

# Responding to AIIB: U.S. Leadership at the Multilateral Development Banks in a New Era

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## Abstract

Last year's launch of the Asian Infrastructure Investment Bank (AIIB) is appropriately viewed as a diplomatic and strategic victory for the Chinese government. In the face of growing U.S. indifference to multilateral development institutions, China is stepping up. The circumstances around the creation of the AIIB have usefully brought to light a longer trend that will ultimately lead to a diminution of U.S. leadership in the multilateral development system, brought about as much by the United States itself as by external challengers. China was successful in attracting so many countries to join the AIIB by offering more

infrastructure financing at a time when the prospect for additional financing appeared limited within the core MDBs, in large part due to U.S. resistance. The task for U.S. officials in the years ahead will be to accommodate a larger role for emerging countries, particularly China, in the multilateral development bank system, but to do so from a position of strength and with ambition for the MDBs in U.S. policy. The alternative, in which the United States neither makes space for new voices nor promotes the MDBs themselves, will inevitably lead to a weaker system that will harm the United States and the global good.

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## Introduction

Last year's launch of the Asian Infrastructure Investment Bank (AIIB)—a new multilateral development bank with fifty-seven sovereign members, among them some of the United States' closest allies—is appropriately viewed as a diplomatic and strategic victory for the Chinese government. Chinese President Xi Jinping sought to reinforce the perception that the AIIB was a Chinese project; he appeared at least four times on behalf of the new multilateral development bank (MDB) over the course of two years.

In doing so, he was borrowing from an old Washington playbook. It had long been U.S. practice for the American president to welcome the world's delegates to the annual meetings of the World Bank and International Monetary Fund (IMF) in Washington with a policy speech. Yet the previously unbroken tradition ended in 1999. Over the course of the next two administrations, the welcoming speech fell off the to-do list.

The contrast between the U.S. and Chinese attitudes toward the symbolism of these meetings reveals something deeper and more troubling. In the face of growing U.S. indifference to multilateral development institutions, China is stepping up. It is not just a matter of presidential speeches. As the Chinese were opening the AIIB's doors in early 2015, the U.S. Congress still had failed to act on a 2010 IMF governance reform package that other major countries considered essential, and across the MDBs, U.S. officials were viewed more as obstacles to than as champions for an ambitious development agenda.

A year later, this dramatic narrative may seem less starkly defined. Congress has finally approved the IMF reforms, and the AIIB has energized the other MDBs to increase their financial capacity with no apparent opposition from the United States. The AIIB itself has now shifted away from the spotlight of signing ceremonies to the more prosaic work of creating a functioning institution.

But the circumstances around the creation of the AIIB have usefully brought to light a longer trend that, if left unaddressed, will ultimately lead to a diminution of U.S. leadership in the multilateral development system, brought about as much by the United States itself as by external challengers. China was successful in attracting so many countries to join the AIIB by offering more infrastructure financing (and all that implies in terms of procurement and commercial opportunities) at a time when the prospect for additional financing appeared limited within the core MDBs, in large part due to U.S. resistance.

The task for U.S. officials in the years ahead should be to accommodate a larger role for emerging countries, particularly China, in the multilateral development bank system, but to do so from a position of strength and with ambition for the MDBs in U.S. policy. The alternative, in which the United States neither makes space for new voices nor promotes the MDBs themselves, will inevitably lead to a weaker system that will harm the United States and the global good.

## U.S. Interests in the MDBs

As the world's largest and most globally integrated economy, the United States has long benefited from the work of a core group of MDBs in the developing world, led by the World Bank, which is active globally, and including four regionally focused MDBs, the Inter-American Development Bank (IDB), the European Bank for Reconstruction and Development (EBRD), the African Development Bank (AfDB), and the Asian Development Bank (ADB). The United States is the largest shareholder in the World Bank, the IDB, and the EBRD; the second largest behind Nigeria in the AfDB; and the coequal largest with Japan in the ADB. Much of the work of these MDBs has aimed to support open, rules-based, market-oriented economies—through policy support aimed at improving regulatory regimes and government functions, through financing to help build the physical infrastructure that underpins development, and in recent decades, through health and education interventions that promote healthier, more productive populations. The ideological agenda of promoting integrated market economies globally has consistently defined the MDBs, and U.S. policymakers have just as consistently viewed this agenda as in the United States' interest.

The United States has also benefited from the financial leverage associated with its contributions to the MDBs (\$2 billion in annual U.S. contributions to the MDBs leverages \$120 billion in financing in developing countries), their financing instruments and modes of operation (providing large-scale loans alongside technical expertise), and their involvement across a larger number of countries and economic sectors than the United States can provide alone through its primary aid agency, the U.S. Agency for International Development (USAID), and other assorted international assistance programs spread across U.S. government agencies.<sup>1</sup>

Fundamentally, the MDBs serve U.S. interests by effectively meeting the needs of developing countries. In surveys of developing country policymakers, the banks are rated more highly as valued partners on development policy issues than bilateral actors, including the United States.<sup>2</sup> Developed and developing countries alike see the value in MDBs that employ financial leverage effectively, are present in a wide array of countries and sectors, and are generally rated as the most effective actors in development finance. And increasingly, the MDBs are employed in a range of activities that promote public goods across country borders, whether as leading financiers and knowledge providers on climate change mitigation and adaptation, responders to health pandemics, or most recently, as leading actors in addressing the Syrian refugee crisis.

There is strong complementarity between MDB and U.S. bilateral assistance programs. Humanitarian assistance is a dominant focus of U.S. bilateral foreign aid, something that is largely not a function of the MDBs. Moreover, infrastructure investment is the single largest function of the banks, an area that forms a small part of the U.S. foreign assistance program, which mostly lacks the basic instruments (loans and guarantees) to support large physical infrastructure. In general, U.S. foreign assistance relies on grant assistance, in contrast to the MDBs which predominantly provide loans, guarantees, and equity investments.

The MDBs can also serve as effective instruments of U.S. foreign policy. The United States has always looked to the MDBs to meet strategic objectives in countries and regions at critical moments,

often leading coalitions of shareholders within the institutions and sometimes acting unilaterally. Typically, the MDBs act as carrots, providing financing and technical assistance in support of a particular objective, such as working with a newly democratically elected government to promote economic growth. Sometimes, withholding or withdrawing MDB support can serve as part of a broader U.S.-led sanctions regime against a country.

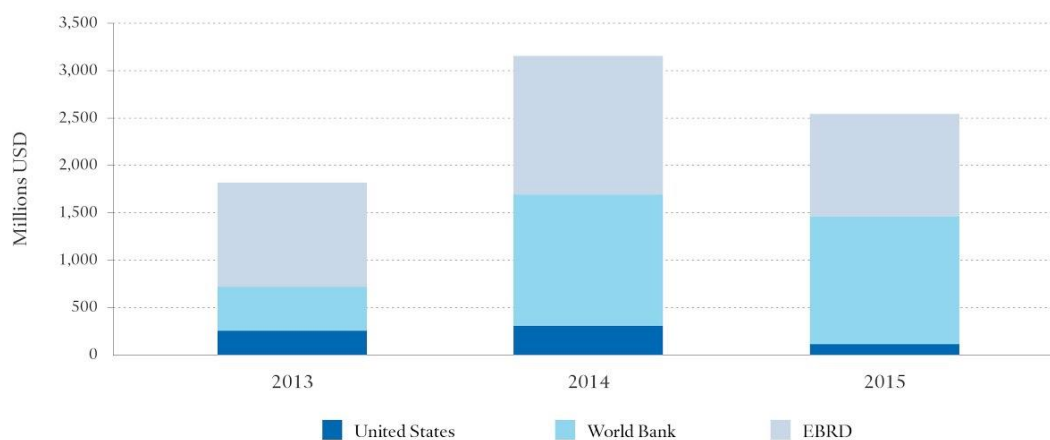
Three recent examples highlight how the MDBs serve as strategic instruments for the United States, and how MDB action in support of U.S. interests depends on Washington's power within the institutions.

#### UKRAINE 2014

The case of Ukraine demonstrates how nonpolitical MDBs can be used as instruments of U.S. foreign policy when there is strong support among U.S. allies. Following Russia's annexation of Crimea in 2014, the United States rallied European allies to use the World Bank and European Bank for Reconstruction and Development as carrots and sticks in the two countries.

At the urging of the United States, the World Bank and EBRD made sizable commitments of support to the Western-oriented government in Kiev. New MDB lending to Ukraine totaled \$5 billion for 2014 and 2015, triple the assistance given prior to the annexation. During the same period, U.S. bilateral assistance increased only modestly, from \$256 million in 2013 to just over \$300 million in 2014 before falling again to just \$115 million by 2015 (figure 1). The disparate responses demonstrate how the MDBs can pursue U.S. objectives better than United States' own bilateral programs: MDB lending is quickly scalable, achieving much greater volumes than the grant-based U.S. programs. U.S. bilateral assistance is also highly constrained when it comes to nonpoor developing countries like Ukraine. More important, the decision to scale up MDB assistance to Ukraine also demonstrates U.S. power in the MDBs in the face of Russian resistance and the ambivalence of China.<sup>3</sup>

Figure 1. Commitments to Ukraine (millions USD)



Sources: World Bank Group, EBRD, USAID Foreign Aid Dashboard.

The United States also successfully led efforts to restrict new MDB lending to Russia following Moscow's de facto annexation of Crimea. For the EBRD, this was a particularly striking move because Russia was the bank's largest client country at the time.

### *MYANMAR 2011*

In Myanmar, the United States and Japan had a shared interest in supporting the country's nascent economic opening to the world, which began in 2011. Myanmar's reforms were partly motivated by its desire to lessen its reliance on China, its largest trading partner and the source of large-scale external financing during a period when foreign flows from other sources were extremely limited.<sup>4</sup> China's development finance in the country was subject to an increasingly frayed bilateral relationship. A \$2.5 billion oil and gas pipeline between the two countries only moved forward in 2010 after a series of delays by Myanmar's government. More recently, the government canceled a six thousand megawatt hydroelectric power project representing \$3.6 billion in Chinese financing.<sup>5</sup>

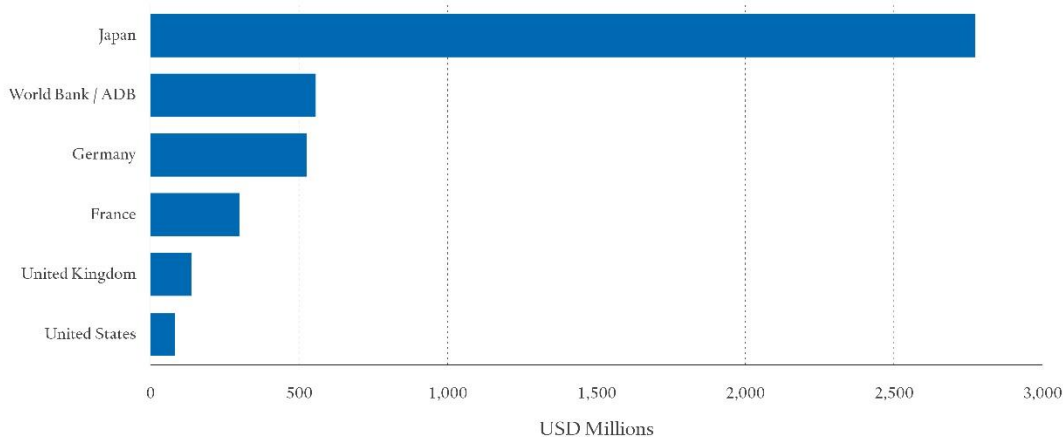
After some political reforms, Myanmar's government saw an opportunity to diversify its economic relationships. U.S. policymakers had a particular interest in encouraging Myanmar's government to accept a leading role for the ADB and World Bank in financing and coordinating major public works projects. At the same time, Japan was preparing to reestablish bilateral flows with the country on a major scale, quickly demonstrating a capacity and commitment to meet a significant portion of Myanmar's financing needs through bilateral programs (figure 2). Alongside China's financing, Japan's interest demonstrated to U.S. policymakers that commercial concerns in the country could quickly be dominated by the region's two largest economic powers to the exclusion of U.S. firms.

Facing an established financing relationship between China and Myanmar and what appeared to be an impending flood of new financing from countries such as France, Germany, and Japan (all of which had much larger bilateral development finance institutions than did the United States), Washington saw particular value in the MDBs' working with Myanmar to set rules creating a level playing field for things like bidding on large public works projects.

The United States employed the MDBs as a central part of its policy toward Myanmar for three reasons: doing so supported the opening of an autocratic and closed regime, U.S. policymakers wished to rebalance the country's relationships away from China, and the United States wanted to promote a transparent and competitive commercial environment on behalf of U.S. firms, as more prominent regional economies (China and Japan) aggressively pursued commercial interests there.

In support of these strategic objectives, U.S. leadership within the World Bank and the ADB helped to ensure that the institutions were aggressive in working toward clearing Myanmar's arrears and convincing the Burmese government that cooperation with the multilateral institutions was desirable. As a result, the two institutions together emerged as the second largest donors to the country behind Japan, with planned assistance quickly rising to just over \$2 billion by 2017, well ahead of China.

Figure 2. Top Donors to Myanmar (2013–2014 average)



Source: OECD DAC.

### POWER AFRICA 2013

The Barack Obama administration sought to counter the increasingly dominant Chinese position in sub-Saharan Africa through a new initiative focused on electrification in energy-poor African countries. At its inception in 2013, Power Africa sought to counter the misalignment of existing bilateral tools with the development interests in the region. U.S. foreign assistance efforts were largely grant-based and focused on disease eradication, while China was responding to African demand for large-scale infrastructure lending.

Power Africa's initial financing commitments have relied heavily on the World Bank and African Development Bank, with combined MDB financing of \$8 billion, surpassing the U.S. government's own commitment of \$7 billion.<sup>6</sup>

Efforts to further reprogram traditional foreign assistance away from politically popular health and humanitarian programs and toward large-scale lending for power projects would have provoked strong resistance in Congress and among advocacy groups. Not only is there strong political support for the disease-eradication programs that dominate U.S. aid, but there is also skepticism in Congress when it comes to commercially oriented financing activities of agencies such as the Overseas Private Investment Corporation and Export-Import Bank of the United States. Both agencies have encountered resistance to the basic premise of a U.S. government-sponsored lender or investor in foreign markets in recent years.

The strong presence of the MDBs enabled a viable U.S.-branded infrastructure initiative in fourteen African countries while avoiding a politically difficult reallocation of bilateral assistance programs during a period of fixed foreign assistance budgets. MDB support was critical in helping to shore up U.S. relationships in the region in the face of growing Chinese influence resulting from China's large bilateral investments across Africa.

In each of these cases (Ukraine, Myanmar, and Power Africa), there were clear U.S. objectives and an equally clear identification of an MDB role in meeting those objectives. Making this role a reality in each case also depended on some exercise of U.S. power within the MDBs.

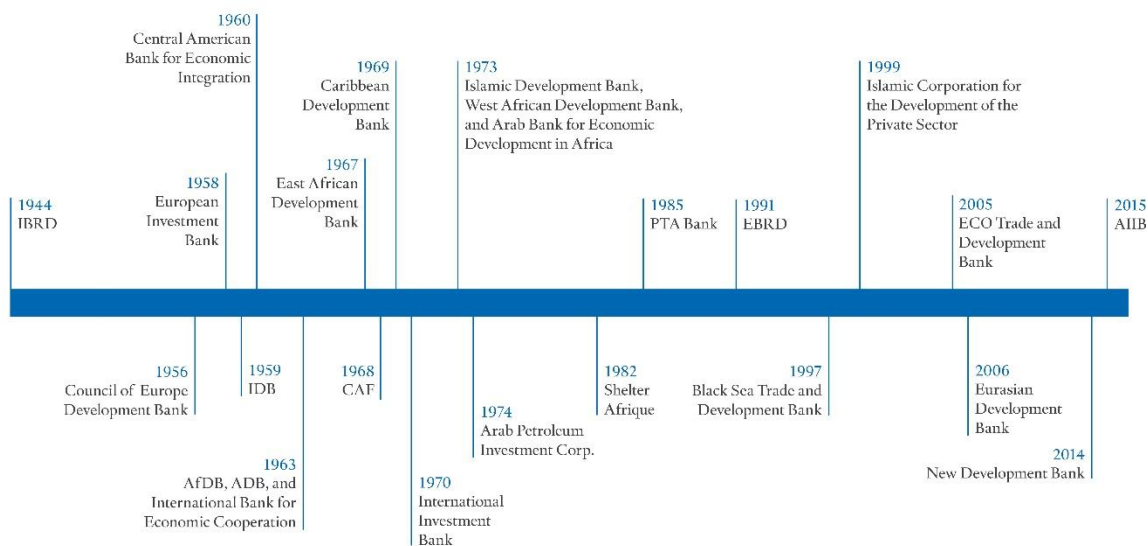
## Defining U.S. Power in the MDB System

Despite these successes, the United States does not have sufficient power within the MDBs to impose its will unilaterally on a consistent basis. MDB action on behalf of U.S. interests has almost always depended on U.S. coalition building among MDB shareholders, which in turn relies on an alignment of interests and sense of goodwill. Moreover, the effectiveness and overall impact of the core MDBs depends on their position in the broader landscape of multilateral actors. And here, the picture is changing.

The core MDBs are commonly understood to be the five institutions in which the United States is the largest or among the largest shareholders. But an understanding of MDBs defined by functions, financial model, and governance arrangements points to a much larger group of institutions that has grown over time, following the launch of the World Bank at Bretton Woods (figure 3). A closer look from this standpoint reveals that the universe of MDBs, twenty-seven in total, is already more diffuse, and further beyond the reach of U.S. leadership, than is commonly appreciated.<sup>7</sup>

A large number of today's MDBs were created during a twenty-year period starting in the mid-1950s, and many of them have existed for decades beyond the purview of U.S. policymakers. In practice, when the United States is an MDB member, it is a leading member. And when it is not a member, its involvement with the institution is minimal or nonexistent. So, for example, despite the existence of a European Investment Bank (an arm of the European Community at the time), U.S. policymakers led efforts to create the EBRD in 1991. And even with the existence of an Islamic Development Bank, the United States expended a great deal of ultimately futile effort attempting to create a Middle East and North Africa Development Bank in the mid-1990s.<sup>8</sup>

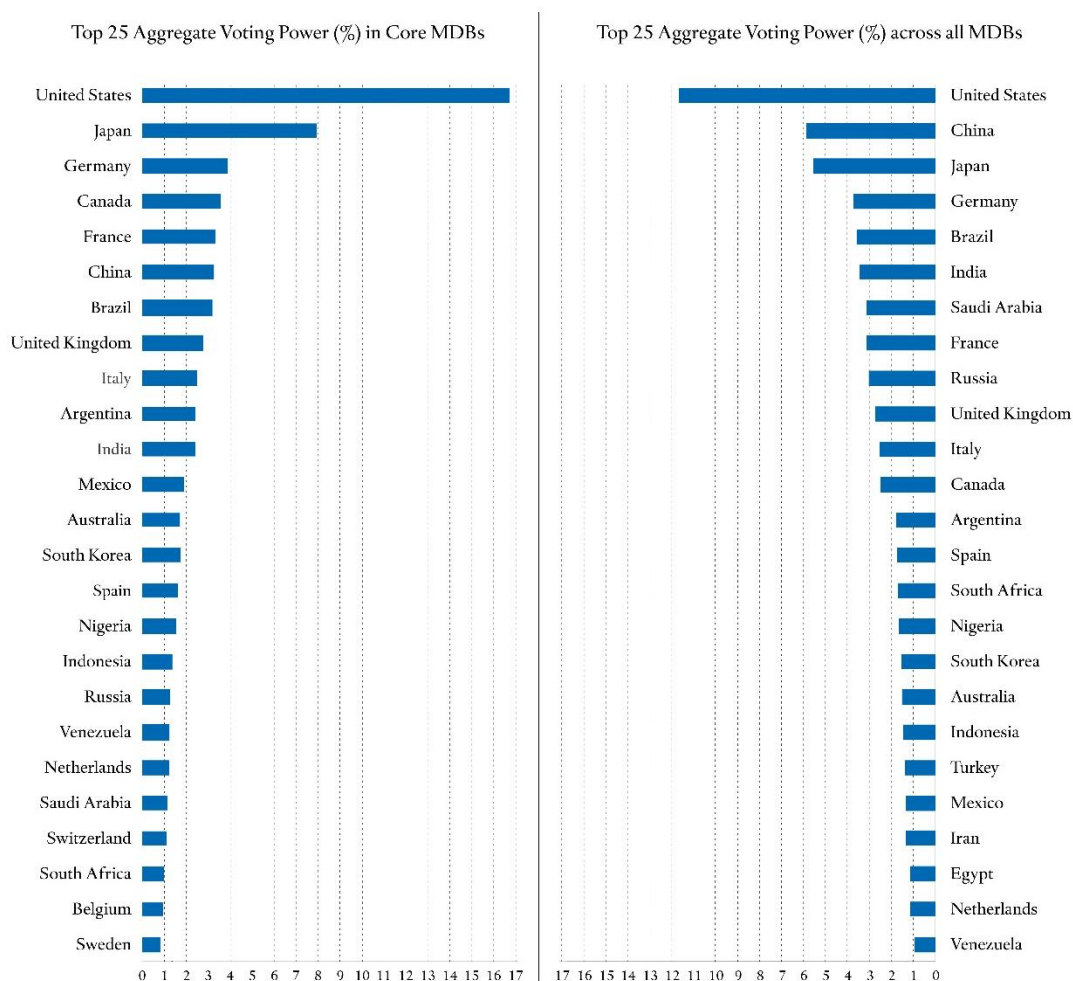
**Figure 3. Timeline of MDB Establishment**



Considering the five U.S.-led institutions as the core MDBs, one can compare the weight of the United States in the core and in the system as a whole based on voting power within each MDB (which

is mostly a function of shareholding within each institution), weighted by the size of the institution based on capitalization (figure 4). The United States is more dominant in the core than in the broader system. Nonetheless, it is also dominant in the broader system.

**Figure 4. Aggregate Voter Power in MDBs**



Source: See Appendix I.

China, by contrast, ranks well below the United States in voting power in the core MDBs but rises to second in the MDB system as a whole. Although the United States is only present in five of the twenty-seven MDBs, its power in the system as a whole points to the size of the core MDBs and the substantial U.S. shareholding in these institutions.

By economic weight, measured as gross domestic product (GDP) share of the global economy, the prominent position of the United States in the core and in the system as a whole makes sense. In fact, by economic size, the United States is significantly underweighted based on its global GDP share of 22 percent.<sup>9</sup> More striking is how significantly underweighted China is in the core MDBs relative to its global GDP share of 13 percent. Both countries have less voting power than their economic weight implies in part because the principles that guide MDB shareholding formulas include distributional equity in addi-



tion to economic size. The fact that China is much more underweighted in the core, however, helps explain the frustrations the Chinese political leadership has felt in seeking to exercise power within the U.S.-led system and also suggests some of the impetus for a different approach to multilateral power.

In sum, the United States has effectively used its position as the leading shareholder in a small number of core MDBs, recognizing that those MDBs in turn exist in a wider system in which power is more diffuse. Going forward, U.S. effectiveness will likely be diminished if China sees limited opportunity for advancement within the core MDBs and instead shifts its attention to new and existing MDBs outside of the core, where it is already becoming increasingly powerful.

### *CHINA'S APPROACH TO MULTILATERAL DEVELOPMENT BANKS*

China's multilateralism did not emerge *sui generis* with AIIB. It has in fact been a multi-decade project, and its political goals have grown with the country's economic importance. In the backdrop of Deng Xiaoping's "reform and opening up policy," China restored its membership in the World Bank in 1980 and joined the ADB in 1986, quickly becoming one of the largest borrowers in both institutions, a position it continues to hold today. During the same period, China sought membership as a non-borrowing member in MDBs outside of Asia, including the AfDB in 1985, the IDB in 2008, and, most recently, the EBRD in 2015.

Yet the experience of joining these institutions as a non-borrower has revealed tensions for China. Shareholding under the MDB rules is a zero-sum arrangement: China cannot obtain nontrivial levels of shareholding without existing members giving up shares. There is a striking contrast between China's experience at the ADB as a borrowing member with significant shareholding and, at the other extreme, at the IDB as a non-borrowing member with a trivial level of shareholding (table 1). Although the burden falls on all shareholders to accommodate a new member, the United States plays a leading role in this process and China's experience demonstrates the United States' unwillingness to allow for significant Chinese shareholding outside of the World Bank and ADB.

**Table 1. Chinese Participation in Core MDBs**

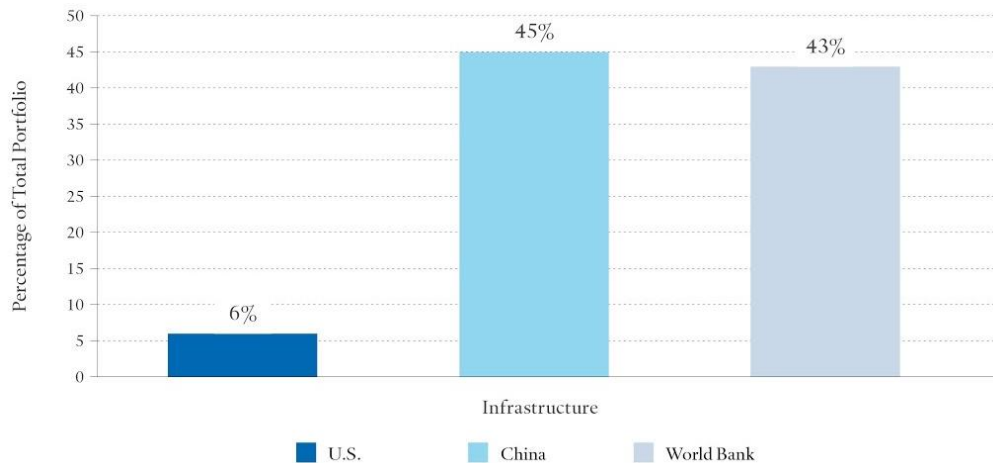
<b>MDB Group</b>	<b>Date of Membership</b>	<b>Shareholding percentage</b>	<b>Trust-fund commitments (USD millions)</b>
AfDB	1985	1.125	2,756
ADB	1986	6.5	350
IDB	2008	0.004	2,500
EBRD	2015	0.1	-

*Source:* AfDB, ADB, IDB, and EBRD.

This experience also reveals that Beijing has found ways to work around the shareholding constraint in order to exercise influence in these institutions. At the AfDB and IDB, China has created multibillion-dollar trust funds to provide parallel financing for existing bank projects. This tactic gives China a greater voice in the institutions even if it comes informally outside of the core shareholding structure.

China views the MDBs differently than the United States does. Where the MDBs serve as complements to the Washington’s grant-based traditional foreign assistance programs, the multilateral institutions essentially replicate Beijing’s bilateral programs. China’s bilateral financing activities, defined largely through the country’s policy banks (China Eximbank and China Development Bank), look similar to MDB financing. Both emphasize lending over grants, and support for infrastructure is the largest category of investment for both, compared to the small share it composes of U.S. foreign assistance (figure 5).

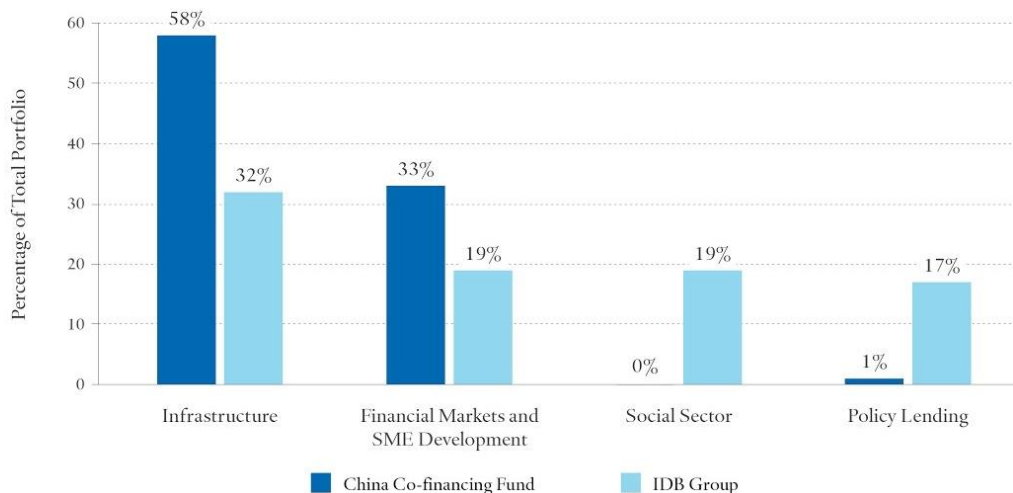
**Figure 5. Infrastructure Share of Assistance Portfolio (2010–2012)**



Sources: USAID Foreign Aid Explorer, PRC State Council, and World Bank.

By creating the AIIB, and by financing MDB trust funds, Beijing has sought to further emphasize the MDBs’ infrastructure financing activities. For example, analysis of projects supported by China’s trust fund at the IDB reveals a dominant infrastructure focus compared to IDB’s portfolio as a whole (see figure 6).

**Figure 6. IDB Portfolio Allocation by Sector (2013–2014)**



Source: IDB.

China's bilateral practices and those of the MDBs do diverge when it comes to conditions on lending and standards of transparency. Chinese lending for infrastructure appears to lack the same level and approach to fiduciary, environmental, and social standards associated with core MDB lending, and in some cases diverges sharply from MDB practice. For example, where MDB financing typically requires competitive bidding for public works, China may require the use of Chinese goods, services, and labor as part of its financing.<sup>10</sup> Chinese lending also lacks transparency, an area where the core MDBs have set the standard.<sup>11</sup> This lack of transparency makes it difficult to assess the degree to which Chinese practices around environmental impact or debt sustainability align with MDB standards.

When it comes to policy standards, it is notable that China has sought to shape the AIIB not in its bilateral image, but in the image of the core MDBs. By early appearances, the Chinese-led AIIB would appear at home among the core, U.S.-led MDBs. The institution's first Chinese president is himself a veteran of the World Bank and ADB, and early work and recruitment demonstrates a heavy reliance on personnel and advisors from the core MDBs. A close look at the rules of the new bank reveals no radical departures from norms and practices of the existing MDBs, with the notable exception of the lack of a resident board of directors, which is a core governance feature of the U.S.-led MDBs. Similarly, China's trust funds at the MDBs adhere to the same standards that apply to the MDBs' core operations.

These similarities suggest that China has embraced many of the norms and standards that the United States defined for the core MDBs. This embrace no doubt reflects a desire by China to take full reputational advantage of the MDB model in the face of considerable backlash over some of its bilateral projects, particularly in Africa. It is also likely seen as expedient in attracting European shareholders to the AIIB and working with them in setting the rules for the new institution.

In sum, China's bilateral programs and those of the MDBs are similar to the degree that both emphasize lending for infrastructure. They diverge on policy conditions and transparency associated with the lending. On this front, Beijing has largely embraced existing MDB standards when it comes to multilateral initiatives. Given the great disparity in the levels of China's bilateral and multilateral financing (for example, China's bilateral policy banks alone currently rival the core MDBs for levels of annual financing in the energy sector), there appear to be opportunities for greater multilateral support.<sup>12</sup>

## Self-Imposed Obstacles to U.S. Leadership in the MDBs

Though the creation of the AIIB generated a sense of sudden Chinese triumph and U.S. defeat on the multilateral stage, China's turn toward multilateral development institutions has been steady and incremental over a twenty-five-year period. By the same measure, the loss of U.S. power in the MDBs will not happen overnight. More troubling is a pattern of decreasing U.S. power in the broader MDB system, largely because the core MDBs are less influential than they once were. Going forward, this trajectory will be reinforced by circumstances largely outside of U.S. control, such as the creation and expansion of new MDBs, and by direct U.S. action and inaction in the MDBs.

However, several U.S. policies and practices are currently limiting the power of the core MDBs: an excessive and unilateral interest in pursuing prohibitions within the institutions, an emphasis on the MDBs as charities with a narrow range of functions pertaining to low-income countries, limited financing for the MDBs, and too little willingness to accommodate rising powers like China within the U.S.-led MDBs.

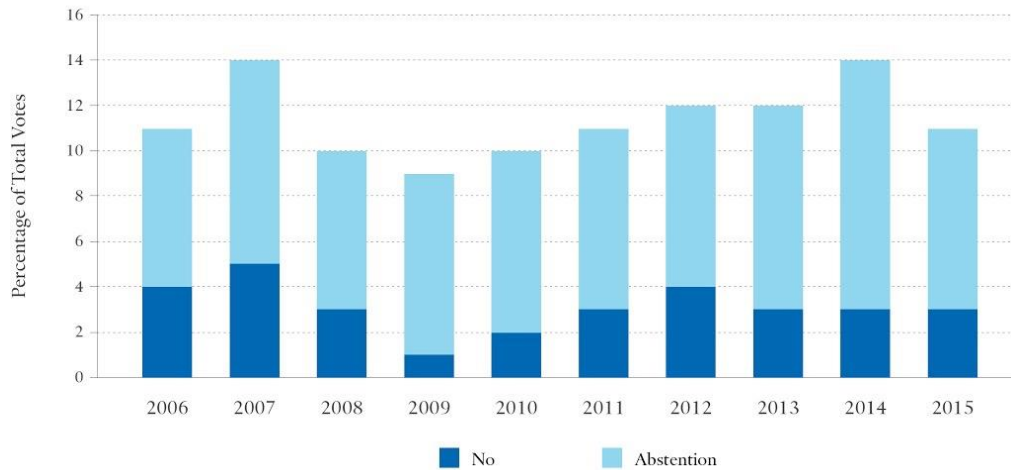
### *THE PROHIBITION CULTURE*

U.S. officials, led by the U.S. Treasury, have pursued an agenda over many decades aimed at making the MDBs good stewards of the shareholders' money—not only in a strict fiduciary sense, but also through applying social and environmental safeguards and development effectiveness standards (for example, measurement and reporting of project outcomes). Importantly, a vocal community of non-governmental organizations (NGOs) based in the United States has played a central role in promoting safeguards at the MDBs, working primarily through Congress and the Treasury.

An unhealthy consequence of this leadership, however, has been the firm entrenchment of a reformist culture surrounding U.S. involvement with the MDBs. This is reflected in the Treasury's interactions with Congress, which focus heavily on the extensive bureaucratic regimes at the MDBs working on regulatory compliance issues. A consistent element of congressional testimony related to MDBs over the past two decades has been a recitation of the Treasury "reform agenda" and questions about MDB adherence to its regulations. This approach feeds a sense of these institutions as risks to be managed rather than as productive assets.

One manifestation of this mindset has been the routine imposition of voting prohibitions attached to congressional funding for the MDBs, often motivated by NGO interests. In recent years, U.S. representatives on MDB boards have opposed (through abstentions or "no" votes) one in every ten projects, on average two hundred each year, far more than any other board members (figure 7). In most of these cases, opposition was required by a congressional mandate (figure 8). There are currently more than seventy such mandates, some specific to countries and others tied to narrowly defined environmental or human rights objectives. Many of these mandates elevate form over substance, requiring negative votes based on technicalities such as whether project documents appear on MDB websites on day 120 or day 119 of the project timeline.

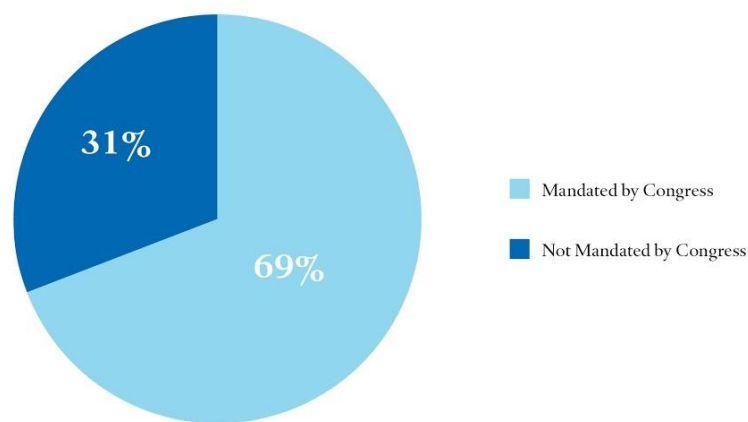
**Figure 7. U.S. Opposition to MDB Projects**



Source: U.S. Treasury.

Setting aside the individual merits of these mandates, the voting pattern is problematic for the United States due to its apparent pointlessness, particularly when it pertains to the largest shareholder in the institution: disapprovals of projects by the board as a whole are exceedingly rare, so virtually every project that the United States has opposed in the World Bank's board has nonetheless been approved.

**Figure 8. Reason for Opposition (2011–2015)**



Source: U.S. Treasury.

### *MDBS AS CHARITIES FOR POOR COUNTRIES*

The World Bank was created to help Europe rebuild after World War II and to promote development projects around the world. Yet the U.S. concept of the World Bank and the other core MDBs today is

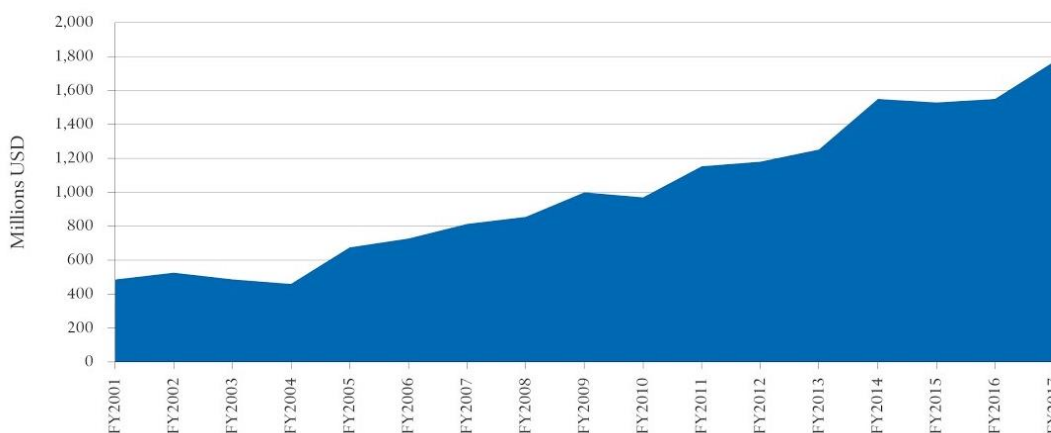
largely limited to a much narrower array of countries, those classified as “low-income countries” with annual per capita incomes below \$1,215 and limited or no access to private capital markets. This does not include countries like Brazil, China, India, Mexico, Nigeria, the Philippines, or Tunisia.

As a result, for many countries where the United States has clear strategic interests (and where most of the world’s poor reside today), U.S. policy in recent decades has espoused the view that MDB activities should be limited. The United States has advocated for China to graduate from MDB assistance entirely, causing persistent problems in the U.S.-China relationship. However compelling the underlying development rationale of this approach (which relies on the notion that creditworthy countries do not need MDB financing), it constrains the scope of countries where MDB assistance can be brought to bear on *behalf* of U.S. interests. In particular, as a growing number of MDB borrowers progress beyond the \$1,215 per year income threshold, the remaining countries, though highly deserving of MDB assistance for purposes of development and poverty reduction, largely fall outside the sphere of top-tier strategic targets for the United States.

### A STINGY ATTITUDE TOWARD THE MDBS

The United States has historically been a generous leading donor to the MDBs’ grant-based support of the poorest countries, which is separate from the MDBs’ banking activities in a wider range of developing countries. Yet even here, U.S. leadership has faltered in recent years. In the most recent funding round, the United Kingdom overtook the United States as the largest donor to the World Bank’s concessional financing arm for the poorest countries (the International Development Association), and as a result, the United States is no longer the largest donor at any of the MDBs. Even as U.S. commitments are falling relative to other donors, the United States is doing worse still in meeting those commitments. Unmet U.S. commitments to the MDBs have increased by a factor of four since 2001 and are projected to reach \$1.8 billion this year.

Figure 9. Unmet U.S. Commitments to MDBs



Source: U.S. Treasury.

However, the fundamental financing problem for the United States relates to MDB capital to support lending to the nonpoor countries. The U.S. focus on the banks’ charitable functions has been viewed by other countries as an obstacle to greater funding for the MDBs. Calls for more capital in the

core MDBs have been commonplace in recent years, particularly among large developing countries such as Brazil, China, and India. The decision of many countries to join the AIIB is itself an expression of this interest, even among non-borrowing European countries.

Despite resistance from U.S. policymakers to capital increases, congressional funding for MDB capital contributions has been strong and not vulnerable to the arrears problems associated with unmet grant commitments. This can be attributed to the fact that capital is tied directly to U.S. shareholding, and therefore voting power in the institutions, in a way that the grant contributions are not. The lack of arrears on U.S. capital contributions then is a measure of the degree to which congressional actors are sensitive to U.S. standing in the institutions as measured by voting power.

The U.S. stance on additional capital for the core MDBs has been particularly vexing for other countries, because the United States has been willing neither to contribute more MDB capital nor to allow other countries to contribute. Under MDB rules, shareholding and voting power are fixed by a formula. As a result, any increase in MDB capital proceeds with each shareholder contributing according to the formula, or alternatively, relative shareholding has to adjust to reflect capital contributions by some and not by others. In short, the United States should agree to make the largest capital contributions in line with its existing shareholding or otherwise agree to become a smaller shareholder with less voting power. With these choices, U.S. policymakers have chosen a third option: to block routine expansions of MDB capital.

This dynamic more than anything may best explain the creation of the AIIB because the United States has impeded China's efforts to become a significant shareholder across the core MDBs. For example, China has just 0.004 percent shareholding at the IDB and no prospects for growth. To the degree the Chinese feel shut out from a role in the core MDBs befitting the world's second largest economy, Beijing will continue to be strongly motivated to expand its multilateral presence outside of the core.

## Recommendations

Sustaining U.S. leadership in the MDB system requires a commitment to four broad objectives: ensuring that the core MDBs remain central, keeping China within the core MDBs, affecting China's behavior outside of the core, and changing U.S. behavior within the core in order to better sway other shareholders on issues of importance to the United States.

### *ENSURING THE CORE IS STILL THE CORE*

The emergence of the AIIB demonstrated that the United States is unable to use diplomatic channels to block initiatives that the rest of the world views as worthy. Many of the AIIB's early joiners may have been seeking to advance their bilateral interests with China, but they also clearly saw the broader value of doing so in a context that could be viewed as pro-development. Specifically, these countries demonstrated a desire to channel more of their foreign assistance resources through an MDB in order to finance infrastructure projects in the developing world. The United States has also embraced the infrastructure agenda within the core MDBs, but its own financing commitments have not matched its rhetoric.

The question of U.S. support is not one of budget constraints at home. For decades, the United States has generously financed the most expensive form of MDB work: grant-based assistance to low-income countries. In contrast, the United States has long resisted capital contributions to the MDBs to support lending to a wider class of countries. Yet capital increases are cheap compared to grant contributions. For example, the crisis-motivated capital increase at the World Bank in 2010 required contributions from the United States of \$187 million a year over a five-year period. In comparison, U.S. grant contributions to the bank's poor-country initiatives are nearly \$1.5 billion a year.

The United States should work with its partners to ensure that the core MDBs maintain their leading financial position in the overall system. This means, for example, that the entry of an AIIB and New Development Bank (NDB, or BRICS Development Bank) should be met with a concomitant U.S.-led expansion of capital at the core MDBs. Direct comparability between the capital efficiency and financing capacity of the new institutions and the core MDBs is difficult, but expanding the financing capacity of institutions such as the ADB and World Bank by a margin that matches the capacity of AIIB and NDB implies manageable financial contributions for the United States—likely one-third to half of its current grant contributions to the World Bank alone over a period of five years. Whatever the precise figure (somewhere in the low hundreds of millions of dollars), it would amount to little more than a rounding error within a U.S. foreign assistance budget of \$34 billion.

This escalation in financing would raise questions about the demand for MDB lending on this scale as well as the appropriateness of certain countries borrowing in large volumes from the MDBs. In particular, a U.S.-led expansion of MDB lending capacity that resulted in more borrowing by China and other emerging market countries could be objectionable to congressional funders. Some members of Congress have already questioned China's MDB borrowing, given its large foreign exchange reserves and ready access to private capital markets.

But concerns about China in particular and emerging market borrowers in general are misplaced. When it comes to overall demand, developing countries, including large emerging market countries,



are seeking MDB financing at record levels. It is hard to see how a strong MDB response to this demand disadvantages the United States. As with Ukraine, the ability of MDBs to operate flexibly in a wide range of countries clearly serves U.S. interests. In China, MDB financing remains a useful channel of policy dialogue and prioritization according to U.S. objectives. For example, MDB investment in China is increasingly focused on global public goods, such as advancing the implementation of carbon capture and storage technologies, which promotes U.S. interests by helping to mitigate the impact of coal emissions on climate change.<sup>13</sup>

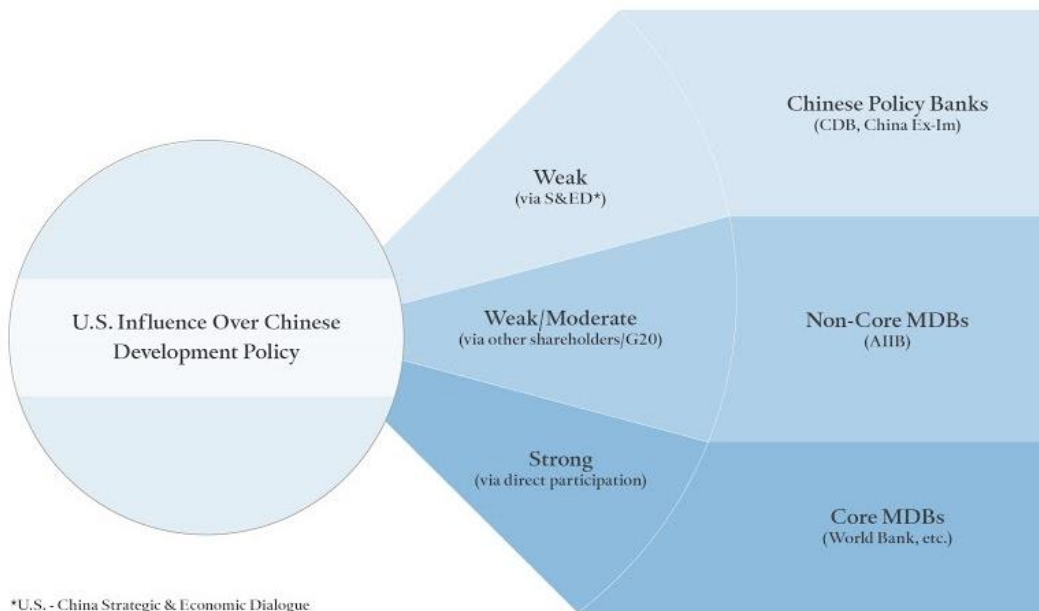
### *KEEPING CHINA IN THE CORE*

Beyond China's borrowing from the MDBs, the United States has a strong interest in how China chooses to finance development globally. China has demonstrated an interest in using multilateral channels, and where it has pursued these channels, Beijing's financing has come with greater transparency and stronger adherence to international norms related to procurement, environmental safeguards, and debt sustainability, compared to its bilateral activities. From this standpoint, the United States has a strong interest in promoting China's participation in multilateral channels.

Within the MDB system, the United States should promote a more actively integrated and empowered China within the core MDBs, rather than simply watch as China's power grows outside the core. In part, this is because of the degree of direct influence the United States has within the core MDBs compared to the indirect influence over MDBs in which it is not a member (figure 10). But promoting China within the core MDBs also keeps the growth of non-core MDBs in check. Keeping the core MDBs dominant in the system is essential to maintaining their collective-action and norm-setting functions, whether directly in support of U.S. strategic interests (as in Ukraine and Myanmar), or increasingly, in favor of broader public goods such as mitigating the effects of climate change or working to avoid the problems associated with debt crises in the developing world.

The clear strategic success of the AIIB for China raises a question about whether and how it might seek to capitalize on that achievement, whether through additional regionally based MDBs in Africa and Latin America or through an expansion of AIIB's activities outside of Asia. Beijing has demonstrated a willingness to work through the core MDBs when given an opportunity to do so, and the more welcoming the United States is within the core institutions, the less likely China will be to pursue its multilateral ambitions elsewhere.

Figure 10. Channels of U.S. Influence Over Chinese Development Policy



In 2016, the United States will need to work with China, Japan, and the large European shareholders at the World Bank to come to an agreement on a new shareholder arrangement that protects the United States' leadership position, advances China's desire for a larger role, and mollifies countries that will have to cede power in this zero-sum arrangement. At the regional MDBs, there is potential for the United States to accommodate greater Chinese ambition without sacrificing the U.S. leadership position. The IDB is a striking example, where current U.S. shareholding of 30 percent is greatly disproportionate to other institutions (for example, U.S. shareholding is just under 16 percent at the World Bank and the ADB) with no apparent additional value in terms of policy influence. The United States has ample room at the IDB to cede shareholding to China and others, while maintaining a clear leadership position.

#### *AFFECTING CHINA'S BEHAVIOR OUTSIDE THE CORE MDBS*

In addition to limiting the growth of institutions such as the AIIB relative to the core MDBs, the United States has an interest in affecting behavior within new MDBs. Beijing has already demonstrated a willingness to shape the institution in line with the norms and practices of the core MDBs. To achieve this, China has relied on the standards of institutions such as the World Bank, Asian Development Bank, and EBRD, and has been guided in part by their European shareholders.

U.S. policymakers should recognize the value of both these channels of influence, however indirect. Going forward, the United States can encourage substantial interaction between the core MDBs and the AIIB, both through project cofinancing and through the many cross-MDB coordinating platforms that exist for everything from anticorruption standards to infrastructure promotion.

More generally, the United States can elevate MDB issues in its bilateral dialogue with the Chinese and the Europeans. The prominence given to the MDBs in the joint economic statement at the time of

President Xi's visit to Washington last fall is encouraging and should point to a more formalized MDB platform in the ongoing U.S.-China Strategic and Economic Dialogue.<sup>14</sup>

### *CHANGING U.S. BEHAVIOR WITHIN THE CORE MDBS*

Beyond financing increases and a more accommodative stance toward China within the MDBs, effective U.S. leadership within the core MDBs depends on sustaining Washington's ability to sway other countries on important policies and projects. The United States is rarely able to exert its will unilaterally within these institutions, even as the largest shareholder. Maintaining goodwill toward U.S. objectives requires a greater sense of priorities on the part of U.S. policymakers and a willingness to cede ground on issues that have isolated the United States with little gain.

Specifically, Congress and the administration should work toward an easing of voting restrictions so that U.S. voting in the MDBs is less reflexively negative and more in line with the multilateral character of the institutions. A more appropriate arrangement would rely on consultation and reporting requirements, such that the administration would have to consult with Congress in advance of a sensitive vote or report on a vote if it triggers some policy concern. The State Department has long viewed congressionally imposed voting restrictions in international organizations as an infringement on the conduct of foreign policy, a view that holds in principle for the MDBs. However, in practice, with Congress willing to withhold MDB funding over highly specific MDB issues and votes, the Treasury Department has complied with voting restrictions in order to avoid greater funding shortfalls. Given the accretion of voting restrictions, it would be worthwhile for the White House and Treasury and State Departments to strongly assert a foreign policy argument to forestall additional restrictions and begin to pare existing restrictions.

This is not to say that the United States should never stake out opposing positions in the MDBs, but the decision to do so should be deliberate and calculated. When such decisions are taken, as with U.S.-led efforts to prohibit new MDB lending to Russia, their weight should not be diluted by a context of rote opposition to MDB projects.

As a general principle, U.S. policymakers should more directly and routinely weigh the costs associated with staking out a position in isolation within the MDBs. Historically, the reaction of other MDB shareholders to U.S. positions has barely registered as a consideration in U.S. decision-making, which has been overwhelmingly focused on the reactions of congressional actors and independent groups that lobby Congress. The views of other MDB shareholders need not be placed on equal footing with those of Congress in order to receive a minimum fair consideration.

Finally, U.S. policymakers should look for opportunities to remediate some of the harmful effects (measured by the size of the bureaucracies and lengthy processes associated with project development and delivery) of the compliance culture that it has so heavily promoted over the years. For example, embracing innovative financing mechanisms such as the World Bank's Program-for-Results, which seeks to promote and rely on domestic regulatory regimes while linking financing to delivery of outcomes and results, would signal a shift in U.S. mindset and help to promote greater efficiency within the core MDBs.

## Conclusion

The core MDBs have been highly effective partners to the United States over seven decades, directly serving U.S. strategic objectives in every region of the world. As U.S. interests expand to address a broader range of global challenges in the years ahead—chief among them climate change, but also global pandemics and populations displaced by conflict—the MDBs will once again be called to act as essential partners. Whether they do so effectively and at an appropriate scale will depend on the decisiveness of U.S. leadership. U.S. policymakers should work with other MDB shareholders to commit the resources that can help finance a wave of green infrastructure while it can have a real effect. U.S. policymakers should break free of rigid rules that inhibit more flexible MDB support for hydroelectric power, developing countries bearing the burden of refugee influxes, and investments in technological advances in lifesaving medicines. These steps require bolder U.S. leadership in the MDBs than has been demonstrated in recent years.

The alternative, marked by U.S. indifference to these institutions, will see the core MDBs fade and with them the benefits to the United States from the multilateral system. For developing and rich countries alike, the loss will be equally great in the face of a new generation of global challenges that lack a leading champion and effective instruments to address them. Whatever China's intentions, it has not shown itself willing or able to lead on the collective action issues facing the world today. For that, the multilateral system still needs the United States.

## Appendix

Appendix 1: List of MDBs Selected for Aggregate Voting Power Calculations

MDBs with U.S. membership	Subregional MDBs and Others	China-led MDBs
World Bank (IBRD)	CAF–Development Bank of Latin America	Asian Infrastructure Investment Bank
Asian Development Bank	European Investment Bank	New Development Bank
African Development Bank	Islamic Development Bank	
Inter-American Development Bank	Caribbean Development Bank	
European Bank for Reconstruction and Development	Central American Bank for Economic Integration	
	East African Development Bank	
	West African Development Bank	
	Black Sea Trade & Development Bank	
	Economic Cooperation Organization Trade & Development Bank	
	Eurasian Development Bank	
	Council of Europe Development Bank	
	International Investment Bank	
	International Bank for Economic Cooperation	
	Arab Bank for Economic Development in Africa	
	Eastern and Southern African Trade and Development Bank	
	Arab Petroleum Investments Corporation	

	Inter-American Investment Corporation	
	International Finance Corporation	
	Islamic Corporation for the Development of the Private Sector	
	Shelter Afrique	

## About the Author

Scott Morris is a senior fellow at the Center for Global Development and director of the Rethinking U.S. Development Policy initiative. This initiative seeks to broaden the U.S. government's approach to development, including the full range of investment, trade, and technology policies, while also strengthening existing foreign assistance tools. Additionally, he works on issues related to the international financial institutions (IFIs) and particularly the relationship between the IFIs and the United States. Previously, Morris served as deputy assistant secretary for development finance and debt at the U.S. Treasury Department during the first term of the Obama administration. In that capacity, he led U.S. engagement with the World Bank, Inter-American Development Bank, African Development Bank, EBRD, and Asian Development Bank. He also represented the U.S. government in the Group of Twenty's Development Working Group and was the Treasury's "plus one" on the board of the Millennium Challenge Corporation. During his time at Treasury, Morris led negotiations for four general capital increases at the multilateral development banks and replenishments of the International Development Association, Asian Development Fund, and African Development Fund.

Before his post at the U.S. Treasury, Morris was a senior staff member on the Financial Services Committee in the U.S. House of Representatives, where he was responsible for the committee's international policy issues, including the Foreign Investment and National Security Act of 2007, as well multiple reauthorizations of the U.S. Export-Import Bank charter and approval of a \$108 billion financing agreement for the International Monetary Fund in 2009. Previously, Morris was a vice president at the Committee for Economic Development in Washington, DC. He has a BA from Franklin & Marshall College and an MPP from the University of Michigan.

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