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on

How America Leads Abroad: An Examination of Multilateral Development Institutions
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Chairman Cleaver, Ranking Member Hill, members of the Subcommittee, thank you for the opportunity to testify this morning. My name is Charles Kenny and I am a senior fellow at the Center for Global Development, a non-partisan think tank in Washington, DC.

I am going to focus my testimony today on the General Capital Increase requests of the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC), which await congressional approval. In particular I will address the role of the IFC in the world's poorest countries and explain why I believe further reform is important to ensure that the proposed capital increase helps benefit those countries.

The World Bank Group, including the IBRD, the International Development Association (IDA) (which provides grants and concessional loans to the poorest countries) and the IFC (which invests in private companies), is a central component of a multilateral financial architecture that has supported global development and furthered US interests in a stable, secure and prosperous world. Between them, the World Bank and the IFC support the two vital pillars of development: an effective government and a robust private sector. The Bank Group leveraged US support to provide commit $62 billion in development financing in FY 2019, operating at a scale and across a range of countries sectors that the US is unable to achieve alone. Continued American leadership in and financial support of the World Bank Group should be a high priority.

Historically, the US Congress (and this committee in particular) has played an important role in promoting the adoption of rules and standards that help ensure the World Bank Group's activities support development that respects human rights and the environment and targets some of the most vulnerable populations in the world.

In that regard, the recent performance of the World Bank Group's private sector arm is concerning. The private sector plays a central role in development and the IFC's overall portfolio includes many projects that generate jobs, profits and needed service provision. But the institution is delivering declining development returns to the poorer countries that need support the most. Without reform, it is unlikely that an IFC general capital increase will help fix that problem.

I would like to make three points and three suggestions for reform: First, the IFC is doing less in the poorest countries not because of lack of cash but because of lack of good deals. Second, the IFC's use of subsidized finance transferred from IDA does not help this problem and, third, they way that the IFC is using subsidies ignores the World Bank Group's own principles as well as common sense. To help fix these problems, the IFC should move towards competitive subsidy award, cap subsidies, and provide far greater transparency across all of its operations.

The volume of support that the IFC is providing to poorer countries is declining. In 2011, 26 percent of IFC's investments were in today's (2019) IDA countries. In 2018, 24 percent of IFC's investments were in IDA countries. Looking at the economies most in need of support, fragile and conflict affected states account for less than five percent of IFC commitments, and low-income countries accounted for 2.6 percent of commitments in 2016 (that compared to 25 percent in 2003).

Beyond volume is the quality of support: Between 2015-17, the Independent Evaluation Group at the World Bank rated only 45 percent of IFC private sector investment projects as mostly successful or better in terms of development outcome. In Sub-Saharan Africa, just 38 percent of IFC projects were rated mostly successful or better. That compares to a 76 percent satisfactory rating globally and 71 percent in Africa for World Bank IBRD and IDA projects with the public sector over the same period.

Looking forward, as part of discussions around the capital increase, the IFC has made promises to increase its focus on lending in poorer countries. To meet them, IFC's investments in low-income IDA countries would have to expand by a factor of eight over 2016 levels and in fragile and conflict-affected states, the portfolio would likely have to increase by even more. But it has struggled in the past to meet similar commitments. In its FY 2011-13 "Road Map" document, for example, the corporation said that around 50% of IFC's projects going forward were expected to be in IDA countries. Between 2005–2008, 30 percent of IFC's investments were in IDA countries. That climbed to 32 percent over 2009–2012 but declined to just 25 percent in 2013–2016.

As this past record implies, the problem is not so much lack of cash as lack of good projects. Nonetheless, the Bank Group's response has been to reverse funding flows between the IFC and IDA so that now some IDA resources are being used by the IFC to give subsidies to private firms. As part of the discussions around IFC's general capital increase, the Corporation's previous policy of transferring a portion of its annual net profits to IDA was terminated, with the intent that this would free even more resources to work in challenging markets. And as part of the last round of IDA funding negotiations, a $2.5 billion "Private Sector Window" (PSW) was set up, of which $2 billion was to support IFC's investments in IDA recipient countries using IDA resources.

But simply applying subsidies does not significantly expand the pipeline of high-impact private sector projects in developing countries that are amenable to IFC support. To quote the mid-term review of IFC's IDA Private Sector Window, "deal origination in PSW-eligible markets does not come easy." To date, the unsurprising result of these reforms has been significantly reduced net financing flows from the IFC to the World's poorest countries.

Making matters worse, subsidies on IFC deals increase the risk of financing lower-impact projects and crowding out other development finance institutions willing to support the same projects –including the US International Development Finance Corporation. That would leave the total volume of quality private sector investment in poorer countries no higher than it would be absent the PSW, all while reducing the financing available to support governments to deliver public services in IDA countries.

And the current use of PSW subsidies by the IFC ignores commonsense rules of effective private sector engagement developed by the World Bank itself. The Bank Group is a founder signatory to multilateral development bank principles that call for identification of "a clear market or institutional failure or public policy goal that is best addressed through a subsidy" before selecting that instrument. They also suggest subsidies should be transparent and that there should be an "equal opportunity for funding to qualified companies on a non-discriminatory basis."[1]

In reality, the process to date for setting the level and recipient of PSW subsidies has not once been competitive or based on an open offer to all qualified firms. Instead it has relied on secret negotiations with select beneficiary firms. The IFC provides no public justification for a negotiated PSW subsidy as the most efficient mechanism to deliver on public policy priorities, for the subsidy level, or for the selection of a particular subsidy recipient. And while the IFC has recently committed to releasing an estimate of the subsidy amount on PSW projects, it will not report on how the subsidy calculation is made.

The IFC needs a new approach in order to increase its development impact in poorer countries and make best use of a capital increase. In particular, the corporation should move more aggressively to a model of creating deals –market making—in poorer countries rather than its traditional model of waiting for project sponsors to emerge and negotiating secret deals with them.

Especially when it comes to the use of subsidized resources, that process should begin with an understanding of country-level public policy priorities with regard to private sector development and delivery of services --because scarce aid resources should be used to achieve the maximum development impact, not allocated to private firms on a first-come, first-served basis.

As a matter of routine, the IFC should use competitive approaches or open offers to allocate subsidies because negotiated approaches are less efficient and more likely to result in crowding out other development finance institutions including the US International Development Finance Corporation. The World Bank Group has considerable experience in competitive subsidy award approaches to build on—the Global Partnership on Output-Based Aid (now the Global Partnership on Results-Based Approaches), housed at the Bank, has backed 49 projects across infrastructure, education, and health that involve open, competitive subsidy allocation to private sector investors.

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[1] MDB Working Group on to Principles to Support Sustainable Private Sector Operations (2017) Multilateral Development Bank Principles to Support Sustainable Private Sector Operations. EBRD: London. Downloaded from https://www.ebrd.com/downloads/news/mdb.pdf

The size of subsidy under any non-competitive projects that remain should be capped (at 10 percent or less of the total value of IFC support), on the grounds that the larger the subsidy, the less likely the project is sustainable and the greater the risk of crowding out rather than adding to the level of private investment in poorer countries. The IFC argues that subsidy scale is already small in most deals. Given that, a cap should be a minor inconvenience while helping to reassure stakeholders that firms are not receiving large payoffs in non-competitive agreements.

And subsidy terms should be transparent: the market rate estimate from which the subsidy is calculated, the mechanism of subsidy calculation, the economic justification for public intervention in support of the project and for the use of negotiated subsidy as the preferred tool should all be published. The distribution of subsidy amounts to sub-projects through financial intermediaries (when the IFC invests in banks for on-lending to enterprises, for example) should also be published.

More broadly, the IFC is not releasing sufficient information and reassurance to allow governments and civil society to verify that its projects have positive development impact. Amongst reforms that should apply to all IFC projects, there should be an exclusion to investing in public-private partnerships where details are not fully disclosed as laid out in the World Bank's framework for disclosure in PPPs. That framework mandates disclosure of financial information including financing structure, government support (grants, tax breaks), tariffs and tariff methodology, performance targets and metrics, termination provisions and handover provisions, and renegotiations or changes in contract terms.

The IFC should also mandate disclosure of beneficial ownership and tax jurisdiction of investee firms (including sub-grantees). Global norms (as highlighted by the G-20 summit in Brisbane, Australia in 2014, for example) increasingly demand release of beneficial ownership information. And the US Consolidated Appropriations Act, 2018 mandated that the US executive directors at these multilateral development institutions push for that information to be released on projects. While the IFC posts project descriptions on its website, which often include the names of sponsors and major shareholders in the company, it does not publish full beneficial ownership or tax jurisdiction information.

This mandate should also apply to recipients of finance through financial intermediaries including banks and equity funds. IFC safeguards including exclusions on harmful child labor, unsustainable forest products, tobacco, weapons and alcohol all apply to financial intermediaries, but it is impossible to know if safeguards are being followed or subprojects are achieving development impact without information on recipients of on-lent funds. The IFC has announced a pilot to report on these recipients but the information should be public as a matter of routine. This applies most urgently to ultimate beneficiaries of PSW financing.

It is important that the US shows leadership and commitment to multilateralism, including at the World Bank Group. At the same time, it is equally important that multilateral development efforts have the maximum impact on improving the lives of poor people in poor countries, and this is where the IFC is falling short. Without reforms it is difficult to see how a general capital increase to the IFC has any

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significant development impact in the world's poorest countries. US support for a *larger* IFC should be matched with reforms for a *better* IFC.