outside of CPEC. See Chaudhury, 2017; Dadwal and Purushothaman, 2017; Su, 2016; Husain, 2016.

[28] SAIS-CARI identifies whether a project has been signed, is signed but inactive, is in the implementation phase, or has been completed.

[29] ICBC, 2015; Medium, 2017.

3.4 The debt effect of the BRI lending pipeline

We then integrate the BRI lending pipeline into a country's debt as of the end of 2016.[30] In order to estimate those countries that may suffer from debt distress due to BRI-related financing, we use a debt threshold. There has been considerable research on debt thresholds, defined as a tipping point for public indebtedness beyond which economic growth drops off to such a degree that it leads to default or debt treatment. The evidence is mixed; some economies with relatively low debt levels have run into debt difficulties while others have been able to grow at relatively high levels of indebtedness for long periods without any apparent difficulty. That said, we base our analysis and judgments on recent research that shows a statistically significant threshold effect in the case of countries with **rising** debt-to-GDP ratios beyond 50-60 percent.[31]

Using this threshold, we find that of the 23 countries identified above, there are 10-15 that could suffer from debt distress due to future BRI-related financing, with eight countries of particular concern. These countries are Djibouti, the Kyrgyz Republic (Kyrgyzstan), Lao People's Democratic Republic (Laos), the Maldives, Mongolia, Montenegro, Pakistan, and Tajikistan (Figure 3).

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[30] We add the total pipeline figure to the numerator and denominator of the debt ratios. The limitations of this method are addressed in Appendix A.
[31] Chudik et al., 2015.

Figure 3: Immediate marginal impact of BRI lending pipeline

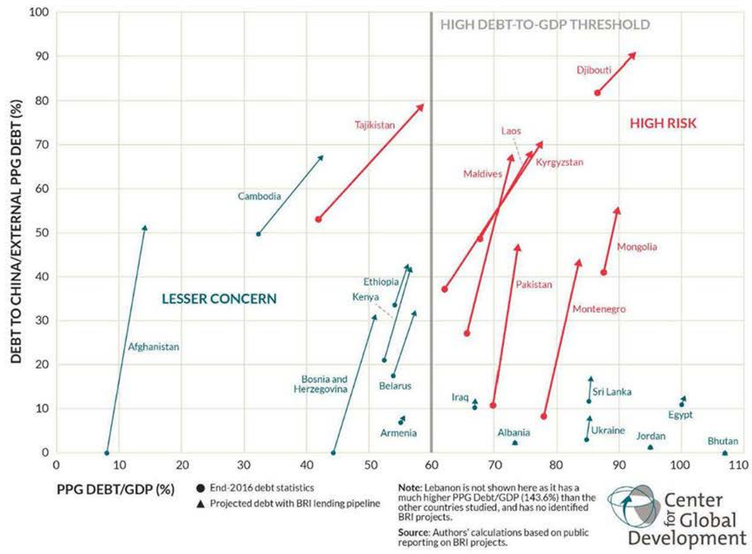

Figure 3 identifies these eight countries (red), and illustrates the estimated changes from BRI project lending in public and publicly guaranteed debt-to-GDP ratios, as well as the changing shares of Chinese debt relative to all external public and publicly guaranteed debt. This can be described as the current "upper bound," or worst-case scenario, of future debt if the initiative is implemented to the fullest extent of President Xi's vision.

Because we are interested in those countries that may invite a policy response from China, it is evident from this illustration that these eight countries are more significant for the purposes of our analysis than others. Countries of lesser concern (blue) are the following:

- While Albania, Bhutan, Jordan, and Lebanon have been represented at BRI events or have expressed interest in engaging more completely in the initiative, we did not identify any BRI projects in these countries.

- Afghanistan and Cambodia may see a significant rise in total debt to China as a percentage of total public external debt, but we do not believe the projects in these two countries will lead to a debt default or debt treatment due to the overall low level of debt.

- The Sri Lankan government may agree to additional BRI-related financial commitments but their size is likely to be tempered by the Hambantota Port experience.

- While our pipeline includes projects in Armenia, Egypt, Iraq, and Ukraine, the level of sovereign or sovereign-backed lending for BRI projects in comparison to the size of their economies or their total external debt exposure is not high enough to have an appreciable effect on debt levels.

- In Belarus, Bosnia and Herzegovina, Ethiopia, and Kenya, there could be an increase in the risk of debt distress in the short-term due to BRI-related projects. However, total public debt should remain low enough to mitigate the likelihood of default. For example, China has played a leading role in financing Ethiopia's investment program, providing 30 percent of total new public external debt over the past five years, and 90 percent of new bilateral debt. Nonetheless, with one of the most rapidly growing economies in the world, we expect Ethiopia will remain within prudent borrowing limits over the next several years.

To further test the risks of debt distress in the eight focus countries, it is useful to consider existing debt and growth projections for these countries. With recent research showing that rising debt-to-GDP ratios are as important as the level of debt in assessing the risk of debt distress,[32] table 1 shows the change in debt levels (actual and forecast) over the 2015-2018 period in our eight focus countries, based on IMF surveillance reports. Given the stylized fact that countries are more capable of sustainably financing high levels of public debt as they become wealthier, the table also provides averages for the world, middle-income economies, and low-income economies. It demonstrates that the expected levels of debt in the eight focus countries are well above the average for their peers.[33]

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[32] Chudik et al., 2015.

[33] Note that the Maldives information reflects statistics prior to the rebasing of its gross domestic product.

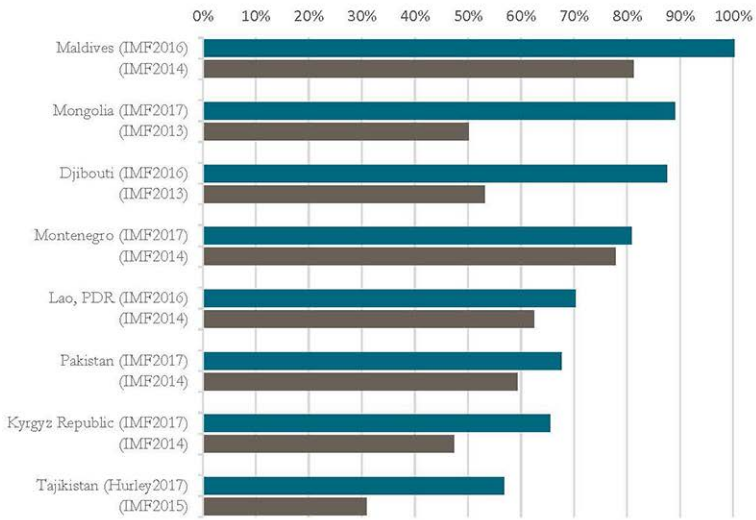
Table 1: General government gross debt (% of GDP)

	Actual		Forecast	
	2015	2016	2017	2018
World	**80.6**	**83.6**	**83.1**	**82.8**
MICs	**44.5**	**47.4**	**48.6**	**49.8**
Mongolia	62.1	87.6	85.3	89.0
Montenegro	76.8	78.0	79.7	80.9
Pakistan	65.7	70.0	69.1	67.6
LICs	**36.1**	**40.4**	**41.9**	**41.6**
Maldives	73.1	83.1	96.5	109.0
Djibouti	72.1	86.6	88.1	87.5
Laos	65.8	67.8	69.0	70.3
Kyrgyz Republic	65.0	62.1	64.2	65.5
Tajikistan	33.4	44.8	51.8	56.8

Moreover, IMF surveillance documents and DSAs indicate that forecasts may underestimate the pace of debt accumulation in these eight countries, suggesting that the risk of debt distress may prove to be higher if or when IMF forecasts become more accurate. Figure 4 shows recent changes in IMF forecasts of debt-to-GDP ratios in 2018 for each of the eight focus countries. For example, the IMF staff report for Mongolia published in May 2017 projects that the public debt to GDP ratio will be 101.3 percent in 2018, while the DSA conducted in 2013 projected that the ratio would be 50.1 percent.[34]

[34] The Tajikistan forecast for 2017 is based on the author's calculations due to lack of a publicly available IMF data. The Maldives data uses the 2016 projection due to the rebasing of the national accounts in 2017.

Figure 4: Forecasts of public debt/GDP for 2018



Recent research reinforces this point.[35] An evaluation of DSAs for low-income countries (LICs) from 2005-2015 finds evidence of a bias towards optimism for public and external debt projections. The bias was most significant for LICs with the highest incomes, greatest access to capital markets, and at a "moderate" risk of debt distress.

Finally, figure 5 summarizes the BRI debt effects identified in our study, highlighting in red the eight countries of greatest concern with the integrated BRI pipeline, with the other BRI countries coded by low and significant risk as determined by the major credit rating agencies.

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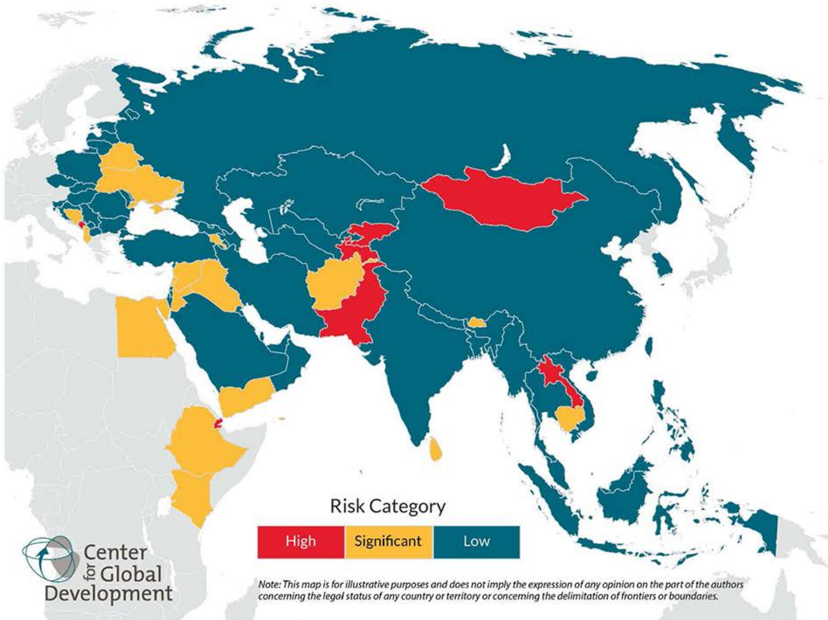
[35] Mooney and de Soyres, 2017.

Figure 5: Risk including BRI pipeline projects



4. Eight focus countries

Beyond the quantitative measures and projections of debt risk, it is useful to consider the qualitative picture for the eight most vulnerable countries. In particular, a characterization of the existing bilateral relationships with China can help to inform expectations about policy behavior in each case.

Djibouti: Djibouti is the site of China's only overseas military base. The most recent IMF assessment stresses the extremely risky nature of Djibouti's borrowing program, noting that in just two years, public external debt has increased from 50 to 85 percent of GDP, the highest of any low-income country. Much of the debt consists of government-guaranteed public enterprise debt and is owed to China Exim Bank. According to multiple reports, China has provided nearly $1.4 billion of funding for Djibouti's major investment projects, equivalent to 75 percent of Djibouti's GDP.[36] Future projects reportedly include at least two new airports, a new port at Ghoubet, an oil terminal, and toll road.[37] While a number of Chinese loans have been extended at below-market rates, which will reduce the risk of default, others, such as the financing for the Addis Ababa–Djibouti railway, are reported to be closer to commercial rates.[38] Moreover, despite cautionary statements from the IMF, there is no indication that new borrowing will be limited to the projects that generate sufficient revenues to meet debt service requirements.

The Maldives: This archipelago in the Indian Sea is in the midst of an unprecedented public investment program aimed at promoting additional tourism, upgrading urban infrastructure, and adapting to climate change in accordance with its National Sustainable Development Strategy. The three most prominent investment projects in the Maldives are an upgrade of the international airport costing around $830 million, the development of a new population center and bridge near the airport costing around $400 million, and the relocation of the major port (no cost estimate).[39] China is heavily involved in all these projects. While China Exim Bank has reportedly announced financing at concessional terms—the airport is reportedly to be repaid in 20 years with a five-year grace period[40]— other creditors have apparently not been as generous, and the country is considered by the World Bank and the IMF to be at a high risk of debt distress due to its vulnerability to exogenous shocks.

Lao People's Democratic Republic ("Laos"): Laos is among the poorest countries in Southeast Asia, though it has been expanding rapidly with GDP growth averaging 8 percent over the past decade. Since 2013, the IMF has been raising doubts about the ability of Laos to service its debts if it moves ahead with its plans to build the China-Laos railway, in addition to other major capital projects. The $6 billion cost for the railway represents almost half the country's GDP, and although Lao Ministry of Finance officials stress that the government will **not** guarantee the vast majority of the financing from China Exim Bank, the Laotian government will be under considerable pressure to cover any losses.[41] The financial terms for many elements of the project remain a secret, although one source has reported that a $465 million loan from China Exim Bank for the joint company building and operating the railway will be provided at 2.3 percent interest with a five-year grace period and 25-year maturity.[42] The Laotian government has also reportedly signed a $600 million loan agreement with China Exim Bank for a hydropower project.[43]

Montenegro: Montenegro's debt problem is enormous. The World Bank estimates that public debt (including guarantees) as a share of GDP will climb to 83 percent in 2018 in the absence of fiscal adjustment. The source of the problem is one very large infrastructure

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36 Downs and Becker, 2017; Downs et al., 2017.
37 IMF, April 2017; Downs and Becker, 2017; SAIS-CARI, 2017.
38 Sun, 2017.
39 IMF, December 2016.
40 Naish, 2015.
41 IMF, January 2017.
42 Janssen, 2017.
43 The Nation, 2016.

project, a motorway linking the port of Bar with Serbia that would integrate the Montenegrin transport network with those of other Balkan countries. The Montenegro authorities concluded an agreement with China Exim Bank in 2014 for the latter to finance 85 percent of the estimated $1 billion cost for the first phase of the project. The estimated cost has since risen to $1.1 billion, or over 25 percent of GDP. The loan for the first phase of the project will reportedly be extended with an interest rate of 2 percent, five-year grace period, and 20-year repayment period.[44] The road is being built in three phases, and the IMF believes the second and third parts of the highway should only go forward with highly concessional funds because non-concessional terms would likely result in debt default.

Mongolia: Mongolia is in a particularly difficult position because its future economic prosperity depends, in large part, on large infrastructure investments that will increase productivity and facilitate exports. Financing for these investments will need to be secured on a concessional basis, which has not generally been the case in the past. Recognizing Mongolia's difficult situation, China Exim Bank agreed in early 2017 to provide financing under its $1 billion line of credit at concessional rates for a hydropower project and a highway project from the airport to the capital. However, according to local reporting, the hydropower project has stalled, and elements of this financing is reportedly being redirected to other projects.[45] But if reports that Beijing expects to channel some $30 billion in credit to BRI-related projects over the next five to ten years are true, then the prospect of a Mongolia default is extremely high, regardless of the concessional nature of the financing.[46]

Tajikistan: Tajikistan has been described as the "first leg" of the land-based elements of BRI. One of the poorest countries in Asia, it is assessed by the IMF and World Bank to have a "high risk" of debt distress. Despite this, it is planning to increase its external debt, both at concessional and non-concessional rates, to pay for infrastructure investments in the power and transportation sectors, including those elements supporting BRI. Most significantly, a $3 billion portion of the Central Asia-China gas pipeline (Line D) will pass through Tajikistan, reportedly financed through Chinese foreign direct investment (FDI), although there could be pressure for the Tajik government to cover some of the financing costs. There are conflicting reports on whether this project has stalled.[47] Most recently, Tajikistan issued $500 million in Eurobonds to pay for a new hydropower generating facility.[48] Debt to China, Tajikistan's single largest creditor, accounts for almost 80 percent of the total increase in Tajikistan's external debt over the 2007-2016 period.

Kyrgyz Republic ("Kyrgyzstan"): Like Tajikistan, Kyrgyzstan is a relatively poor country with significant new BRI-related infrastructure projects being constructed, much of it financed by external debt. By the end of March 2017, public and publicly guaranteed debt amounted to roughly 65 percent of GDP, of which external debt represented about 90

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[44] Government of Montenegro, 2014.
[45] Kohn, 2016; Mongolian News Agency, 2017.
[46] Kenderdine, 2017.
[47] Kosolapova, 2017; Michel, 2017.
[48] Reuters, 2017.

percent of the total. China's Exim Bank is the largest single creditor, with reported loans by the end of 2016 totaling $1.5 billion, or roughly 40 percent of the country's total external debt. Kyrgyz and Chinese authorities are reportedly discussing the construction of a chain of hydropower plants, a China-Kyrgyzstan-Uzbekistan railway, additional highway construction, and completion of the Central Asia-China gas pipeline.[49] While currently considered to be at a "moderate" risk of debt distress, Kyrgyzstan remains vulnerable to shocks resulting from a sizeable exchange rate depreciation exacerbated by the scaling up of public investments.

Pakistan: Through CPEC, Pakistan currently serves as a centerpiece for BRI. The total value of CPEC projects is currently estimated at $62 billion, with at least $33 billion of this amount expected to be invested in energy projects.[50] China will reportedly finance roughly 80 percent of that amount.[51] Yet despite this ambition, there have already been canceled projects, most recently three major road projects at the end of 2017.[52] Adding to Pakistan's risk of debt distress are the relatively high interest rates being charged by China. Unlike the 2-2.5 percent "concessional rate" given to some China Exim Bank customers, reports indicate that some of Pakistan's loans reflect rates as high as 5 percent.[53] The IMF notes that adverse shocks could lead to public debt ratios well above 70 percent. As a country that has requested six debt treatments from the Paris Club, Pakistan's massive amount of borrowing from China raises concerns that it will need to return a seventh time.

5. How will China respond to problems of debt distress in BRI countries?

In countries suffering from debt distress, the Chinese government has provided debt relief in an ad hoc, case-by-case manner.[54] It has generally refrained from participating in multilateral approaches to debt relief, though it does participate in debt relief discussions at the international financial institutions and engages informally with IMF staff on individual country cases. This contrasts with other major official creditors, all of whom participate actively in multilateral mechanisms dealing with sovereign defaults, in particular the Paris Club. While China is an observer at meetings of the Paris Club, it is not a member, so it is under no obligation to act in solidarity with Paris Club members or even to inform the Paris Club about the management of its credit activities.

Without a guiding multilateral or other framework to define China's approach to debt sustainability problems, we only have anecdotal evidence of ad hoc actions taken by China as the basis for characterizing the country's policy approach.

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[49] Taldybayeva, 2017.
[50] Shaikh and Tunio, 2017.
[51] See footnote 25.
[52] NDTV, 2017.
[53] Naviwala, 2017.
[54] The examples cited are taken primarily from press reports and IMF program documents. China does not disclose information on the details of any bilateral debt agreements.

Examples of the ways in which China has managed its claims include the following:[55]

- In 2011, China reportedly agreed to write off an unknown amount of debt owed by Tajikistan in exchange for some 1,158 square kilometers of disputed territory. At the time, Tajik authorities said they only agreed to provide 5.5 percent of the land that Beijing originally sought.[56]

- In 2011, with Cuba in a desperate economic situation and seeking debt relief, China, its largest single creditor, agreed to restructure between $4-6 billion of the debt. The details of the transaction were not disclosed, but it reportedly included an agreement by China to extend additional trade credits and financing for port rehabilitation. Some recent reports indicate that some of the debt was forgiven.[57]

- The IMF estimates that China has delivered over 80 percent of what it is expected to provide under HIPC. It was a creditor to 31 of the 36 HIPC countries, and the most recent publicly available information indicates that it provided relief in at least 28 of them, including 100 percent forgiveness for several (e.g., Burundi, Afghanistan, and Guinea).

- With Sri Lanka unwilling to service a $8 billion loan at 6 percent interest that was used to finance the construction of the Hambantota Port, China agreed in July 2017 to a debt-for-equity swap accompanied by a 99-year lease for managing the port.

China has also demonstrated a willingness to provide additional credit so a borrower can avoid default. A prominent example is China's agreement in early 2017 to extend an RMB 15 billion swap line to Mongolia for three years in support of an IMF Extended Fund Facility.

China's case-by-case approach to debt relief is likely to continue in the absence of full membership in the Paris Club or commitments to some multilateral framework. China gave serious consideration to Paris Club membership during its G20 presidency in 2016 but ultimately did not make a commitment to pursue membership. It did, however, agree to keep the door open and to play a "more constructive role" in Paris Club discussions.[58] Given Paris Club members' commitment to share data on their claims on a reciprocal basis, a decision by the Chinese authorities to fully participate in Paris Club activities would be a very significant signal of the government's willingness to change a history of non-transparent credit activities.

Finally, despite ad hoc approaches to the treatment of debt problems, there are some signs that Chinese officials are moving toward greater policy coherence and discipline when it comes to ***avoiding*** unsustainable debt. For example, in November 2017, the China Banking

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[55] Appendix C includes a table on debt relief actions taken by Chinese authorities according to public sources.
[56] Atovulloev, 2016.
[57] Franks and Frank, 2010.
[58] G20, 2017.

Regulatory Commission issued its first ever regulations for China's policy banks, emphasizing greater risk controls for the overseas activities of CDB, China Exim Bank, and the ADBC.[59]

6. Recommendations

It is unlikely that BRI will be plagued with widescale debt sustainability problems. But it is also unlikely that the initiative will avoid any instances of debt problems among its participating countries. To date, China's behavior as a creditor has not been subject to the disciplines and standards that other major sovereign and multilateral creditors have adopted collectively. Following are recommendations for how China and major BRI partners can better align BRI with such disciplines and standards.

There are two underlying rationales for pursuing this alignment. First, there is the appeal to China as a good global citizen, so that its investment practices align with the pro-development rhetoric of BRI. In part, this will require pressure from leading partners in the initiative, and particularly the multilateral development banks (MDBs). Second, there is the appeal to China to take more effective approaches in its own interests as a creditor, recognizing the power of collective action over go-it-alone strategies.

These recommendations serve both purposes.

6.1. Multilateralizing BRI

A first-order question for BRI when it comes to debt sustainability—and operational features that relate to debt sustainability, such as lending transparency, procurement standards, and concessionality—is the degree to which the initiative will be multilateral in character, with a high degree of Chinese government influence, versus an initiative that is overwhelmingly directed, financed, and operated by the Chinese government. Chinese officials have encouraged participation by multilateral institutions like the World Bank and ADB, and BRI itself has coincided with the creation of Chinese-led MDBs like the AIIB and New Development Bank. Both suggest that Chinese officials see some value in a multilateral approach. But multilateral institutions, including the AIIB, adhere to a common set of practices pertaining to debt sustainability that do not reflect China's bilateral lending practices. Will BRI bend to the will of existing multilateral norms and standards, or will these standards fail to shape the activities of the dominant sources of BRI financing, which so far have been CDB, China Exim Bank, and the Silk Road Fund?

The very creation of the AIIB, and its adoption of existing MDB rules, demonstrates a willingness to embrace multilateral norms in some instances. But the AIIB remains very

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[59] Xiaomeng and Jia, 2017.

small as a share of China's international financing, with annual investments so far of about $2 billion, compared to annual lending from the bilateral institutions of $30-40 billion.[60]

The World Bank, ADB, AIIB, and European Bank for Reconstruction and Development (EBRD) have reportedly signed a memorandum of understanding with the Chinese government to support BRI.[61] Yet, characterizations of the MOU suggest that it does not seek to apply MDB standards to the initiative overall, instead focusing more narrowly on cooperation among the MDBs themselves on BRI projects.[62] This approach by the MDBs is a missed opportunity. They are lending their reputations to the broader initiative while only seeking to obtain operational standards that will apply to a very narrow slice of BRI projects: those financed by the MDBs themselves.

Before going further, the World Bank and other MDBs should work toward a more detailed agreement with the Chinese government when it comes to the lending standards that will apply to any BRI project, no matter the lender.

6.2. Other mechanisms for standard-setting in BRI

When it comes to an agreement on lending standards, there are additional mechanisms for the Chinese government to consider.

6.2.1 A post-Paris Club approach to collective creditor action

The Chinese government has moved closer to joining the Paris Club in recent years, participating alongside some Paris Club treatments on an ad hoc basis and signaling intentions to join through the G20 and the US-China Strategic and Economic Dialogue.[63] The task for Paris Club members to date has been to convince Chinese officials that membership is in China's interests as a creditor. The Club, after all, is a forum for ensuring maximum repayment under distressed conditions, rather than a "debt relief" forum. To date, China has determined that its interests are better served outside of the Club, and in particular, that it has sufficient leverage in its bilateral relationships to protect its interests. However, this view may continue to evolve as the number of strained bilateral relationships grow as a result of debt distress. One of the key protections afforded by the Paris Club's collective action approach is reputational. No one creditor country can be singled out for bad behavior since the members agree to act together.

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[60] A review of the CDB and China Exim annual reports indicates total foreign currency exposure for these two banks increased by roughly $40 billion in the 2016 fiscal year, though not all of this involves sovereign lending.
[61] Kim, 2017.
[62] It is also notable that the MOU itself is not publicly available, suggesting that transparency standards normally associated with the MDBs have been set aside in favor of those associated with the Chinese government.
[63] The September 2016 White House Fact Sheet on the dialogue included this statement: "China will continue to participate in the Paris Club on a regular basis and play a more constructive role, including further discussions on potential membership," The White House, 2016.

Nonetheless, even if China becomes convinced of the benefits of a collective approach, the political barriers to joining a G7-dominated institution may continue to delay Chinese membership in this debt forum. And it now appears that the US-China dialogue, the forum in which progress toward China's Paris Club membership has been made to date, has been set aside by the Trump administration.[64]

As a result, it may be incumbent on the wider Paris Club membership to consider the leverage that China has in these membership discussions as the basis for moving forward with a new agreement. Club members should consider, for example, that outstanding Paris Club claims currently total just over $300 billion. China's claims alone likely approach this figure, if not surpass it. For example, we estimate that China Exim Bank has credit exposure that is Paris Club "treatable" of about $90 billion, and we estimate CDB's foreign sovereign credit exposure at approximately $125 billion.[65] These are just two sources of Chinese government financing that are clearly Paris Club treatable. Other sources include the ADBC, as well as the newly launched Silk Road Fund, which was initially capitalized at $40 billion. There is no aggregate reporting on the Chinese government's credit exposure to other sovereigns, so the two figures for China Exim Bank and CDB certainly understate the extent of China's role as a creditor to other governments. It is unambiguously the case that China is the largest sovereign-to-sovereign creditor in the world based on the policy bank figures alone, and it is almost certainly the case that it has no close rival.

From this standpoint, it may be worthwhile to reorient the Paris Club membership discussion in favor of something new. The aim would be to maintain the core principles that guide the Paris Club, while opening the discussion to the possibility of a new forum, one in which China plays a meaningful role as a founding architect.

Whether the question is China's membership in the Paris Club, or movement toward a newly defined group of sovereign creditors, progress will depend on concessions from both sides of the deal. Chinese officials would do well to concede that the operating principles of the Paris Club have been forged through experience and do not inherently reflect a Western bias. For the existing Paris Club members, there needs to be clear recognition that the list of the world's largest sovereign creditors looks different today than it did in 1956 when the club formed. If the club is to continue to be effective in providing a public good to developed and developing countries alike, then China, along with a prospective class of emerging sovereign creditors, cannot continue to be outside the fold.

6.2.2. Implementing a China-led G20 sustainable financing agenda

As part of China's 2016 G20 presidency, G20 leaders endorsed the "G20 Agenda toward a More Stable and Resilient International Financial Architecture." This agenda was carried forward in 2017 to include "G20 Operational Guidelines for Sustainable Financing," which provide a detailed, multifaceted approach to improving debt sustainability and debt restructuring processes. Given the provenance of this agenda, and China's ongoing

[64] Flemming and Donnan, 2017.

[65] China Exim Bank, 2016; CDB figures compiled from the AidData database.

leadership role as a 2017 member of the G20's "troika," the operational guidelines provide a sound basis for new Chinese commitments and leadership on debt issues. Pursuing these commitments in a BRI context would strengthen China's reputation in the G20 at a time when it is eager to be viewed by other G20 members as a rightful leader within the group. Moving forward on the operational guidelines would include commitments with respect to:

- "enhanced information sharing with respect to debt sustainability, including signaling to IFIs' staff if large public liabilities appear not to be included in the DSA of a debtor country";

- "as a general policy, information on past debt restructurings from official and private creditors should be made public";

- a shared responsibility between borrowing countries and sovereign lenders in maintaining debt on a sustainable path, including recognition of the "applicable requirements of the IMF's Debt Limit Policy and of the International Development Association's Non-Concessional Borrowing Policy."

It would fall to the IMF to play a leading role in monitoring progress toward these commitments.

6.3. China as donor

Chinese officials have emphasized the commercial nature of BRI while downplaying the role that traditional foreign aid will play. Yet, China's role as an aid donor is expanding globally. Increasingly, alongside loans and FDI, China is providing grant resources in LICs and through multilateral mechanisms like the World Bank's International Development Association (IDA). The evolution of China's participation in IDA is telling. After two decades as an aid recipient from the World Bank's fund for the poorest countries, China "graduated" from IDA assistance in 1999. In the years that followed, China was a very reluctant donor *to* IDA, allocating nominal sums while claiming that it remained a poor country and therefore was unable to play the role of donor. However, in the last funding round for IDA in 2016, China emerged as one of the largest donors. This rapid shift appears to be part of a broader strategy that embraces the role of grant-based foreign aid as part of China's engagement with developing countries.

Given China's outsized role as a commercially oriented creditor to developing countries, there is a case for directing some of these aid dollars in ways that mitigate the risks of commercial lending and better promote the development impact of that lending. We offer two recommendations for Chinese aid here: 1) to finance technical legal support to developing country borrowers, through new and existing multilateral mechanisms; and 2) to offer debt swap arrangements in support of environmental objectives.

China should take the lead in establishing and funding an international legal support facility (LSF) that would address potential asymmetries in financial sophistication between BRI creditors (largely Chinese institutions) and BRI borrowers. Some BRI borrowers may be well informed about markets and financial techniques while others may not enjoy the same level of knowledge. An LSF would allow LICs to secure expert counsel to advise them on the negotiation of debt operations. Since this recommendation would have China playing a leading financial role in the establishment of a facility, care would need to be taken that such funding would not constrain or bias the outcome of any negotiation. This facility would build upon the success of the African Legal Support Facility (ALSF), hosted by the African Development Bank. The ALSF was originally established in 2008 to help HIPCs establish a "level playing field" in the fight against litigating creditors, commonly known as vulture funds. Over time, it has increasingly focused on the negotiation of complex commercial and business transactions, including large-scale infrastructures, extractive resources, and debt operations. The total amount committed has been fairly small, $11.3 million in 2016 ($9 million for advisory services) and $46 million since the ALSF was established, but the ALSF has received widespread praise for the value of its services.

Following the ALSF model, a new LSF should partner with an existing MDB. There are various potential options, including the World Bank, which currently provides advisory services for structured finance and guarantees across a range of countries; the EBRD, which has a rich history of providing legal support for economic transition issues; and the ADB, which currently offers expertise in the development and structuring of public-private partnership projects. Housing a LSF at an existing MDB would give the parties involved in an individual transaction confidence that the advice is being rendered in an ethical, accountable, and professional manner.

There are also existing facilities—the World Bank-IMF Debt Management Facility and UNCTAD's Debt Management and Financial Analysis System—which rely on donor support and do not yet count China among their donors. Both initiatives provide technical support to developing country governments to improve debt management practices. By channeling support through these multilateral mechanisms, China would ensure an arm's-length approach to its aid.

Finally, China could adopt debt-for-nature swaps, an approach championed by environmental organizations since the 1980s and used extensively by the United States and some multilateral funds like the Global Environment Facility. Under a swap arrangement, borrower country debt is forgiven in exchange for the country's commitment to fund key environmental objectives, such as tropical forest preservation. These swaps proved to be enduringly popular in the United States until the pool of countries that owed money to the US government *and* had worthy environmental objectives to address became too small to justify an ongoing program. In contrast, China has a growing number of debtor countries to draw from, and the swap mechanism itself could be deployed in support of a wider range of public goods. Care should be taken that the swap's environmental objectives do not obscure debt reduction terms or conditions that are unfavorable to the debtor country. For example, there should be no requirement for the purchase of Chinese goods or services. The fundamental objective would be to address an indebtedness problem in a manner that achieves a wider benefit (and in the case of forest protection, even a global benefit) and allays concerns about China's behavior as evidenced in the cases of Sri Lanka and Tajikistan.

Appendixes

Appendix A: Limitations of the methodology

Transparency: As we discuss on page 8, the level of transparency around reporting on BRI projects and financing greatly influences the accuracy we can ascribe to our estimates of the project pipeline. As much of the information is gathered from media publications (in both our own analysis as well as the other databases), the majority of projects remain unverified and there is a risk of inaccuracy on project-level reporting. We do not claim our lending pipeline to be comprehensive, but rather an illustration based on what we can reasonably estimate from available information. It is inevitable in our calculations we unintentionally omitted announced projects or included projects that may not add to a country's future debt.

Project pipeline: In addition to transparency limitations, while we identify this pipeline as the current "upper bound" of risk, new projects will likely be announced, while others will be delayed, modified, or cancelled. This implies a potential further "upper bound" beyond the estimates in this paper. For example, according to a Sri Lankan government official, Beijing says it is "willing to give" an estimated additional $24 billion as part of BRI.[66] In Cambodia, China proposed a plan to develop over two million kilometers of national expressways by 2040 under BRI, at a cost of approximately $26 billion.[67] China-Belarus agreements are reported to be as high as $15.7 billion,[68] and in Pakistan, approved Chinese financing has reportedly reached $62 billion.[69] We also do not know the financing terms for most of the pipeline projects nor the terms for many existing project loans. If all new projects are financed with highly concessional loans then the risk of debt distress drops considerably, but the prospect for this is unlikely based on public reporting.

Project implementation: We do not know the pace of project implementation for a significant number of projects. There is the possibility that proper public financial management will result in the delay of projects until feasibility studies determine that the debt can be properly amortized and financing will be on extremely concessional terms. Additionally, beyond disbursement schedules outlined in a limited number of government documents, we do not know, for many projects, if funds have been completely or partially disbursed for a project.[70]

Debt-growth dynamics: We do not incorporate any debt-growth dynamic effect into our assessment, assuming that any such positive impact will only occur over the long run. And we do not know the degree to which Chinese financing will merely substitute for other

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[66] The Economic Times, 2017.
[67] Chheang, 2017.
[68] SCMP, 2015.
[69] Venkatachalam, 2017.
[70] For example, the Sri Lankan Ministry of Finance reports loan disbursement schedules for many Chinese projects, so our project pipeline could estimate how much, if at all, credit lines had been drawn down on a specific project. In other cases, this information was not available, so the authors made an estimate based on the publicly available status of the project.

external (or domestic) financing. To address that issue, we focus our attention on those countries where the BRI pipeline is so large that substitution is unrealistic.

Appendix B: Select debt figures for countries significantly or highly vulnerable to debt distress

All figures in USD millions

Country	GDP	PPG Debt	PPG ED	Debt to China	BRI lending pipeline
Djibouti	1,727	1,496	1,464	1,200	1,464
Kyrgyz Republic	6,551	4,068	3,976	1,483	4,564
Lao, PDR	15,903	10,782	8,604	4,186	5,471
Maldives	4,224	2,775	879	240	1,107
Mongolia	10,951	9,593	7,392	3,046	2,469
Montenegro	4,374	3,412	2,406	200	1,535
Pakistan	278,913	195,239	58,014	6,329	40,021
Tajikistan	6,952	2,906	2,252	1,197	2,807
Afghanistan	19,469	1,558	1,227	0	1,280
Albania	11,864	8,696	4,069	100	0
Armenia	10,572	5,825	4,916	341	60
Belarus	47,407	25,552	17,588	3,094	3,828
Bhutan	2,213	2,370	2,341	0	0
Bosnia and Herzegovina	16,910	7,474	5,124	0	2,329
Cambodia	20,017	6,465	6,385	3,191	3,495
Egypt	332,791	333,124	43,096	4,779	740
Ethiopia	72,374	39,154	21,785	7,314	3,719
Iraq	171,489	114,726	67,395	7,010	1,000
Jordan	38,655	36,761	14,496	200	0
Kenya	70,529	36,957	19,325	4,089	6,879
Lebanon	49,599	71,224	18,848	500	0
Sri Lanka	81,322	69,286	32,565	3,850	2,136
Ukraine	93,270	79,186	50,832	1,590	2,475

PPG Debt = Public and Publicly Guaranteed Debt; ED = External Debt; PPG ED = Public and Publicly Guaranteed External Debt

Note: All GDP and debt statistics reflect 2016 or end-2016 values, with the exception of the lending pipeline, which reflect estimated values post-2016.
Source: World Bank, IMF, authors' estimates based on publicly available sources and the various databases cited in the paper

Appendix C: Debt relief actions taken by Chinese authorities

Year	Country	Description	Amount (US Dollars)
2000	Vanuatu	China agrees to write off 5 million USD of outstanding loan payments from Vanuatu relating to the construction of a parliamentary complex and law school	$ 5,000,000
2001	Equatorial Guinea	Chinese President Jiang Zemin announces an agreement on debt relief for Equatorial Guinea but no specific amount is mentioned	NA
2001	Cameroon	China cancels up to $34 million of Cameroon's debt	$ 34,000,000
2001	Ethiopia	China cancels $122.56 million of Ethiopian debt.	$ 122,560,000
2001	Mali	China cancels 37 billion CFA francs worth of Mali debt.	$ 49,900,000
2001	Sudan	China cancels 63 percent ($40.131 million) of Sudan's $63.7 million debt.	$ 40,131,000
2001	Zambia	China cancels USD$40 million in Zambian debt.	$ 40,000,000
2001	Uganda	Ugandan Vice President Wandira Specioza Kazibwe and Chinese Vice President Hu Jintao sign an agreement for China to cancel 50 million USD of debt.	$ 50,000,000
2001	Burundi	Burundi's External Relations and Cooperation Minister and the Chinese ambassador to Burundi sign an agreement for partial write off of debt worth 38 billion Burundi Francs.	$ 45,722,577
2001	Angola	A Chinese economic and trade delegation promises to write off about 10 percent of Angola's $80 million external debt to China during a three-day visit to Luanda.	$ 8,000,000
2001	Congo, Rep.	Chinese deputy economy minister Zhang Xiang signs an agreement cancelling $75 million of maturing debt owed by the Republic of Congo.	$ 75,000,000
2001	Guinea-Bissau	China cancels $5.8 million in debts owed by Guinea-Bissau.	$ 5,800,000
2001	Niger	President Tandja and PM Hama Amadou sign a protocol on forgiving $12 million of Niger's debt owed to China.	$ 12,000,000
2001	Mozambique	Sun Zhenyu, Chinese vice-minister of Foreign Trade and Economic Cooperation, announces that China will write off 22 million US dollars of Mozambique's debt.	$ 22,000,000
2001	Kenya	The Chinese government cancels 113 million RMB yuan (about $13.66 million USD) of Kenya's debts owed to China.	$ 13,652,177
2001	Tanzania	The government of China agrees to cancel part of Tanzania's debt with a value of over $70 million.	$ 70,877,778
2001	Madagascar	The Chinese Assistant Minister of Foreign Trade and Economic Cooperation and the Madagascar Acting Minister of Foreign Affairs sign an agreement to reduce USD 30 million of debt (64% of the total debt owed).	$ 30,000,000
2001	Rwanda	Chinese President Jiang Zemin and Rwandan President Paul Kagame signed a debt reduction deal cancelling loans totaling 113 million yuan.	$ 13,673,924
2001	Lesotho	China writes off R40-million debt owed by Lesotho for the construction of a national convention center.	$ 4,646,203
2002	Afghanistan	China agrees to write off all of Afghanistan's debt.	$ 19,500,000
2002	Cambodia	At the ASEAN summit, Chinese Premier Zhu Rongji announced the cancellation of Cambodia's debts	$ 200,000,000
2002	Cameroon	China and Cameroon agree to reschedule a loan of nearly 4,000 million FCFA (6 million dollars).	$ 5,738,978
2002	Ghana	China agrees to write off 85 percent of the debt owed by Ghana, the equivalent of $53.5 million USD.	$ 53,500,000
2002	Myanmar	China writes off $72 million of the debt owed by Myanmar to China.	$ 72,000,000
2002	Yemen	Yemen and China sign an agreement that eliminates 84 million USD out of an outstanding $185 million debt to China.	$ 84,000,000
2003	Bolivia	China agrees to forgive debt owed by Bolivia. The amount is not provided.	N/A

Year	Country	Description	Amount (US Dollars)
2003	Ghana	China cancels the $66 million USD debt owed by Ghana.	$ 66,000,000
2003	Guyana	China cancels 20 million USD of loan repayments from Guyana.	$ 20,000,000
2003	Eritrea	Eritrean Economic Advisor and China's Vice Minister for Foreign Trade and Economic Cooperation sign a $3m debt cancellation agreement.	$ 3,000,000
2003	Kyrgyz Republic	China EXIM restructures Kyrgyzstan's state debt of 250,000 dollars pursuant to the Paris Club agreement on the consolidation of the Kyrgyz Republic's debt.	$ 239,216
2003	Serbia and Montenegro	In 2003, China agrees to forgive $70 million of the arrears the Serbian oil and gas company Naftna Industrija Srbije (NIS) owed to Sinochem, a Chinese state-owned company.	$ 70,000,000
2003	Nigeria	Chinese Vice Foreign Minister Qiao Zonghuai signs a N325 million debt cancellation agreement with Nigeria.	$ 2,515,045
2003	Zimbabwe	The Chinese government agrees to reschedule a $42 million loan that the Chinese government had originally provided to the Zimbabwe Iron and Steel Company (ZISCO).	$ 42,000,000
2004	Zimbabwe	ExIm Bank officials sign two rescheduling agreements with Zimbabwe for loans totaling $17.9 million US dollars.	$ 17,900,000
2005	Equatorial Guinea	Following a visit to China, Equatorial Guinea's President Teodoro Obiang Nguema referenced China debt relief but it is unclear when it occurred and the amount involved.	NA
2005	Guinea	China cancels Guinea's debt in the amount of $45 million USD.	$ 45,000,000
2005	Somalia	A Chinese delegation (no further information) waives $3 million of Somalia's debt.	$ 3,000,500
2006	Benin	During his visit to Benin, Chinese foreign minister Li Zhaoxing agrees to cancel the country's debt.	NA
2006	Fiji	Chinese Prime Minister Wen Jiaboa pledges to cancel Chinese loans to Fiji that matured at the end of 2005. The value of the debts is unknown.	NA
2006	Georgia	At a meeting between Chinese President Hu Jintao and Georgian President Mikheil Saakashvili, China announces it would forgive most of Georgia's $3 million debt.	$ 2,600,000
2006	Laos	Chinese President Hu Jintao visited Vientiane and offers assistance and debt forgiveness.	$ 45,000,000
2006	Myanmar	China and Myanmar sign an agreement for China to cancel 240 million yuan ($30 million) in debt.	$ 30,099,938
2006	Samoa	Samoa Finance Minister Niko Lee Hang reports that China had forgiven $11.5 million USD of Samoa's debt.	$ 11,500,000
2006	Senegal	China agrees to cancel $18.5-$20 million USD in debt. The exact amount is unclear.	$ 18,500,000
2006	Zambia	China writes off $211 million of Zambia's debt which was incurred in the 1970s to build the TAZARA railway line.	$ 211,000,000
2007	Angola	The Chinese government signs an agreement with the Angolan government to cancel 50 million RMB (approximately 7 million USD) of debt owed by the Angolan government.	$ 6,572,433
2007	Burundi	During a two-day conference in Burundi, China announces it is cancelling 213 million CNY ($ 28 million) of Burundian debt.	$ 27,998,566
2007	Cameroon	Chinese President Hu Jintao agrees to cancel 16 billion CFA of Cameroon's debt to China.	$ 32,000,000
2007	Cape Verde	Chinese Premier Wen Jiabao announces cancellation of Cape Verde debts that matured at the end of 2005. No figures disclosed.	NA
2007	Central African Rep.	Chinese foreign minister Li Zhaoxing announces in the Central African Republic a debt cancellation worth 5.5 billion XAF ($11 million USD).	$ 11,475,863
2007	Chad	Chinese Foreign Minister Li Zhaoxing signs a CFA 16 billion debt-relief deal with Chad.	$ 33,384,329
2007	Congo, DR	China cancels $29 million of outstanding DRC debt	$ 29,000,000
2007	Congo, Rep.	Republic of Congo and China sign a protocol agreement on the cancellation of 30.6 billion CFA francs (about 64 million U.S. dollars) of debt owed to China.	$ 64,000,000

Year	Country	Description	Amount (US Dollars)
2007	Cote D'Ivoire	China writes off 40% of the debt owed by Cot d'Ivoire, amounting to 18 million EUR.	$ 24,636,020
2007	Equatorial Guinea	Chinese foreign minister Li Zhaoxing signs an agreement with Equatorial Guinea to write-off $75 million debt.	$ 75,000,000
2007	Ethiopia	Ethiopia and China sign a debt relief agreement for $18.5 million.	$ 18,500,000
2007	Ghana	China and Ghana sign a series of agreements, including one for debt cancellation worth $126 million USD.	$ 126,000,000
2007	Guinea	China promises Guinea debt relief worth $4 million USD.	$ 4,000,000
2007	Liberia	President Hu Jintao formally signs away 80 million RMB and 1 million USD in Liberian debt owed to China.	$ 11,000,000
2007	Madagascar	Four deals were signed with Madagascar for partial debt cancellation. No amounts were announced.	
2007	Mauritania	China forgives $61 million USD worth of Mauritanian debt.	$ 61,000,000
2007	Mozambique	Chinese President Hu Jintao announces the cancellation of all Mozambican public debt to China incurred in the period 1980 to 2005. According to Mozambican Finance Minister Manuel Chang, this debt amounts to about 30 million US dollars.	$ 30,000,000
2007	Rwanda	Rwandan President Paul Kagame and Chinese President Hu Jintao sign an agreement canceling Rwandan debt owed to China 'up through 2005' worth 160 million dollars.	$ 160,000,000
2007	Sierra Leone	Chinese Vice Foreign Minister Zhai Jun and Sierra Leone's Foreign Minister Zainab Bangura sign an agreement to cancel $22 million USD worth of Sierra Leone's debt.	$ 22,000,000
2007	Sudan	Sudan's President Umar al-Bashir and China's President Hu Jintao sign an agreement for forgiving part of Sudan's debts due to China amounting to some 470 million RMB (70 million USD).	$ 70,000,000
2007	Tanzania	The governments of China and Tanzania agree to forgive payment for 7 interest-free loans. The value of the debts are not disclosed.	NA
2007	Togo	Togolese Foreign Minister Ayeva Zarifou reports that the Chinese government has fulfilled an agreement to cancel 149 million RMB of debt owed by Togo.	$ 18,687,045
2007	Uganda	China's Assistant Minister for Commerce and Uganda's Finance Minister sign an agreement for China to cancel 17 million USD worth of Uganda's debt.	$ 17,000,000
2007	Zambia	The Chinese government cancels Zambia debt worth 8 million USD (60.3 million RMB).	$ 8,000,000
2008	Bolivia	China's Ambassador signs a debt relief protocol in La Paz. The amount of relief was not reported.	NA
2008	Cuba	China agrees to postpone the repayment of a part ($7.2 million) of Cuba's debt to China.	$ 7,200,000
2008	Kyrgyz Republic	The Governments of China and Kyrgyzstan signed an agreement transforming a credit worth $7 million into a grant.	$ 7,000,000
2010	Cambodia	Hun Sen, Cambodia's Prime Minister and Wu Bangguo, chairman of the National People' s Congress, sign an agreement to cancel the 200 million USD debt owed by Cambodia.	$ 200,000,000
2010	Cameroon	At the Africa-China Forum, China commits to additional debt cancellation for Cameroon, valued at CFA 2.1 billion.	$ 4,095,000
2010	Iraq	China and Iraq sign an agreement to officially forgive 80% of Iraq's debt---around $6.8 billion USD.	$ 6,800,000
2010	Sudan	The Chinese ambassador to Sudan and Sudanese officials sign an agreement to cancel 40 million RMB worth of Sudan's debt.	$ 5,908,185
2010	Zimbabwe	The Chinese government reaches an agreement with Zimbabwean state-owned steel company Ziscosteel to reschedule the $54.684 million in debt owed by the Zimbabwean steel producer.	$ 54,684,000
2011	Tanzania, Zambia	The Chinese government agrees to write off roughly 50 percent of the $150 million USD owed by Tazara.	$ 75,000,000
2011	Cote D'Ivoire	The Chinese Vice Foreign Minister and Cote d'Ivoire Foreign Minister sign documents that cancel certain debts. Details were not disclosed.	NA

Year	Country	Description	Amount (US Dollars)
2011	Cuba	China restructures or forgives Cuba's $6 billion debt to China. Details not provided.	$ 6,000,000,000
2011	Seychelles	China reschedules Seychelles' debt, allowing it to pay its 321 million rand debt over a period of 20 years, with a grace period of 10 years.	$ 44,207,982
2012	Togo	China cancels CFA 8.3 billion of Togo's debt.	$ 16,061,830
2014	Sudan	Sudan's Minister of Finance says the Chinese have offered more time for Khartoum to pay debts but declines to disclose any further details.	NA
2017	Comoros	China announces that it will write off Comorian government debt worth Cfr630m ($1.43m)	$ 1,430,000

Source: Drawn from the AidData database and supplemented by references to debt relief in IMF public documents

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RESPONSES TO ADDITIONAL QUESTIONS FOR THE RECORD SUBMITTED TO SCOTT MORRIS BY SENATOR ROBERT MENENDEZ

Multilateral Development Banks

In your testimony you state "the MDBs have been rated as the most effective development institutions by multiple systematic reviews of aid and development finance."

Question 1. Please provide support for that statement.

Answer. See the information provided below.

- Nancy Birdsall and Homi Kharas (2010 and 2014). *The Quality of Official Development Assistance (QuODA), 1st and 3rd Eds.* Washington, DC: Center for Global Development; Global Economy and Development at Brookings.
- William Easterly and Tobias Pfutze (2008). "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 (2010). "Aid Quality and Donor Rankings," World Development 39(11): 1907-17.
- Samantha Custer, Zachary Rice, Takaaki Masaki, Rebecca Latourell, and Bradly Parks (2015). *Listening to Leaders: Which Development Partners Do They Prefer and Why?* Williamsburg, VA: AidData at William and Mary
- UK Department of International Development (2011). *Multilateral Aid Review: Ensuing maximum value for money for UK aid through multilateral organisations.*
- UK Department of International Development (2016). *Raising the Standard: the Multilateral Development Review 2016.*

In your testimony you state "by my estimates, one-third to nearly half of the bank's lending in China is not appropriately focused."

Question 2. Please explain.

Answer. See the attached report, "Examining World Bank Lending to China: Graduation or Modulation?" Expected publication date January 2019.

[The report referred to above follows:]

Examining World Bank Lending to China: Graduation or Modulation

Scott Morris and Gailyn Portelance

Examining World Bank Lending to China: Graduation or Modulation?

Scott Morris and Gailyn Portelance

Abstract

Under the World Bank's 2018 capital agreement, borrowing countries are expected to gradually reduce their portfolios once a base income threshold—the Graduation Discussion Income (GDI)—is reached. However, the agreement also affirms the case for ongoing lending to these countries. One justification is tied to external value beyond the borrowing country's borders (global public goods, or GPGs). Another is tied to building capacity within the borrowing country, which can mean a focus on sub-regions where poverty remains high and capacity weak. In this paper, we examine World Bank graduation policies and lending through the lens of China, which maintains a large portfolio of World Bank projects. China currently exceeds the GDI thresholds for IBRD borrowing at the national level, while income inequality within the country leaves many noncoastal provinces below the GDI per capita threshold. Aggregate and provincial-level analysis of World Bank lending in China shows that less than half of China's portfolio comprises activities clearly linked to GPGs, while a slight majority of projects are based in provinces with per capita income below the GDI threshold. A substantial number of World Bank projects in China focus on climate change mitigation and transportation infrastructure construction, while a smaller number relate to capacity building. Overall, we find evidence that China's borrowing is broadly consistent with the 2018 principles of institutional capacity strengthening and GPG-related engagement, although significant areas of bank engagement do not appear to fall within the parameters of these principles.

Center for Global Development
2055 L Street NW
Fifth Floor
Washington DC 20036
202-416-4000
www.cgdev.org

Scott Morris and Gailyn Portelance. 2018. "Examining World Bank Lending to China: Graduation or Modulation?" CGD Policy Paper. Washington, DC: Center for Global Development. https://www.cgdev.org/publication/examining-world-bank-lending-china-graduation-or-modulation

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CGD Policy Paper [#]
January 2019

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The World Bank and its shareholders have wrestled with the question of eligibility for assistance since the bank's founding in 1944. In recent decades, the non-borrowing members (the United States in particular) have tended to press for clearer standards and a meaningful way to end country eligibility based on measures of economic progress, relying heavily on growth in per capita income within the borrowing country. The borrowing member countries, particularly countries like China that have seen the most economic progress, have tended to resist firm rules and automatic triggers, seeking to maintain access to the bank's preferential lending rates and technical support.

The eligibility issue came to the fore again early in 2018 as the bank's shareholders struck a deal to increase the bank's capital and lending capacity going forward. The written agreement reveals the contours of the debate. It affirms the need for a "graduation policy" that ultimately makes some countries ineligible for bank lending while also affirming that all countries who want access to IBRD assistance should get it.

Clearly, the World Bank's approach to country graduation remains contested among the bank's shareholders. This paper seeks to inform the ongoing debate by:

- reviewing the World Bank's rules pertaining to eligibility and graduation to ineligibility, including new language contained in the 2018 capital agreement (section I)

- examining the borrowing practices of countries that are deemed ready for graduation according to the rules (section II)

- assessing the borrowing practices of China as a leading borrower according to the policy framework in the 2018 capital agreement (sections III and IV)

In particular, the paper introduces new analysis of China's borrowing from the World Bank in order to better understand the degree to which bank policies around graduation affect the composition of projects for a major borrower. China is the focus of this analysis (among other possible graduation-eligible borrowers) because its project portfolio with the World Bank is large and its borrowing has been a target of criticism by the United States, the World Bank's largest shareholder.

We conclude with recommendations for how current World Bank policy on graduation, and the ongoing debate that drives it, could best be supported by changes in country-level operations to better align country portfolios with bank policy and modest changes in reporting practices to facilitate this alignment. On balance, we conclude that the way forward for the World Bank's engagement in countries like China calls for modulation rather than graduation.

I. IBRD Eligibility Rules

According to bank policy, countries remain eligible to borrow from the International Bank for Reconstruction and Development (IBRD) until they are able to sustain long-term development programs without relying on bank financing. Thus, graduation is not an automatic consequence of passing an income threshold but is based on whether a country has reached a level of institutional development and capital-market access that enables it to sustain these programs. However, there is significant ambiguity surrounding what bank programs in graduation-eligible countries should look like, and little clarity, beyond these broad guidelines, on what exactly makes a country ready to graduate. Reinforcing this ambiguity is the fact that graduation from the IBRD has not represented an orderly, linear trajectory—of the 25 countries that have graduated from IBRD eligibility, eight have since "degraduated" or received additional loans after graduation.

The Elements of IBRD Graduation

The bank's Articles of Agreement provide the legal basis for IBRD graduation policy. Specifically, there are two relevant provisions (italics added):

- **Article III, section 4 (i)**: The bank may make or guarantee a loan when "the bank is satisfied that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the bank are *reasonable* for the borrower."

- **Article 1 (ii):** "When private capital is not available on *reasonable* terms, [the purpose of the bank is] to supplement private investment by providing, on suitable conditions, finance for productive purposes."

Use of a "reasonableness" standard in both articles introduces considerable ambiguity to the question of eligibility and eventually to graduation. It also accounts for the ongoing debate attached to graduation policy. Various elements of policy relating to graduation have emerged over the years, adding some detail to the otherwise ambiguous nature of the language in the Articles. In 1973, the bank first proposed using the "rough benchmark" of $1,000 gross national income (GNI) per capita, in 1970 dollars, to trigger a conversation of graduation.[1] The policy also included a provision that this threshold was to be adjusted yearly based on prices and exchange rates.

In 1982, the World Bank's executive directors approved a more comprehensive policy that went beyond the limited focus outlined in the Articles of Agreement.[2] The new policy established that a graduation decision should be based on two key factors: a country's level of development and overall economic situation, and a country's capacity to sustain a long-term development program. They further directed the bank to assess these conditions by a country's ability to access capital markets on *reasonable* terms and a country's progress in establishing *key* institutions for economic and social development. The new policy stated that

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[1] Jac C. Heckelman, Stephen Knack, F. Halsey Rogers, "Crossing the Threshold: An Analysis of IBRD Graduation Policy," Policy Research Working Paper 5531, World Bank, January 2011.
[2] Ibrahim F.I. Shihata, *The World Bank Legal Papers*, 2000.

graduation should be "flexible and fair," with graduation from new lending ideally occurring within five years after a country passes the threshold.

A year later, the bank affirmed that the GNI per capita guidelines should continue to be adjusted based on the annual rate of change of the SDR-deflator. Today (FY2018), the threshold for "initiating graduation" is $6,895 per capita and is set to fall to $6,795 per capital for FY2019.[3]

In 1984 bank policy further clarified that the GNI per capita threshold is one of many indicators of development and should only be used as a trigger to start the discussion of graduation on the basis of a country's ability to access capital markets and its progress on institutions for economic and social development. Shortly after, five reports were published—for Cyprus, Oman, the Bahamas, Trinidad and Tobago, and Barbados—starting this very conversation of graduation.[4] Three of these countries did in fact graduate within five years, though one (Trinidad and Tobago) reversed course in 1990 and remains eligible for IBRD lending today.

Policy Reforms in 2018

In April 2018, the World Bank's shareholders reached an agreement to expand the bank's capital. The agreement also outlined a set of policies pertaining to engagement in graduation-eligible countries.[5] Importantly, the 2018 agreement does not adjust existing policy when it comes to basic eligibility for borrowing and reaffirms the core elements of the policy established in 1982.

In fact, the 2018 language puts the graduation decision in the hands of the borrowing country, indicating that the "[b]orrowing countries' decision to graduate from IBRD involves a dialogue between the country and the bank, and takes place on a case-by-case basis reflecting country context."[6] Consistent with this approach, the 2018 report adopts the designation "Graduation Discussion Income" (GDI) to describe the threshold of per capita country income that will trigger a discussion about graduating from IBRD assistance.

Rather than adopting harder triggers for graduation or hastening the timeline for country graduations, the 2018 agreement focuses on the terms of engagement with countries that are above the graduation threshold. Specifically, it adopts three approaches:

- a limitation on the overall share of the IBRD **portfolio** allocated to these countries

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[3] Shantayanan Devarajan, Haishan Fu, Bala Bhaskar Kalimili, "Per Capita Income Guidelines for Operational Purposes," World Bank, May 2018. The threshold for a given year is based on per capita income data from two years' prior.
[4] Ibrahim F.I. Shihata, *The World Bank Legal Papers*, 2000
[5] World Bank Group, "Sustainable Financing for Sustainable Development: World Bank Group Capital Package Proposal," April 2018
[6] Ibid., paragraph 32

- a hardening of **pricing** on IBRD lending to these countries
- an articulation of **principles** for the types of engagement by the IBRD in these countries

On portfolio shares, the agreement indicates that the share of non-crisis lending allocated to graduation-eligible or "GDI" countries will be targeted at 33 percent through FY2030 and 30 percent after FY2030. At current lending levels, these constraints do not appear to be binding and are consistent with historical lending levels (see figure 1 in section II). However, they may become binding over time as more countries exceed the per capita income threshold that determines graduation eligibility.

On pricing, the agreement adopts a very modest hardening in terms for GDI countries, introducing loan surcharges of 5 to 25 basis points for these countries. Compared to the cost of market borrowing for an illustrative list of affected countries, these surcharges are very small and still provides a substantial "discount" in borrowing for these countries relative to their cost of borrowing in bond markets.

Table 1. IBRD "discounts" to borrowing countries as compared to 10-year government bonds

	10-year government bond	IBRD "discount"
China	4.03	+0.51 to +1.01
Brazil	9.84	+6.32 to +6.82
Mexico	7.58	+4.06 to +4.56
Chile	4.57	+1.55
Turkey	11.45	+8.43
Romania	4.32	+1.30

Nonetheless, the agreement marks the first time that the bank has sought to differentiate pricing based on country income levels, with higher-income countries paying more.

On the principles guiding IBRD engagement in GDI countries, the agreement indicates that "new IBRD activities. . .will have a primary focus on interventions to strengthen policies and institutions required for sustainable IBRD graduation."[7] This language carries forward the vague standards of the 1982 policy.

However, additional language suggests that the bank's engagement could include:

> managing potential crisis risks that can have regional and global spillovers;. . . delivery of regional and global public goods; innovative solutions to poverty and

[7] Ibid., paragraph 9

> shared prosperity challenges that can be scaled up. . .and generate lessons for lower income countries; and creating knowledge.[8]

Each of these examples illustrates a type of global public good, which suggests a strong intent to focus on engagements that can demonstrate value for other countries.

II. Borrowing Practices of Graduation-Eligible Countries

It is quickly becoming an IBRD world. In 1969 there were 62 IDA countries and 31 IBRD countries.[9] As of 2017 the composition has flipped: there are now 24 IDA countries and 78 IBRD countries.[10] Of the IBRD borrowing countries, 29 are currently above the GDI threshold, 8 of which are high-income countries.[11]

Over the past 10 fiscal years, lending to GDI countries has accounted for a minority share of the IBRD portfolio, although the spike in crisis-lending circa 2009–2010 and its aftermath distorted these shares. Figure 1 shows, in real terms, the share of IBRD annual commitments to GDI countries both in aggregate and as a total share of IBRD lending, which has averaged about one-third of the portfolio over the decade.[12]

From this standpoint, the bank's new policy to allocate 30 percent of resources to countries above the GDI seems to align with the existing pattern of IBRD lending.

Of the 30 countries that were graduation-eligible in FY 2018, 13 borrowed from the IBRD.[13] Many countries, including Trinidad and Tobago, Suriname, St. Kitts and Nevis, Palau, and Malaysia, have not borrowed from the IBRD over the past 10 years, but their continuing eligibility reflects the bank's concern that external shocks could place a country in a position where IBRD financing is necessary, a characterization seemingly at odds with the 1982 policy, which suggests a country should ideally graduate from new IBRD lending within five years of crossing the GDI. Currently, there are 10 countries—Brazil, Chile, Gabon, Lebanon, Mexico, Panama, Romania, Seychelles, Turkey, and Uruguay—that crossed the GDI five or more years ago yet received IBRD loans in FY 2018.

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[8] Ibid., paragraph 32

[9] For a more comprehensive analysis of transformations in World Bank engagement since its establishment, see "The World Bank at 75" by Scott Morris and Madeline Gleave, Center for Global Development, March 2015.

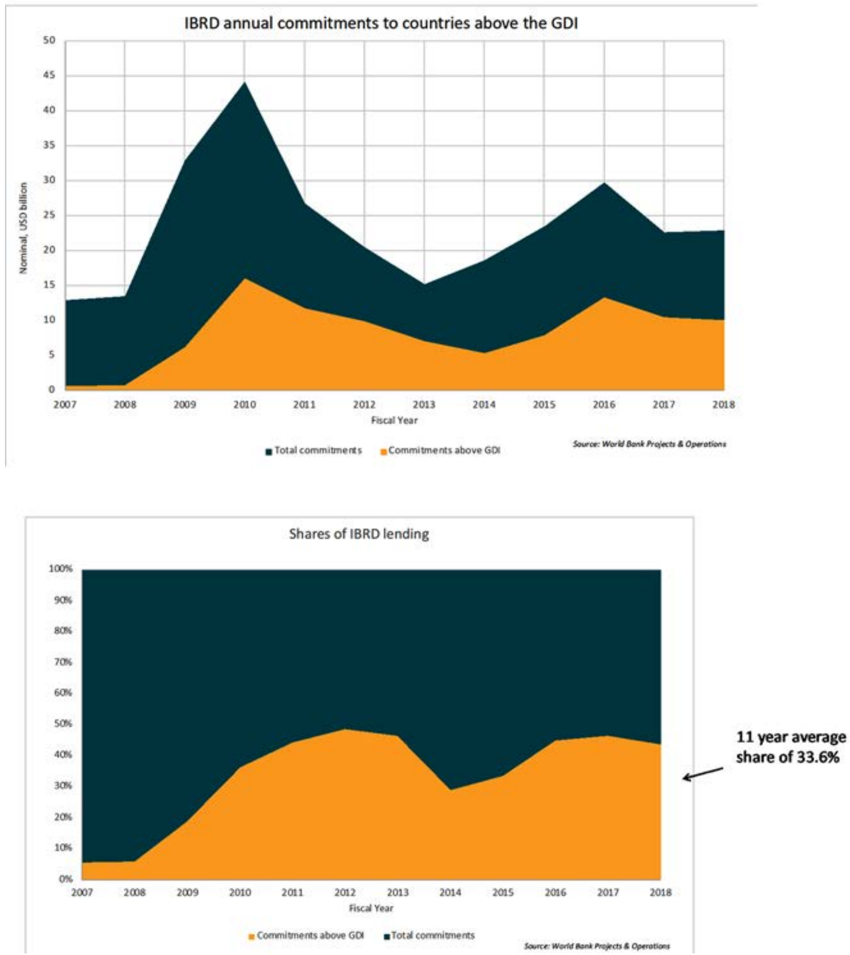
[10] The 78 IBRD countries includes 9 "Blend" countries; see World Bank Policies, Financial Terms and Conditions of Bank Financing.

[11] Six of these countries—Dominica, Grenada, Grenadines, the Maldives, St. Lucia, and St. Vincent—receive IDA financing on Small Economy terms.

[12] These figures were calculated by aggregating the total amount of lending for each country above and below the GDI given each fiscal years' threshold. Not every country that exceeded the threshold in a given year exceeded it in all years.

[13] Argentina, Brazil, Chile, China, Gabon, Lebanon, Mexico, Montenegro, Panama, Romania, Seychelles, Turkey, and Uruguay.

Figure 1.


IBRD annual commitments to countries above the GDI
Nominal, USD billion
Fiscal Year
Total commitments
Commitments above GDI
Source: World Bank Projects & Operations
Shares of IBRD lending
Fiscal Year
Commitments above GDI
Total commitments
Source: World Bank Projects & Operations
11 year average share of 33.6%

Some research finds that observed correlates of graduation are generally consistent with stated bank policy. For example, among the IBRD graduates that have crossed the GDI, those that are wealthier and more institutionally developed, as well as those that are less vulnerable to trade, financial, and other shocks, are more likely to have graduated.[14] Additionally, the bank's Independent Evaluation Group (IEG) recently concluded that IBRD support remains highly relevant for higher-income borrowers from two perspectives: in helping countries address certain developmental challenges (such as improving the quality of public sector institutions) and in having a key demonstration effect for other low-income countries.[15]

However, the IEG also found that broad systemic improvements to public sector institutions were less common, and despite noticeable individual project and country achievements, significant challenges persisted for achieving large and sustained improvements in the quality of basic public services and for strengthening national natural resource management institutions. Considering that 2018 principles for bank engagement in GDI countries emphasize institutional capacity building, further investigation into the constraints around lending in support of these activities is needed.

III. Examining China's IBRD Borrowing According to the 2018 Agreement

China represents a leading case for questions about IBRD eligibility and engagement following the 2018 capital agreement. It is one of 30 borrowing countries that sit above the FY 2018 GDI threshold of $6,895. Since China first crossed the threshold in FY 2016, the IBRD has made commitments to the country totaling over $7.8 billion. On a per capita basis, China is not the bank's wealthiest borrower. There are currently eight borrowing countries with higher per capita incomes. Nonetheless, China is among the bank's largest borrowers. Further, China's economy is the second largest in the world, and the Chinese government has become one of the largest official lenders to other countries, rivaling World Bank lending itself. This juxtaposition has made China emblematic of the need to encourage graduation in the eyes of key World Bank shareholders like the United States.[16] But it also represents a test of whether the World Bank does in fact take a different approach in its wealthier borrowing countries and the degree to which the emphasis on global public goods in the 2018 agreement might already inform engagement in these countries.

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[14] Jac C. Heckelman, Stephen Knack, F. Halsey Rogers, "Crossing the Threshold: An Analysis of IBRD Graduation Policy," Policy Research Working Paper 5531, World Bank, January 2011.

[15] World Bank, "World Bank Group Engagement in Upper-Middle-Income Countries: Evidence from IEG Evaluations," 2017. Independent Evaluation Group, Synthesis Report. Washington, DC: World Bank. After a review of the portfolio of engagement in these countries, they found that the bank had a positive role in helping to address gaps in the quality of UMICs' public sector institutions; in accelerating growth in private sector productivity and innovation; in increasing the private financing of infrastructure; in ensuring improved quality of basic health, education, and urban services; and in providing crucial support to enhance UMIC's resilience to environmental and security shocks.

[16] See Financial Times, "Mnuchin call for sweeping IMF and World Bank reform," October 13, 2017.

Overview of the World Bank-China Relationship

Despite the critical view of the United States, the relationship between the bank and China appears to be strong, such that it appears unlikely that China will seek to graduate from IBRD any time soon. Since graduating from IDA in 1999, three documents have shaped the World Bank's relationship with China: the Country Partnership Strategy (CPS) covering FY 2006–10;[17] *China 2030: Building a Modern, Harmonious and Creative High-Income Society;*[18] and the CPS covering FY 2013–16.[19]

The first CPS outlines a clear role for IBRD lending: to employ international expertise to help the government of China (GoC) "complete the transition to a market economy, improve the welfare of the poor and near-poor, and develop and implement sustainable resource-management practices." The bank directly addresses the question as to why China is a client of the bank, stating that although the GoC can access international capital markets at similar or lower interest rates than what the IBRD charges, it still borrows from the IBRD because it values the non-financial services it provides as a part of its lending package. Indeed, whatever advantage China obtains from preferential IBRD lending rates, it applies to an extremely small amount of borrowing in context: over the past decade, IBRD commitments have hovered around $2 billion per annum, for an economy that reached $11 trillion in 2016.[20]

The bank also clarifies in the 2006-10 CPS that while China remains eligible for IBRD lending, there is no reason to treat it differently from other borrowers, a position now at odds with the 2018 capital agreement.[21] China 2030, developed in partnership between the bank and GoC, establishes the new era of China's development strategy and identifies China as an upper-middle-income country (UMIC) aiming to achieve high-income country status in the next couple of decades. There is no comment on China's impending "graduation" from IBRD's assistance.

The most recent CPS, covering FY13–16, characterizes World Bank engagement based on two strategic themes: supporting greener growth and promoting more inclusive development, and one cross cutting theme to advance China's relationship with the rest of the world.[22] These themes of engagement are designed to align with China's 12th Five-Year

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[17] World Bank, "Country Partnership Strategy for The People's Republic of China For the Period 2006–2010." May 2006.

[18] World Bank and the Development Research Center of the State Council, the People's Republic of China, *China 2030: Building a Modern, Harmonious, and Creative Society*. 2013. Washington, DC: World Bank.

[19] World Bank, "Country Partnership Strategy for The People's Republic of China for the Period FY2013–FY2016." October 2012.

[20] Scott Morris, "China Borrows a Lot of Money from the World Bank, and That's Okay." January 2018.

[21] World Bank, "Country Partnership Strategy for The People's Republic of China for the Period 2006-2010." May 2006, page 17.

[22] The CPS broadly defines the strategic themes as including the following projects: Supporting Greener Growth (sustainable energy, urban environmental services, low-carbon urban transport, sustainable agricultural practices, sustainable natural resource management approaches, pollution management, and mechanisms for managing climate change); Promoting Inclusive Development (increase access to quality health services and social

Plan. In the CPS, the World Bank explicitly acknowledges that China has asked for new IBRD instruments (Development Policy Loans [DPLs] and Pay for Results [P4R]) to respond to the new economic context, and references China's growing role as a WBG stakeholder as donor to IDA. The bank states that its comparative advantage in China remains in its ability to provide and facilitate knowledge sharing both with China and in relation to other countries, particularly related to environmental remediation, health sector interventions, and in the energy and transport sectors.[23]

The most recent CPS articulates an overall objective to focus on the less-developed western and inland provinces ("move west") and on environmental objectives, particularly aligning with China's Air Pollution Prevention and Control Action plan which focuses on pollution control in or around the three-main urban and industrial regions: Beijing-Tianjin-Hebei (Jing-Jin-Ji). There is not yet a CPS for China beyond the most recent document covering FY13–16. However, in the most recent Performance and Learning review covering Bank engagement during this time, the bank categorizes current and pipeline projects under the three aforementioned thematic categories.

Aggregate and Provincial-Level Analysis of World Bank Lending to China

Taking the 2018 capital agreement as a new framework for engagement in graduation eligible countries, we seek to apply it to IBRD lending to China in practice. Specifically, we use provincial-level analysis to examine the degree to which China's borrowing on an aggregate basis is aligned with the principles for GDI countries established in the 2018 capital agreement: efforts to better enable graduation, including initiatives explicitly framed as "capacity building," and support for global public goods (GPGs).

According to information available in project documents, the bank generally appears to orient engagement in China at the provincial level. A provincial or municipal government actor or a subnational project management office is the implementer for nearly every project. This allows for a basic analysis on the provincial distribution of cumulative project financing since China became graduation-eligible.

We find in project level analysis that just 44 percent of the China portfolio comprises activities that are clearly GPG-related (primarily pollution control and sustainable infrastructure) or designated strictly as capacity building. This suggests weak alignment with the 2018 principles.

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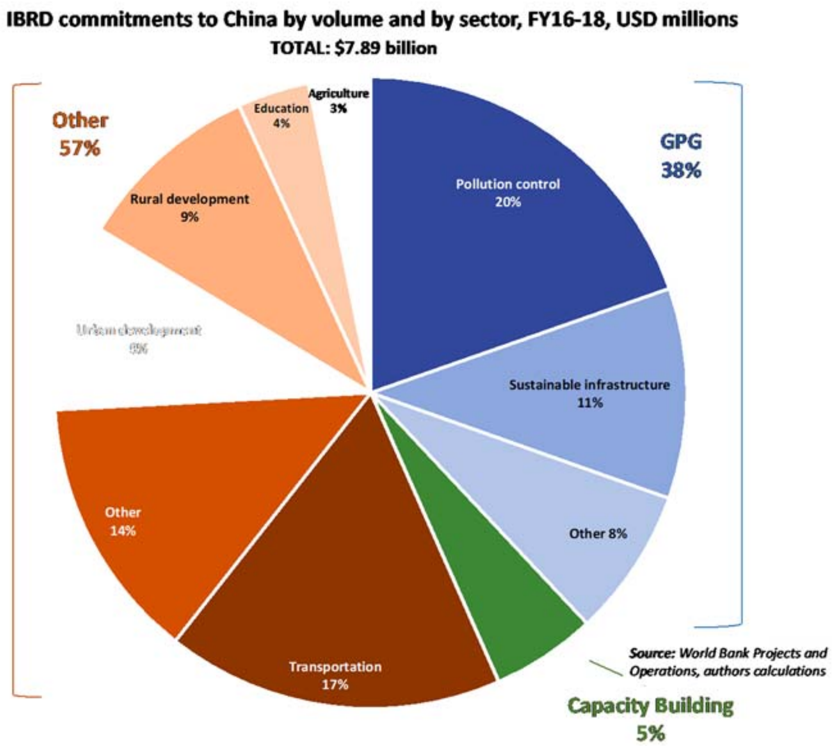
protection, strengthening skills development, enhancing opportunities in rural areas, and improving transport connectivity); Cross-cutting Theme (advance mutually beneficial relations with the world, by supporting China's South-South cooperation and China's role as a global stakeholder).

[23] World Bank Group, "Performance and Learning Review of the Country Partnership Strategy for the People's Republic of China for the Period FY13- FY16." January 2016, page 13.

Figure 2.



Source: World Bank Projects and Operations, authors calculations

But a strict measure of capacity building may be overly limiting. The stated 2018 goal of "institutional strengthening" could also accommodate a broader rationale and approach to engagement. Namely, we interpret a key element of this rationale to be a focus on sub-regions within the country where economic progress has been weak. From a geographic perspective, World Bank focus on lower income provinces would generally support the principle of assisting the country toward graduation.

From this standpoint, we consider World Bank lending to China from a provincial perspective. First, we identify Chinese provinces in relation to the IBRD's GDI threshold (see figure 3).

Just over half of Chinese provinces have per capita incomes below the GDI threshold, with 45 percent of provinces above the threshold. The latter are concentrated in the eastern half of country.

Next, we compare this distribution of provinces by income with the pattern of IBRD lending by identifying the location of projects supported through IBRD loans. Figure 4 compares the previous map illustrating provinces above and below the GDI with aggregated project pipeline commitments by province over the past three fiscal years.

As outlined in the CPS, bank projects by volume do appear to be concentrated in the inland provinces: about 83 percent of lending by volume are in noncoastal provinces, with the smaller share of lending in the coastal provinces where GDP per capita is significantly higher and growth has been rapid over the past decade.

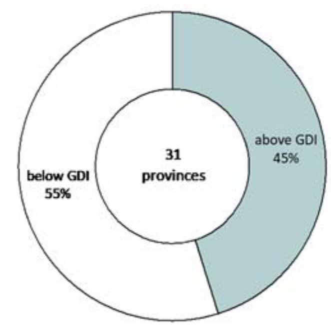
However, by a more precise measure of provincial-level per capita income, just 58 percent of lending has gone to provinces below the GDI threshold. If IBRD lending were designed to be strictly focused on the poorer provinces as a path toward graduation, then actual lending appears to have fallen well short.

Nonetheless, the 2018 agreement also emphasizes the value of GPG activities in GDI countries. From this standpoint, we consider the IBRD lending portfolio according to GPG alignment. Of the $7.9 billion lending portfolio during the period, $3 billion was devoted to GPG-related activities, 60 percent of which were in the wealthier provinces. In principle, we can expect leading GPG activities to be concentrated in areas of higher economic activity and therefore higher incomes. Specifically, climate mitigation efforts within China, which represent a clear GPG, are likely to be associated with provinces and regions where emissions are high. For example, a large concentration of climate-related financing is in the wealthier province of Hebei, where the bank and the GoC have focused efforts on pollution control. More generally, nearly two-thirds of GPG-related lending by volume is concentrated in GDI provinces, with just over a third in below-GDI provinces (see figure 5).

In sum, the majority of IBRD lending has been concentrated in China's below-GDI provinces. Of the lending that has gone to GDI provinces, 54 percent has been devoted to GPG activities. Of the non-GPG activities generally, there is a strong bias in favor of the below-GDI provinces. Seventy percent of the bank's non-GPG portfolio is allocated to these provinces. And of all of the bank financing going to below-GDI provinces, 74 percent is for non-GPG activities (see figures 6 and 7).

Figure 3.

14 Chinese provinces are above the Graduation Discussion Income over FY16-18



Note for all maps: This map template includes 31 provincial-level administrative divisions, including 22 provinces, four municipalities, and five autonomous regions. This template does not include the two Special Administrative Regions (SAR) of Macau and Hong Kong or Taiwan province. Authorities from these three regions report separate social and economic statistics to the World Bank.

Disclaimer: All maps in this paper are for illustrative purposes and does not imply the expression of any opinion on the part of the Center for Global Development concerning the legal status of any country or territory or concerning the delimitation of frontiers or boundaries.

Note: *Evaluated against per capita income figures from 2014-16. The WB uses 2016 per capita figures for the FY 2018 GDI, 2015 per cap figures for the FY 2017 GDI, etc.*

Source: *World Bank Projects and Operations, World Bank: "How does the World Bank classify countries?*

Figure 4.

Provinces above and below the GDI (1st) vs. concentration of IBRD lending (2nd)

2nd map displays lending in aggregate nominal USD millions over a three-year period, FY16-FY18

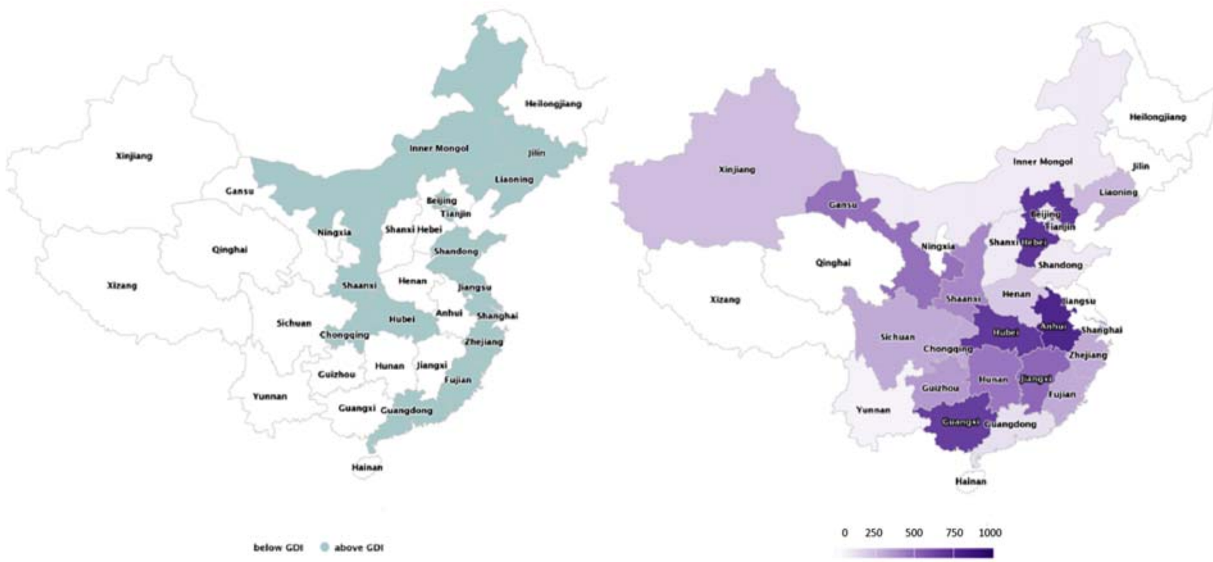
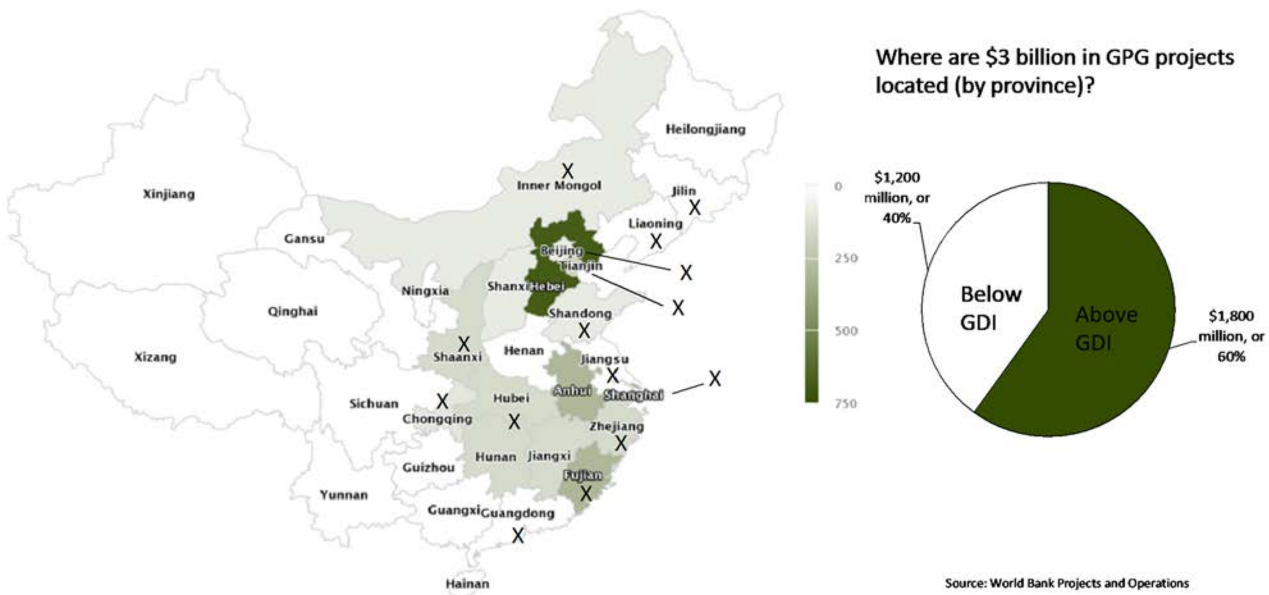


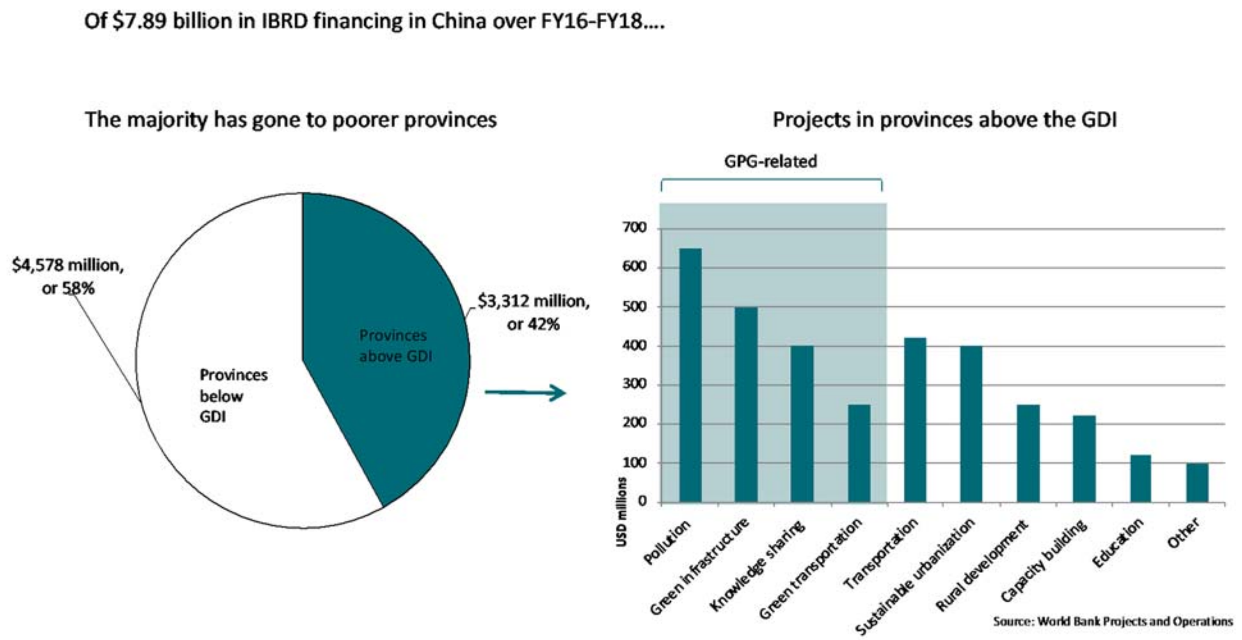
Figure 5.

Concentration of lending by province for Global Public Goods (GPGs) related projects
An "X" identifies a province above the GDI



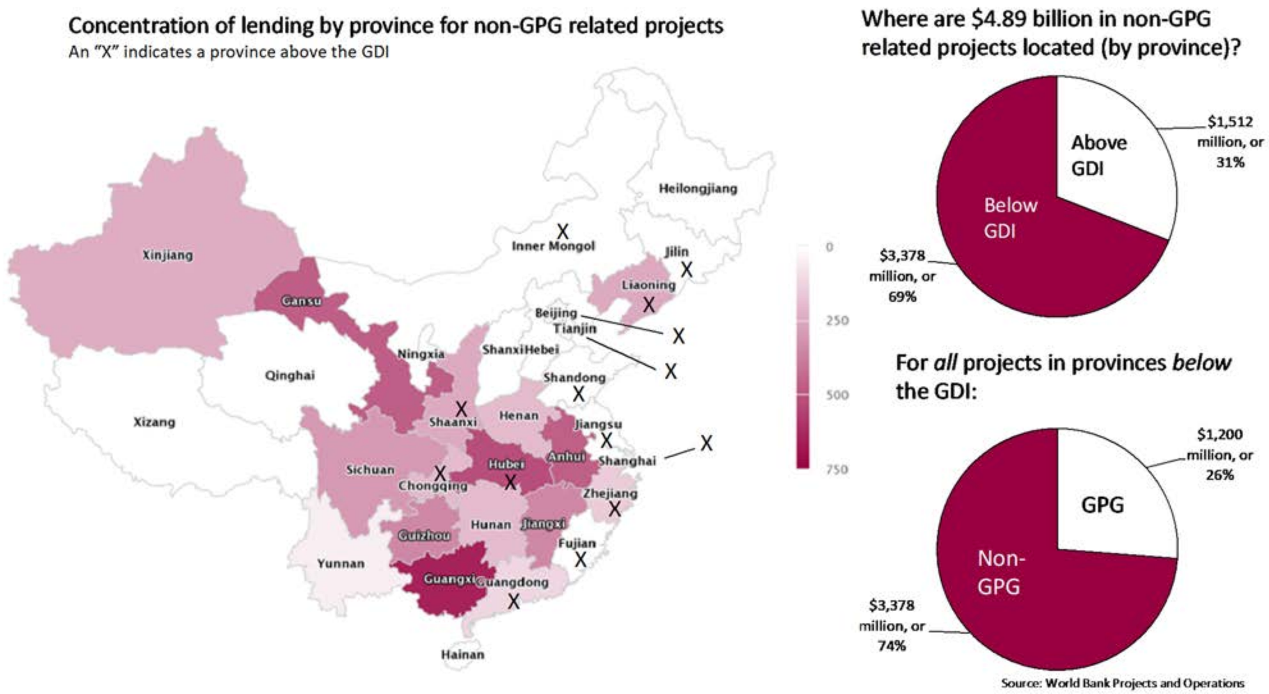
Source: World Bank Projects and Operations

Figure 6.



Of $7.89 billion in IBRD financing in China over FY16-FY18....
The majority has gone to poorer provinces
$4,578 million, or 58%
Provinces below GDI
Provinces above GDI
$3,312 million, or 42%
Projects in provinces above the GDI
GPG-related
700
600
500
400
300
200
100
0
USD millions
Pollution
Green infrastructure
Knowledge sharing
Green transportation
Transportation
Sustainable urbanization
Rural development
Capacity building
Education
Other
Source: World Bank Projects and Operations

Figure 7.


Concentration of lending by province for non-GPG related projects
An "X" indicates a province above the GDI
Xinjiang
Gansu
Qinghai
Xizang
Ningxia
Inner Mongol
Heilongjiang
Jilin
Liaoning
Beijing
Tianjin
ShanxiHebei
Shandong
Henan
Shaanxi
Jiangsu
Anhui
Shanghai
Sichuan
Chongqing
Hubei
Zhejiang
Hunan
Jiangxi
Guizhou
Fujian
Yunnan
Guangxi
Guangdong
Hainan
X
0
250
500
750
Where are $4.89 billion in non-GPG related projects located (by province)?
Above GDI
Below GDI
$1,512 million, or 31%
$3,378 million, or 69%
For all projects in provinces below the GDI:
GPG
Non-GPG
$1,200 million, or 26%
$3,378 million, or 74%
Source: World Bank Projects and Operations

IV. Qualitative Assessment of World Bank Projects in China

This section uses projects examples to illustrate the categorizations used in figure 1 and in our provincial-level analysis, which sought to categorize World Bank projects according to GPGs, bolstering economic and political institutions to prepare for sustainable graduation, and projects that fall outside of these categories.

Global Public Goods in China: Trends and Focus Areas

A focus on global public goods does appear to genuinely define some of the World Bank-China partnership. GPGs account for 38 percent of the lending portfolio and encompass a range of activities and sectors, with climate change mitigation the leading objective.

Pollution control. Since 2013, the GoC has focused on and monitoring Particulate Matter (PM2.5), considered to be the most critical pollutant for public health.[24] In response to this concentrated focus, the bank is implementing projects to help mitigate PM2.5. For example, two projects totaling $600 million are in Hebei—an air pollution prevention and control project and a clean heating project—where pollution levels are some of the highest in the country.[25] Additionally, the bank has focused on cleaning up water and land pollution in areas of both regional and global significance. For example, there are two projects in the provinces of Jiangxi and Zhejiang to control water pollution, the former targeting a large freshwater lake that flows into the Yangze river (a significant ocean polluter), and the latter cleaning up a lake to address, in part, broad negative ecological effects due to water pollution.[26] All three projects include a small provincial capacity building component. For example, the latter project will include an inter-provincial capacity building piece and focus on the institutional strengthening of the provincial project management office. Additionally, a project in the province of Hunan is oriented towards remediating brownfields and combatting soil pollution.[27] There are no pollution control projects in the province of Henan, which has the highest concentration of PM2.5 when weighted by population.[28]

Sustainable infrastructure. In response to today's compelling development and climate imperatives, financing for sustainable infrastructure—mainly financing productive, efficient,

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[24] PM2.5 is a particulate matter that causes a wide range of health effects, especially respiratory and cardiovascular systems. It is measured through primary particles (fine particles directly emitted from a source such as dust from construction sites), and secondary (produced through chemical reactions in the atmosphere, which includes SO_2, NO_2, and NH_3. These substances are emitted from the combustion of fossil fuels, use of fertilizers, livestock waste, and industrial production.

[25] Hebei Clean Heating Project, Hebei Air Pollution Prevention and Control Program

[26] Poyang Lake Basin Town Water Environment Management Project; Zhejiang Qiandao Lake Xin'an River Basin Water Resources and Ecological Environment Protection Project

[27] Zhuzhou Brownfield Remediation Project

[28] Angel Hsu, "Provinces in China commit to air pollution targets." February 2014.

and green infrastructure investments—is a key component of the GPG agenda.[29] The IBRD's financing in China reflects this effort in the areas of transportation and urbanization. For example, the bank is currently financing sustainable urban transport projects including supporting low carbon development of inland waterway transport capacity in Hubei province, focusing on data integration and utilization to improve green public transportation efficiency and reliability in Shaanxi province, and upgrading to a green metro system and encouraging public transportation in urban areas of Tianjin province.[30] Additionally, one urbanization project in Shanghai, another high emitter, will focus on providing sustainable long-term financing to green infrastructure in selected small towns.[31] As will be discussed later, this appears to be one of few urban regeneration projects that has a clear climate-oriented program component.

Knowledge sharing. Part of the bank's strategy in China is to facilitate South-South knowledge sharing, and this objective is a key component of a few projects. One project focused on reforming two provincial health programs—in Anhui and Fujian—includes an explicit intention to facilitate study tours for Chinese officials to Brazil and Costa Rica to learn about health reforms in those countries and share the Chinese experience.[32] Additionally, a project in the province of Chongqing is applying evidence-based approaches to urban regeneration to reduce environmental impact and introduce green solutions in select cities. The project aims to share these experiences across the municipality and globally, and situates the project among other cities around the world that are looking to apply such strategies.[33]

Development policy data and research. A few projects indicate the bank's intention to help develop China's data collection frameworks. For example, one project aims to expand capacity for open data at the subnational level. Starting with Guangdong province as a pilot city, the bank aims to demonstrate how China is "a unique place to benefit from the use of technology and data to improve its development outcomes." As illustrated above, the bank aims to support the development of an Intelligent Public Transport Management System in the Shaanxi province, using data integration and utilization to improve operations within the public bus system.[34]

Capacity Building

In the previous section, we suggested that a focus on below-GDI provinces in itself reflects a core principle of the 2018 agreement: "institutional strengthening to promote graduation."

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[29] Nancy Birdsall and Scott Morris, "Multilateral Development Banking for This Century's Development Challenges: five Recommendations to Shareholders of the Old and New Multilateral Development Banks." Center for Global Development, October 2016.
[30] China: Tianjin Urban Transport Improvement Project, China: Hubei Inland Waterway Improvement Project, Shaanxi Xi'an City Intelligent Public Transport Project,
[31] Shanghai New Urbanization Financing and Innovation Project
[32] China Health Reform Program (Anhui and Fujian)
[33] Chongqing New Urbanization Pilot and Demonstration Project
[34] Shaanxi Xi'an City Intelligent Public Transport Project; Capacity Building and Supporting Program for Open Data Initiatives in China;

Nonetheless, it is also worth considering the degree to which the bank is directly engaged in "institutional strengthening" or "capacity building" irrespective of provincial-level income.

A clearly identifiable focus on capacity building yields a much smaller number of World Bank projects within China, whether within non-GDI provinces or nationally. These projects account for just 5 percent of the overall portfolio.

The bank is currently implementing two subnational pilot programs to support fiscal sustainability and control subnational debt. In a fiscal sustainability project in Hunan, the bank states "the nature of Hunan's current economic and fiscal situation breeds significant risks for local progress on poverty and social indicators," implying a concerted effort by the bank to target subnational provinces that have a capacity problem.[35] The implementing agency is Hunan Provincial Financial Bureau, and project documents describe that "the operation is encouraged by the pride and determination of the Hunan Provincial Government." The second pilot project is implemented by the Chongqing Municipality Finance Bureau and Dadukou District Government in Chonqing province. Project documentation indicates "the operation is encouraged by the pride and determination of Dadukou District to transform itself from one of many fiscally distressed local government in China into a positive example of fiscal turnaround that could be followed by other localities."[36]

There appears to be one national-level capacity-building project. The bank is currently implementing one project to provide technical assistance for China's reforms in public finance. This is to align with China's own program of reform for the nation's tax system, of which, per bank documents, "many details of these reform plans are being developed or not yet proposed." This project aims to supplement—at the request of the GoC—the fiscal plan by informing the design and implementation of reforms in these select areas.[37]

The Rest of the Portfolio

Over half of the remaining bank portfolio in China is neither GPG-related or explicitly capacity-building. A large portion of these projects are in the transportation sector—and lack a clear sustainability related focus—in line with the bank's second pillar of promoting inclusive growth. Interestingly, these projects are often targeted towards provinces below the GDI, but will sometimes target incidences of high poverty in cities. For example, the bank is implementing three transportation projects in the province of Hubei alone (a province above the GDI): two projects developing freight logistics infrastructure through improved technologies in the low-income regions of Yichang and Xiaogan, a pilot project for a regional program focusing on improving transport amongst multiple cities in the

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[35] Hunan Fiscal Sustainability DPF

[36] Chongqing-Dadukou Fiscal Sustainability DPF

[37] Building a Modern Fiscal System Technical Assistance

municipality of Wuhan.[38] In some cases, the bank makes a clear effort to focus a transport project in the poorest provinces. For example, the bank is aiding the Anhui provincial transport department to upgrade rural roads in various poor counties, which will include a capacity building piece oriented towards the municipalities. According to project documents, this is because as part of decentralization reform in a province like Anhui, municipalities and counties are now responsible for a significant share of transport budgets.[39]

In Guizhou province, one of the poorest in China, the bank is implementing two transport projects. One project strengthens rural connectivity and transport in the poor city of Tongren, and in Qianxinan, another poor city, there is a focus on applying new technologies to evaluate rural accessibility, and the bank plans to train staff to use an open-source platform for quantifying and evaluating accessibility and focus on municipal capacity building.[40]

The bank has financed three projects in the education sector, two of which are in provinces below the GDI. An early childhood education innovation project in Yunnan aims to boost enrollment and is being implemented by the Yunnan Provincial Department of Education (which has 10 percent of China's total population in poverty),[41] and a technical and vocational education and training program in the second poorest province of Gansu is being implemented by the Gansu Provincial Department of Education.[42] However, neither of these projects include a significant project component devoted to capacity building at either the subnational or municipal level. In Guangdong, one of the wealthiest provinces but with a large urban-rural divide, the bank is funding a compulsory education project in rural Guangdong, which is being implemented by the Guangdong Department of Education.[43] Similarly, there is no explicit project component that implies efforts to also help the provincial government build capacity and institutional strength.

One cluster of projects includes those that are focusing on town conservation, to promote "heritage-based sustainable tourism." In Gansu, the bank aims to enable lower-income communities in historic cities, towns and villages to benefit from the overall BRI and maximize partnership with the private sector. [44] Finally, the bank is engaging on a variety of urban regeneration programs oriented at the city or municipal level. These projects tend to target poor cities or regions that have fallen behind during periods of rapid growth.[45] This is

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[38] CN-Hubei Xiaogan Logistics Infrastructure; Three Gorges Modern Logistics Center Infrastructure Project; Wuhan Integrated Transport Development.

[39] Anhui Road Maintenance Innovation and Demonstration Project, Anhui Rural Road Improvement and Upgrading PforR, Wuhan Integrated Transport Development ,

[40] Guizhou Tongren Rural Transport Project, Qianxinan Rural Transport Program for Results

[41] Yunnan Early Childhood Education Innovation Project (YECEIP)

[42] China: Gansu Technical and Vocational Education and Training Project

[43] China: Guangdong Compulsory Education Project

[44]CH-Second Gansu Cultural and Natural Heritage Protection and Development Project; Hubei Jingzhou Historic Town Conservation Project; Gansu Silk Road Revitalization Project

[45] Shaanxi Sustainable Towns Development Project; Shaanxi Poor Rural Areas Community Development Project; Guangxi Rural Poverty Alleviation Pilot Project

a part of the GoC's National New-Type Urbanization Plan (2014-2020), among other national directives, which aims to create a new urban development model by 2020.

V. Conclusion

The 2018 agreement to increase the World Bank's capital also established a consensus around core principles to guide bank policy on country eligibility for borrowing and approaches to graduation from borrowing. Our effort to apply these principles in practice to China's borrowing from the bank reveals a program of engagement that is broadly consistent with the 2018 principles, although significant areas of bank engagement do not appear to fall within the parameters of these principles.

This picture suggests that in China's case, shareholder discussions within the World Bank should be less about graduation and more about modulation. Specifically, the question of the bank's ongoing engagement with China as a borrower should focus on how best to align the entire portfolio with the 2018 principles and what adjustments in project-level selection and decisions might be necessary to achieve that.

The 2018 agreement points to further discussions within the institution aimed at elaborating the parameters and details of bank engagement in GDI countries and approaches to graduation. This language reveals the degree to which the question of graduation remains contested among the bank's shareholders. With the ongoing discussion and debate in mind, it will be helpful going forward for these discussions to include a consideration of consistent terminology and categorization of bank projects to better enable all shareholders to have a common understanding of the bank's lending practices in GDI countries. With this as a starting point, country programs can then seek greater discipline in lending practices such that nontrivial volumes of lending do not fall outside of agreed parameters for engagement or are otherwise hard to assess as consistent or inconsistent with these parameters.

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