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STATEMENT OF THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
AND RELATED PROGRAMS
COMMITTEE ON APPROPRIATIONS
HOUSE OF REPRESENTATIVES

I. INTRODUCTION

I am pleased to be here today to endorse legislation providing for the maintenance of the U.S. share of International Monetary Fund quotas and the Administration's Fiscal Year 1981 appropriations request for the multilateral development banks (MDBs). We meet in the context of a difficult international situation which is characterized by greater tension -- in both the strategic and economic spheres -- than has been the case in recent history.

The tension affecting our strategic interests is most clearly linked to events in Southwest Asia. The unrest in Iran and the Soviet aggression in Afghanistan have heightened awareness throughout the world of the vulnerability of the world's major oil-producing region to both internal instability and external aggression. These

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developments clearly threaten our national interests, and we have set in motion a comprehensive program of action to reinforce the U.S. political and military position in the region and elsewhere.

The economic tension stems from the somber global economic outlook. Much of the 1970's was characterized by high inflation, soaring energy costs, low growth rates, and unprecedented imbalances in external payments. Largely as a result of various cooperative efforts, the international community weathered the economic turbulence reasonably well. Nevertheless, adverse oil market developments have again radically affected economic prospects. Many economic problems are not only likely to persist for the foreseeable future but may well intensify. The re-emergence of a large current account surplus in the OPEC countries -- projected at about $120 billion for 1980 -- and the inevitable generation of a corresponding deficit in non-OPEC countries will make serious balance of payments pressures inevitable for a growing number of countries.

Events in the Middle East have driven home dramatically the linkages between foreign policy and economics. Political and military concerns cannot be addressed in isolation from the realities of the world economy, and conversely all basic economic issues have a large political element. We can be successful in the pursuit of our broad global objectives only if we deal with both the strategic and economic crises which we face, and the inter-relationships between them.

The Administration response to the increased tensions in both the strategic and economic arenas has relied heavily on the international institutional framework which has evolved since World War II. This framework was designed under U.S. leadership to provide a system whereby all countries, large and small, could turn to seek cooperative solutions to their fundamental concerns. In the foreign policy area, the United States has recently turned to NATO, the United Nations, and the World Court. Economically, we rely heavily on the institutions which are the subject of today's hearings.

The International Monetary Fund (IMF) and the multilateral development banks (MDBs) are the front lines of defense for the world economy. During the 1970's, they were pivotal factors which both facilitated needed economic adjustments and helped sustain growth: the IMF through its surveillance and oversight activities and also through its expanded and liberalized financing facilities, and the MDBs through their increasingly important role in Third World development.

The distinct but complementary operations of these institutions serve U.S. interests greatly. They will be invaluable assets in facing the growing economic and financial problems of the new decade. The uncertain world economic environment -- which the Soviet Union will seek to exploit -- makes it all the more important for the United States to assure that the IMF and the MDBs can respond effectively to the needs of their members. In the economic arena, as in the international political and military spheres, the United States cannot maintain an effective leadership role -- and assure our national security -- unless we are willing to provide resources adequate to the dangers confronted.

The Administration's requests for both the International Monetary Fund and the multilateral development banks are designed to do that. I am submitting for the record a detailed background paper which deals fully with the Administration's request and provides specific material on the operations of the Fund and the banks.

In today's testimony I want to emphasize my conviction that it is absolutely crucial for the United States to continue its strong support for these institutions. They are valuable examples of successful international cooperation. More importantly they are directly supportive of vital long-term U.S. foreign policy interests. Now is not the time to undermine our influence in these institutions or reduce the constructive role they play in global economic developments. The stakes are too high.

II. THE INTERNATIONAL MONETARY FUND

The purpose of the IMF is the maintenance of a strong and orderly international monetary system. It is not foreign aid. It is not commodity financing. It is not like any other institution in which our country participates.

The IMF has two basic functions, and they are closely related. The first is general guidance over the operation and evolution of the international monetary system. The second is provision of temporary financing in support of adjustment programs by IMF members facing balance of payments problems.

In its first function, the Fund has been given important new powers of surveillance over exchange rates and the balance of payments adjustment process. The IMF membership has also established the objective of making the Special Drawing Right the principal reserve asset in the system, in order to avoid the instabilities inherent in a system based on a multiplicity of national currencies.

These changes have paralleled and to a large extent reflected changes in the position and role of the dollar in the system. The original Bretton Woods arrangements assumed a fixed and central role for the dollar with the U.S. position essentially passive and the product of other countries' actions in pursuing their own balance of payments policies and objectives. That arrangement ultimately became both unsustainable and intolerable in terms of U.S. economic interests. The new arrangements have provided much more scope for balance of payments adjustment by the United States and recognize the need for greater symmetry in encouraging adjustment by all nations -- those in surplus as well as those in deficit.

At the same time, the world's reserve system has been undergoing significant change. Increases in the relative economic size and financial capacity of other major countries have tended to bring some growing use of their currencies in international transactions and reserves. On the one hand, such a development could help to mitigate some of the burdens on the dollar and U.S. financial markets that arose from its extremely large international role. On the other hand, the process of change can itself be unsettling and disruptive, and there is a widespread view that increasing reliance on the SDR -- an internationally created and managed reserve instrument -- would be preferable to development of a full-scale multiple currency reserve system. The IMF over the past few years has taken a number of important steps to promote the role of the SDR and is presently considering a potentially significant further step in its examination of the substitution account.

The dollar nonetheless remains critically important to the operation of the international monetary system, and the

U.S. economy remains a powerful element of that system. This will continue to be the case, and we recognize and accept the responsibilities incumbent on the United States to maintain a sound economic position and a stable dollar. At the same time, a strong IMF -- able to encourage effective economic and balance of payments adjustment by all countries and able to guide the orderly evolution of the resersve system -- is of direct and immediate importance to our economy and to our efforts to maintain the integrity and strength of the dollar.

The IMF's second main function, balance of payments financing for its members, is closely linked to its broader role in guiding the overall balance of payments adjustment process. The aim is to encourage timely adjustment by individual countries through policies that disrupt national or international prosperity as little as possible.

This objective is in the interest of every country and every IMF member is obligated to support it in concrete, financial terms. This is a critically important point to bear in mind. The IMF is a revolving fund of currencies, provided by every member. Every member must allow its currency to be used by the IMF, and every member in turn has a right to draw on the IMF's currency pool when in balance of payments need. When a country's currency is used by the IMF, that country receives an automatically available claim on the IMF, which it can use to get needed foreign exchange if it runs into trouble.

Financing flows back and forth through the IMF depending on balance of payments developments. There is no set group of lenders or borrowers. Many IMF members, both developed and developing, have been on both sides of the financing and drawing ledger, providing their currency at times and drawing other currencies at other times. In fact, while the U.S. quota subscription has been drawn upon many times over the years, our own drawings of $7.3 billion on the IMF are the second largest of the entire membership. As a net result of all IMF transactions in dollars over the years -- dollar drawings and repayments by others, and U.S. drawings -- the IMF's holdings of dollars currently exceed the U.S. currency subscription to Fund resources. Consequently, there has been no net use of the U.S. currency subscription by the Fund over its 35 year history.

Quotas are absolutely central in the IMF. They are the IMF's permanent resources. They determine the amounts countries can draw. They determine the distribution of SDR allocations. They determine voting power. Because of these important advantages, the competition is always for increases in shares -- not for reduction, as is the case in many other institutions.

IMF quotas are reviewed periodically and have been increased four times in the IMF's history in response to growth in the world economy and international trade and finance. These increases have been needed to keep the Fund's financing capability in some reasonable relation to demands that may arise.

The proposal for this quota increase resulted from a review that began in 1977. Quotas had fallen to an unrealistically low level, about 4 percent of world trade compared to 12 percent earlier, during a period of massive expansion of payments imbalances and international financing needs. The recognition that an increase was necessary came early in the review -- even though a long period of negotiation was required to reach agreement on the precise amount and shares.

The 50 percent increase ultimately agreed in December 1978 -- raising total quotas from about SDR 39 billion to SDR 58 billion -- will barely halt the decline in the relative size of the IMF over the next five years. Many countries pressed hard for a larger increase. The quota increase proposed for the United States is 50 percent, amounting to SDR 4,202.5 million or about $5.3 billion at current exchange rates, and will raise our quota from SDR 8,405 million to SDR 12,607.5. This maintains the U.S. quota share intact at 21.5 percent. Given the continuing large role of the U.S. economy and the dollar in the international monetary system, maintenance of an appropriate U.S. share and influence over decisions on the international monetary system is particularly important. An increased U.S. quota will augment the foreign exchange resources available to us should we need them for balance of payments purposes. Without the proposed increase in the U.S. quota, our veto power over major IMF decisions affecting the operations of the entire system could be jeopardized.

Developments since completion of the quota review and the IMF Governors' resolution formally proposing the increase have only strengthened the need.

We are now faced with the consequence of another round of huge oil price increases and with events in Iran and Afghanistan that greatly heighten the level of world concern and tension. These developments make it absolutely essential that we have in place the institutional framework for assuring monetary stability and providing advice and support to countries as they contend with radically altered economic prospects.

Both financing and economic adjustment are going to be more difficult in this environment. The private financial markets will have to meet the bulk of expanded international financing needs -- no other source is available -- and development aid must continue to increase. But some countries will run into growing financing difficulties and pressures to bring their external balances into line with sustainable flows of financing.

Without adequate financing, the efforts of deficit countries to adjust would necessitate curtailing economic growth so abruptly that it would cause severe human hardships and could well jeopardize the political stability of a number of countries. Countries could also be forced to adopt restrictive trade policies in an attempt to ration the foreign exchange available to them, or to resort to aggressive exchange rate behavior. In today's interdependent world, the adoption of such policies -- particularly because it could lead to retaliatory policies or emulation by other countries -- could have disastrous worldwide repercussions and would be reminiscent of the self-defeating economic policies followed in the 1930's.

The task of assuring a strong and stable international monetary system in the circumstances of the 1980's will be formidable. We cannot predict the amount of IMF financing that will be needed. No one can. But we can foresee very tangible dangers to the system and to ourselves if the Fund's resources prove to be insufficient when they are called on. It is therefore critical that IMF operations in this period of stress be buttressed by prompt Congressional approval of the proposed quota increase. In so strengthening the base of the international monetary system, the United States will not only be contributing enormously to an international environment conducive to effective foreign policy but will also be strengthening a source of balance of payments financing on which it has drawn many times itself.

Before concluding this discussion of the IMF, I would like to note that the Supplementary Financing Facility, for which U.S. participation was approved by the Congress late in 1978, has proved to be an extremely important temporary reinforcement of IMF resources during a period of growing financial strain. The Facility began operation in early 1979 on the basis of financial commitments amounting to about SDR 7.8 billion. OPEC is providing over 40 percent the total with Saudi Arabia the largest single participant. To date, the facility has been used in conjunction with IMF programs totaling $3.0 billion and is assisting a wide variety of countries of special interest to the U.S. -- including Turkey, Jamaica, Peru, Korea, the Philippines and Sudan -- in dealing with severe payments difficulties. A number of countries are now discussing with the IMF programs under the Facility, and total use before the Facility expires (scheduled for early 1981 or 1982) should be substantial. This Facility, designed as a temporary bridge to the quota increase now in process, is a timely and valuable source of support for the Fund's operations in this period, and Congressional approval for it has proven to be extremely wise.

Finally, let me mention the question of the budget and appropriations treatment of this quota increase. The President's budget proposes that a program ceiling on the increase be provided in an appropriations act. We have been consulting closely on this question with interested committees, and it appears that considerable interest is developing in an alternative approach which would involve the following:

-- Appropriations would be required in the full amount of the increase, and that sum would be included in budget authority totals for fiscal year 1981.

-- Payment of the quota increase would result in budgetary outlays as cash transfers are actually made to the IMF on the U.S. quota obligation.

-- Simultaneously with any cash transfer, an offsetting budgetary receipt representing an increase in the U.S. reserve position in the IMF would be recorded.

-- As a consequence of these offsetting transactions, transfers to and from the IMF under the quota obligations would not result in net outlays or receipts.

-- Net outlays or receipts resulting from exchange rate fluctuations in the dollar value of the SDR-denominated U.S. reserve position in the Fund would be reflected in the Federal budget. These net changes cannot be projected and thus would be recorded only in actual budget results for the prior year.

We are continuing consultations on this matter. The point I would stress today is that under either the program ceiling contained in the President's budget or this alternative approach, U.S. payments on its quota subscription would not affect net budget outlays or, therefore, the Federal budget deficit.

Also under either approach, it is important that the appropriations action be denominated in SDR although I know this is a departure from normal practice. This is because our IMF quota -- and those of all other countries -- is denominated in SDR, the IMF's unit of account. We negotiated hard to maintain our quota share and influence over IMF decisions. There were many who sought increases in their own shares at our expense. We should not allow a cut through inadvertence, which could happen if the appropriation number were expressed in dollars and the dollar depreciated in terms of the SDR prior to implementation of the quota increase. An SDR denomination of the appropriation figure -- SDR 4,202.5 million -- will protect us against that danger.

III. THE MULTILATERAL DEVELOPMENT BANKS

The United States has an important responsibility in working to establish and maintain an international economic environment which furthers the process of equitable economic growth in the developing countries. This reflects the realities of economic interdependence, in which the prosperity of each nation depends upon the well-being of others. The non-oil developing countries have, for example, become the largest single market for U.S. exports. In addition the countries of the developing world are an increasingly important factor in protecting U.S. security and other foreign policy interests. It is a simple truism to recognize that the prospects for developing country support on global issues of importance to the United States will be enhanced by U.S. cooperation on issues of keen interest to them. In the case of most of the third world countries, the fundamental concern is development.

Poverty exists on a large and pervasive scale in developing countries throughout the world. There are large gaps between developed and developing countries in terms of living conditions and the quality of life; in health and nutrition, literacy and education, life expectancy, and in the overall physical and social environment. The natural growth of population and the process of industrialization have compounded already immense problems of unemployment and underemployment and fueled a rapid increase in the size of urban populations most of which are without access to rudimentary health and sanitation services. In addition to new problems generated by this rapid urban growth, the primary concerns in low income countries -- with large numbers of rural poor and heavy reliance on agriculture -- remain with the requirements of the rural economy and the need to improve production of the small farmer.

The multilateral development banks (MDBs) are at the heart of international efforts to address these development concerns. They are unique institutions by which the United States can work cooperatively with developing countries in support of their aspirations for economic and social progress.

The banks have proven themselves to be effective instruments for promoting growth with equity. Last year they made loan commitments totaling nearly $14 billion which helped to finance 425 projects in 90 developing countries. During the past five years, IBRD/IDA activities have provided the base for producing one third of all increased fertilizer production in the developing countries for the first half of the 1980s, one fifth of the total investment in rural road networks in developing countries, and one quarter of total public investment in developing country irrigation systems. Furthermore, 358 IBRD/IDA agricultural projects over these past five years have had the rural poor as their principal beneficiaries, and an estimated 60 million of the 100 million direct beneficiaries of these projects had incomes below the absolute poverty levels in their respective countries.

The banks now account for between 10 and 15 percent of the total external resources moving to the developing world. This proportion is much higher for the poorer countries which do not have access to the international capital markets.

Important as this transfer of resource function is for the MDBs, a far more important contribution to development lies in the way their projects have become the principal catalyst for growth and contributed to rational sector and macro-economic policies in developing countries. In this regard, they have organized increasing amounts of co-financing from private as well as from other public sources.

The MDBs also have a key role in the transfer of technology and in providing sound advice on economic policy associated with their lending activity. This contribution to "institution building" and "human capital formation" permeates the process of project implementation and is perhaps the greatest contribution made by the banks to the long-term economic prospects of the developing countries.

It is the combination of project financer, financial catalyst, and institution builder which makes the MDBs such unique and important agents in the development process.

Throughout the history of bank operations, the United States has supported and encouraged those adaptations in bank operations which we believed would further increase the effectiveness of bank lending. Among the more important results of past U.S. initiatives are the shift in the sectoral composition of MDB lending to those sectors -- such as agriculture and rural development -- where project benefits accrue more directly to the poor, the use of the MDBs' considerable aid leverage to promote policy changes in the borrowing countries which favor the poor, and the recently emphasized stepped-up MDB lending to increase developing country energy supplies.

Reaching the Poor

To more effectively reach the poor, all the MDBs are engaged in modifying their organizational structures and their project identification and appraisal procedures.

The World Bank has established a Rural Operations Review and Support Unit (RORSU) and an Urban Operations Review and Support Unit (UORSU) to develop poverty impact methodology and to monitor and evaluate poverty-lending projects in their beginning, intermediate, and final stages. Ninety percent of the World Bank's rural development projects have had provisions for monitoring and evaluation units. These units assist in the identification of the project's beneficiaries, insure during the project implementation stage that the benefits are actually going where intended, and, finally, evaluate the impact of the project in terms of what changes were made in the lot of the poor.

The Inter-American Development Bank has designated a specific unit within the Bank's organizational structure to define low income groups and to monitor the bank's progress in reaching its current replenishment (1979-1982) goal to provide 50 percent of total lending to low income groups. In addition, the Asian Development Bank is undertaking a major expansion of its Post Evaluation Unit to facilitate its greater attention to data collection and benefit monitoring.

Capital Saving Technology

The United States has also been successful in seeking policy decisions through which the MDBs will place increased emphasis on the use of capital saving technologies in their projects. Since these technologies involve the productive and often innovative use of small-scale and labor-intensive processes, techniques, equipment, and tools which are less complex and costly than those usually employed by more developed countries, their application generally will: (1) create employment opportunities, increase productivity, and raise the incomes of poor people at lower per capita costs; (2) ensure that the greatest number of people benefit from development projects; and (3) promote the most efficient use of scarce resources within developing countries in accordance with relative factor endowments.

By strengthening their project appraisal activities at the preinvestment stage, the MDBs have enhanced their ability to select projects which incorporate techniques most appropriate to the circumstances and requirements of the borrowing countries. This has resulted in increased utilization of capital saving technology in individual bank projects. Most recently, capital saving technology -- in addition to continuing its important role in civil works construction projects -- has become an integral element in MDB-financed renewable energy and urban and rural development projects.

Economic Benefits of U.S. MDB Membership

As the Administration's chief fiscal officer, I am committed to budget restraint. At the same time, for the reasons I have outlined, the United States must maintain a reasonable program of foreign assistance. The multilateral development banks reconcile these needs.

First, other members contribute $3 for every $1 contributed by the United States. Second, supported by callable capital, the banks finance the bulk of their lending program through borrowings in the private capital markets. The result is that U.S. budget expenditures are multiplied many times over in actual MDB lending. For every dollar the United States has paid into the World Bank over the past 35 years, for example, the Bank has lent over $50 (at no net cost to the U.S. taxpayer, because increased federal tax receipts from IBRD activities, i.e. procurement, administrative expenses, and net interest, have been more than double U.S. paid-in contributions to the bank). Our development assistance gets maximum leverage when channeled through the MDBs.

In addition, U.S. producers and consulting firms have received the largest share of MDB-financed procurement contracts. This has led to a significantly beneficial impact on U.S. employment and GNP. For every dollar we have paid into the MDBs for the years 1977 and 1978, the U.S. economy has grown by an average of $3. Over the life of the institutions, they have contributed a net surplus of $11 billion to our current account.

The cooperation among countries within the MDBs contributes significantly to the substance as well as the atmosphere of U.S. ties with developing countries. U.S. participation in the banks also reflects a successful partnership with Europe, Japan, and Canada -- with whom we work closely on MDB financing arrangements. Any significant slackening of traditional U.S. support for the MDBs would both seriously jeopardize our relations with the developing world and weaken the confidence of our allies in U.S. ability to play a cooperative role across a broad range of international activities. Undermining such a pillar of the international institutional framework would also make it much more difficult for us to get the support of the developing countries for our positions in other international bodies on issues of central concern to our own national interests.

The FY 1981 Appropriations Request and Callable Capital

For FY 1981, the Administration has requested total budget authority of $1,666 million for U.S. subscriptions and contributions to the MDBs. In addition, because of the shortfall in actual appropriations for FY 1980 from what had to be assumed when the FY 1981 budget was prepared, we will be submitting budget amendments which will increase this amount modestly. The outlay effect of the request will be spread over time and, thus, will have only a minimal impact on this year's or next year's budget.

The amount of the FY 1981 request is much lower than that for last year. This is principally because we are seeking a program ceiling rather than budget authority for the callable portions of our capital subscriptions to the banks.

The "callable capital" concept is one of the most attractive features of the multilateral development banks and results in considerable budgetary savings for the U.S. Government. With callable capital as backing, the MDBs are able to borrow most of the non-concessional funds they require in international capital markets. The cost to the U.S. Government of subscriptions to callable capital is solely contingent in nature, since callable capital can only be used to meet obligations of the

MDBs for funds borrowed or guaranteed by them in the unlikely event that the banks' other resources are insufficient to meet those liabilities.

The risk of a "call" is virtually nil. The loan portfolios of the MDBs are distributed broadly, and major defaults are almost inconceivable. In the more than thirty year history of the World Bank, there has never been a loan default. Similarly there has never been a default at the Asian Development Bank (ADB). At the Inter-American Development Bank two very small loans were defaulted in the 1960's, but this was before institution of the policy that all loans have the recipient country's government guarantee for loan repayment. (One of the IDB loans was fully recovered and the loss on the other was $1.8 million.)

Even if a number of their largest borrowers were to default, the MDBs have considerable financial assets upon which they could draw. The first line of defense of the MDBs is their paid-in capital and accumulated reserves, which total over $6.0 billion at the World Bank, over $1.9 billion at the IDB, and $1.5 billion at the ADB. Moreover, prior U.S. subscriptions to MDB callable totaling $11.5 billion have already been funded by the Congress against the potential U.S. liabilities -- and other donor countries have committed themselves to much larger amounts. It is therefore virtually certain that there will not be budget outlays resulting from the callable subscriptions proposed in the legislation before the Committee.

Unlike other donor countries, however, the United States in its budgetary procedures has heretofore treated callable capital subscriptions as though they would have an outlay impact. The issue of changing the appropriations and budgetary treatment of callable capital has been under serious consideration for over a year both within the Administration and between the Administration and Congress. The Administration has concluded that appropriation for the full amount of callable capital, and the resulting scoring of the appropriated amounts as budget authority, distort the true size of the request for the MDBs and is not consistent with the treatment of other contingent obligations of the United States Government.

The Administration therefore proposes enactment of program limitations in the FY 1981 Foreign Assistance Appropriations Act for U.S. subscriptions to callable capital instead of actual appropriation and budgetary authority. We have also submitted proposed changes in the authorizing legislation which will enable us to make the subscriptions after program limitations are enacted. Full Congressional control over callable capital subscriptions is retained both by the program limitations and because subscriptions to callable capital and paid-in -- which must be appropriated in full -- must be made in specified proportions. The General Counsel of the Treasury Department issued opinions in 1975 and 1979 that appropriations are not legally required to back subscriptions to callable capital unless and until payment is required of the United States on a call made by an institution.

The Sixth Replenishment for the IDA (IDA VI)

The background paper submitted for the record details the specifics of the Administration's full appropriations request. I would like to highlight two of the larger components of the request: the sixth replenishment for the IDA and our remaining subscription to the Special Capital Increase of the World Bank itself.

The United States has important reasons for continuing to support IDA. We have a strong tradition of international leadership in mobilizing the international community to give special attention and effort to those most in need of help, and that is IDA's reason for existence. In this context, IDA has an excellent track record as an effective instrument for reaching the poor, providing job opportunities, and helping to meet basic human needs.

IDA is, in effect, the centerpiece of U.S. North/South strategy, and the symbol of our commitment to Third World Development. It serves to undermine those in the developing world who favor confrontation with the United States, to bolster U.S. economic and political interests in North/South fora, and to improve prospects for multilateral cooperation on issues of primary importance to the United

States. At a time when global economic difficulties have exposed a large number of the world's poorest countries to serious threats of political, economic, and social instability, IDA operations make an invaluable contribution to our national security and other U.S. foreign policy objectives.

The extremely somber economic prospects for the low-income countries underscores the importance of IDA's development role in the 1980's. IDA is the world's largest source of concessional resources. It is particularly important to Black Africa, providing valuable assistance to such key countries as Kenya, Somalia, and Sudan. Egypt and Pakistan are also important IDA borrowers. IDA will be crucial in determining whether per capita food production in the poorest countries will increase and whether real progress is made in alleviating world hunger. It will also depend largely on IDA resources -- utilized within broad-based development strategies -- whether these countries will be able to improve education, health, sanitation and housing standards and produce material improvements in the lives of the poor throughout the 1980's.

IDA expresses the determination of the more advanced countries to reduce, albeit slowly, the problems of absolute poverty in the poorer nations of the world. The 54 IDA borrowers account for approximately 31 percent of the world's population but only about 3 percent of the global gross national product. Approximately 90 percent of IDA's funds go to countries whose per capita income is below $300 per year (1977 dollars). Lending is concentrated on those sectors which promise to improve most directly the lives of the very poor.

With few exceptions, IDA recipient countries lack the physical and human resources to adapt quickly to the problems confronting the global economy. Their terms of trade have deteriorated. They have not been able to attract sufficient capital to maintain imports and thus sustain even their already low growth rates. Since 1974, the real value of their imports has declined. As a result, most of the poorest countries achieved per capita growth of only around 1 percent per annum during the 1970's.

Even with a major effort by the poorest countries themselves, additional concessional resources are required to achieve both higher rates of growth and greater progress in poverty alleviation. More than one-third of the total population of the developing world -- 800 million people -- still subsist in conditions of absolute poverty.

After eighteen months of negotiation, donor countries reached agreement last December on a $12 billion IDA VI to permit continued IDA lending for the three year period beyond June 1980. Relative to donors' gross domestic products, the size of the replenishment remains at roughly the ratio of IDA V and will thus permit a modest annual growth in IDA lending.

The United States joined other donors in supporting this replenishment -- noting, however, that our support was contingent on the enactment of necessary authorization and appropriations legislation. The United States insisted on a sharp reduction in the U.S. share. After lengthy negotiation, we achieved a reduction in our share from 31 percent in IDA V to 27 percent in IDA VI. This decline continues the downward trend in the U.S. share of IDA from its initial level of 42 percent and was accompanied by a substantial increase in the shares of Germany (from 10.9% to 12.5%) and Japan (from 10.3% to 14.65%). The reduction of four percentage points in the U.S. share constitutes a very significant improvement in the distribution of responsibility for providing funds for IDA, saving us $480 million over the life of the agreement.

A U.S. share of 27 percent of a $12 billion IDA VI replenishment results in an average annual U.S. contribution of $1,080 million. This represents virtually no increase in real terms in U.S. funding for IDA -- its annual lending rises by a modest amount, but our share declines by 4 percent. All real growth in IDA lending will be financed by other donors.

World Bank Selective Capital

In 1977, Congress authorized United States participation in a Selective Capital Increase (SCI) for the IBRD. The United States has been behind in its scheduled SCI payments since the first installment, however, even though 90 percent of our subscription represents callable capital and thus no budget outlays.

Reluctance to meet our full SCI subscriptions is ironic because the Bank's great success is to a large extent due to the leadership the United States has provided in it since its creation in 1946. The shortfall in U.S. funding is particularly inopportune now that the Bank, at U.S. initiative, has mounted a major program to increase world energy supplies. The World Bank's energy program will grow to at least 15 percent of total Bank lending within five years. It will amount to $7.7 billion over the period as part of projects totaling about $30 billion for the exploration, production, and development of oil, gas, and coal, and for the construction of new hydroelectric facilities. In operation, these Bank projects will produce additional primary energy estimated at 2-2.5 million barrels of oil a day, thus reducing by that amount potential world demand for OPEC oil.

A U.S. failure to complete our SCI subscription could lead other members to insist on a significant cutback in the Bank's annual lending program because doubts would be generated about

U.S. support for Bank lending throughout the 1980's. Such a cut-back in the lending program would be disastrous for our relations with the developing world, undermining Bank programs in countries and regions of particular concern to the United States (e.g. Egypt, Turkey, the Caribbean, and Central America) and heightening international monetary problems by increasing demand on private capital markets.

Subscription of the full SCI amount is also essential to maintain United States voting strength above 20 percent and thus protect the U.S. veto in the Bank. The veto ensures that no changes are made in the Charter which would have a detrimental impact on U.S. interests.

The African Development Bank

The U.S. subscription to the African Development Bank (AFDB) is an important new component of the FY 81 appropriations request. Subject to receiving authorization for U.S. membership in the bank, an initial appropriation of $18 million is being sought.

Membership in the AFDB to date has been restricted to African nations. The limited resources of the African members have, however, severely restricted the Bank's access to the private capital markets and its lending program. As a result, in May 1979, the Governors of the Bank agreed, subject to necessary ratification by member governments, to invite nonregional countries to join their institution. The proposed U.S. subscription would represent 5.68 percent of the AFDB's total capital and 17.04 percent of the non-regional subscription. The United States will therefore have its own Executive Director on the Board of the Bank.

The United States has direct economic, humanitarian, and political interests in assuring a strong and viable Africa where poverty is reduced, the pace of economic growth accelerated, and serious financial problems avoided. While a wide range of U.S. political and economic policies already contribute toward these objectives, our membership in the AFDB, the most prominent pan-African development institution, would help strengthen our ties with African nations and meet our growing interests in the region.

Other Regional MDBs

The remainder of the Administration's request is for appropriations for capital subscriptions and contributions for the Inter-American Bank (IDB), the Asian Development Bank (ADB) and Fund (ADF), and the African Development Fund (AFDF):

-- $51.6 million in paid-in capital for the IDB and $318 million for the Fund for Special Operations, the IDB's concessional lending window;

-- $25.2 million in paid-in capital for the ADB and $111.2 million for the ADF, the Bank's concessional window; and

-- $41.7 million for the AFDF, which provides concessional financing for Africa's poorest countries.

As noted above, most of these numbers will have to be supplemented by budget amendments to reflect the shortfall in actual FY 1980 appropriations.

These regional institutions were established to complement the activities of the World Bank Group and increase the direct involvement of the recipient countries in the development process. They now provide a central element in the development strategies of many friendly nations and are unique positioned to bring to bear a special regional expertise to local problems. The regional MDBs also facilitate the mobilization of additional resources from the developing countries themselves.

The Decision-Making Process

I recognize that one of the major concerns regarding the MDBs is whether the United States has adequate influence to promote its interests effectively through such multilateral institutions. The formulation of MDB policy and the extent of influence exercised by the United States in their decision-making involve both a formal and informal process.

The MDBs are like any other bank, or, indeed, any other corporate entity. They are controlled by a board -- in their case, of member country Governors and, through them, their appointed Executive Directors. Management is hired by the national representatives of the member countries to carry out the day-to-day functions of the banks within the policy framework set for the banks by the member governments. The management of the banks executes that policy under the general guidance of the Boards of Executive Directors. Their task is facilitated greatly by the fact that there exists among bank members a broad consensus on both the aims and the most effective usage of development lending.

In practice, influence also is manifest in a variety of informal ways -- official and unofficial meetings of national officials at the bilateral and multilateral level; informal discussions among the Governors at the annual meetings; informal meetings preceding and during the periodic replenishment negotiations; and countless exchanges between bank officials and national representatives at all stages of the formulation and implementation of the banks' lending programs. Subtly, and often imperceptibly, a country's interests are advanced in such ways, and these interests become woven into the fabric of MDB activities.

The cardinal test of U.S. influence is of course not procedure but substance -- whether the institutions have consistently pursued policies which promote the national interests of the United States. In my judgment, they clearly have done so and continue to do so. We have only to consider MDB lending programs in agriculture aimed at increasing production and providing employment, and now more effectively concentrated on reaching the poorest rural inhabitants. The expansion of developing country energy supplies is a second priority that the MDBs are employing which is also very much in our interests. The facts are that the United States has steadily reduced its share of contributions to the MDBs while preserving its influence. The MDBs are, moreover, a constructive arena for North/South cooperation on practical problems with the great confluence of interests among all MDB member countries making these institutions unique among North/South fora.

Restrictive Amendments

The majority of MDB recipient countries operate economic systems which are compatible with western oriented market systems. Moreover, most MDB lending is directed to countries which occupy strategic geographic positions, which are important sources of critical raw materials, or where the United States has other key political and economic interests.

There has understandably been serious concern however about loans by the MDBs to Vietnam and perhaps a few other countries. But this issue is largely moot, given the suspension of MDB lending to Vietnam and Afghanistan. I must urge you to oppose inserting restrictions on U.S. MDB contributions into law.

Under their charters, the banks cannot legally accept contributions which are subject to unilaterally imposed conditions from the United States or any other bank members.

Acceptance of such restricted contributions would be inconsistent with Charter provisions dealing with (1) the purposes of the banks, (2) the permitted uses of Bank resources, (3) the prohibition on political considerations affecting loan decisions, and (4) callable capital.

The fact that the MDBs could not accept U.S. contributions with country restrictions has been confirmed by legal opinions from the MDBs themselves, the Executive Branch, the General Accounting Office, the Congressional Reserach Service, the American Bar Association, and an expert group of the District of Columbia Bar. In 1975, the Inter-American Development refused to accept contributions earmarked for a specific purpose by the United States because such acceptance would have violated the charter of the Bank. The funds were accepted only after the earmarking requirement was repealed in subsequent legislation.

The imposition of restrictions by the United States would also be unwise from a policy standpoint. Other countries, which are increasingly important contributors, could well emulate the United States and impose restrictions which would not be acceptable to us. Clearly to start down this path would run the very serious risk of damaging the global development effort by crippling the ability of the MDBs to execute their operations objectively and efficiently.

The real issue posed by restrictive amendments, therefore, is continued U.S. participation in the MDBs. The adoption of such amendments would have the effect of taking the United States out of the banks. Such an outcome would have a disastrous impact on U.S. foreign policy and national interests, and would undermine greatly world confidence in the United States just at a time when we are striving to mobilize a cooperative global response to the challenges emerging in Southwest Asia and other regions of the world.

IV. CONCLUSION

In conclusion, Mr. Chairman, I would like to re-emphasize that the International Monetary Fund and the multilateral development banks are essential to U.S. interests.

The international monetary system is undergoing a period of major change and political strain. The IMF is our central institution for monetary cooperation and an important source of strength, stability, and broad direction as we try to contend with these changes. We need, of course, to recognize our own continuing large role in the world economy, and our responsibility for maintaining a strong U.S. economy and a sound dollar. But we need also to understand that a strong IMF role in guiding the system is of direct importance to our own efforts to strengthen the economy and maintain the integrity of the dollar. In strengthening the IMF, the United States will be making an important contribution to an international environment which greatly facilitates effective foreign policy.

We will also be strengthening a source of balance of payments financing on which we can and do draw ourselves.

U.S. national interests clearly require that we maintain a reasonable program of foreign assistance. Such a program directly supports U.S. economic, foreign policy, and national security objectives which we have in the less developed countries of the world. It also directly benefits substantial numbers of the most deprived and disadvantaged people in the poorest countries. Foreign assistance is a particularly important and necessary complement to other parts of the President's budget request which have been designed to enhance the protection of our national security and foreign policy interests. We need the support of developing countries on a broad range of international issues. We cannot expect this support unless we, in turn, help address their fundamental concern of development.

The multilateral development banks are the most cost-effective instrument for promoting economic growth and political stability -- and hence U.S. interests -- in the developing world. They encourage sound national economic policies and provide an effective framework for bringing the developing countries into the open market system we espouse. Moreover, the banks give us good value for our money with U.S. budgetary expenditures multiplied many times over in actual bank lending. They benefit borrowers and lenders, developing and developed countries alike. The importance of the banks have been reinforced by the fact that recent economic difficulties have exposed a number of developing countries to serious threats of political, economic, and social instability.

These problems have a direct bearing on our national security interests. They are difficult but not unmanageable. Given a reasonable degree of international cooperation, we have the resources to assure a gradual expansion of the world economy. Healthy and growing economies strengthen the foundation of the international economic system and maintain an environment conducive to multilateral cooperation on a broad range of other issues critical to the United States.

The seriousness of the current world situation leaves little doubt about the importance of a sound international structure for dealing cooperatively with vital issues. Now is clearly the time for renewed United States leadership in support of the Fund and the multilateral development banks and of the mutually beneficial endeavors which they represent. For these reasons, the Administration urges Congress to provide the necessary funding to sustain the operations of these institutions and to encourage their pivotal role in building a cohesive and stable world.

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NEWS

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STATEMENT OF THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
AND RELATED PROGRAMS
COMMITTEE ON APPROPRIATIONS
HOUSE OF REPRESENTATIVES

I. INTRODUCTION

I am pleased to be here today to endorse legislation providing for the maintenance of the U.S. share of International Monetary Fund quotas and the Administration's Fiscal Year 1981 appropriations request for the multilateral development banks (MDBs). We meet in the context of a difficult international situation which is characterized by greater tension -- in both the strategic and economic spheres -- than has been the case in recent history.

The tension affecting our strategic interests is most clearly linked to events in Southwest Asia. The unrest in Iran and the Soviet aggression in Afghanistan have heightened awareness throughout the world of the vulnerability of the world's major oil-producing region to both internal instability and external aggression. These

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developments clearly threaten our national interests, and we have set in motion a comprehensive program of action to reinforce the U.S. political and military position in the region and elsewhere.

The economic tension stems from the somber global economic outlook. Much of the 1970's was characterized by high inflation, soaring energy costs, low growth rates, and unprecedented imbalances in external payments. Largely as a result of various cooperative efforts, the international community weathered the economic turbulence reasonably well. Nevertheless, adverse oil market developments have again radically affected economic prospects. Many economic problems are not only likely to persist for the foreseeable future but may well intensify. The re-emergence of a large current account surplus in the OPEC countries -- projected at about $120 billion for 1980 -- and the inevitable generation of a corresponding deficit in non-OPEC countries will make serious balance of payments pressures inevitable for a growing number of countries.

Events in the Middle East have driven home dramatically the linkages between foreign policy and economics. Political and military concerns cannot be addressed in isolation from the realities of the world economy, and conversely all basic economic issues have a large political element. We can be successful in the pursuit of our broad global objectives only if we deal with both the strategic and economic crises which we face, and the inter-relationships between them.

The Administration response to the increased tensions in both the strategic and economic arenas has relied heavily on the international institutional framework which has evolved since World War II. This framework was designed under U.S. leadership to provide a system whereby all countries, large and small, could turn to seek cooperative solutions to their fundamental concerns. In the foreign policy area, the United States has recently turned to NATO, the United Nations, and the World Court. Economically, we rely heavily on the institutions which are the subject of today's hearings.

The International Monetary Fund (IMF) and the multilateral development banks (MDBs) are the front lines of defense for the world economy. During the 1970's, they were pivotal factors which both facilitated needed economic adjustments and helped sustain growth: the IMF through its surveillance and oversight activities and also through its expanded and liberalized financing facilities, and the MDBs through their increasingly important role in Third World development.

The distinct but complementary operations of these institutions serve U.S. interests greatly. They will be invaluable assets in facing the growing economic and financial problems of the new decade. The uncertain world economic environment -- which the Soviet Union will seek to exploit -- makes it all the more important for the United States to assure that the IMF and the MDBs can respond effectively to the needs of their members. In the economic arena, as in the international political and military spheres, the United States cannot maintain an effective leadership role -- and assure our national security -- unless we are willing to provide resources adequate to the dangers confronted.

The Administration's requests for both the International Monetary Fund and the multilateral development banks are designed to do that. I am submitting for the record a detailed background paper which deals fully with the Administration's request and provides specific material on the operations of the Fund and the banks.

In today's testimony I want to emphasize my conviction that it is absolutely crucial for the United States to continue its strong support for these institutions. They are valuable examples of successful international cooperation. More importantly they are directly supportive of vital long-term U.S. foreign policy interests. Now is not the time to undermine our influence in these institutions or reduce the constructive role they play in global economic developments. The stakes are too high.

II. THE INTERNATIONAL MONETARY FUND

The purpose of the IMF is the maintenance of a strong and orderly international monetary system. It is not foreign aid. It is not commodity financing. It is not like any other institution in which our country participates.

The IMF has two basic functions, and they are closely related. The first is general guidance over the operation and evolution of the international monetary system. The second is provision of temporary financing in support of adjustment programs by IMF members facing balance of payments problems.

In its first function, the Fund has been given important new powers of surveillance over exchange rates and the balance of payments adjustment process. The IMF membership has also established the objective of making the Special Drawing Right the principal reserve asset in the system, in order to avoid the instabilities inherent in a system based on a multiplicity of national currencies.

These changes have paralleled and to a large extent reflected changes in the position and role of the dollar in the system. The original Bretton Woods arrangements assumed a fixed and central role for the dollar with the U.S. position essentially passive and the product of other countries' actions in pursuing their own balance of payments policies and objectives. That arrangement ultimately became both unsustainable and intolerable in terms of U.S. economic interests. The new arrangements have provided much more scope for balance of payments adjustment by the United States and recognize the need for greater symmetry in encouraging adjustment by all nations -- those in surplus as well as those in deficit.

At the same time, the world's reserve system has been undergoing significant change. Increases in the relative economic size and financial capacity of other major countries have tended to bring some growing use of their currencies in international transactions and reserves. On the one hand, such a development could help to mitigate some of the burdens on the dollar and U.S. financial markets that arose from its extremely large international role. On the other hand, the process of change can itself be unsettling and disruptive, and there is a widespread view that increasing reliance on the SDR -- an internationally created and managed reserve instrument -- would be preferable to development of a full-scale multiple currency reserve system. The IMF over the past few years has taken a number of important steps to promote the role of the SDR and is presently considering a potentially significant further step in its examination of the substitution account.

The dollar nonetheless remains critically important to the operation of the international monetary system, and the

U.S. economy remains a powerful element of that system. This will continue to be the case, and we recognize and accept the responsibilities incumbent on the United States to maintain a sound economic position and a stable dollar. At the same time, a strong IMF -- able to encourage effective economic and balance of payments adjustment by all countries and able to guide the orderly evolution of the resersve system -- is of direct and immediate importance to our economy and to our efforts to maintain the integrity and strength of the dollar.

The IMF's second main function, balance of payments financing for its members, is closely linked to its broader role in guiding the overall balance of payments adjustment process. The aim is to encourage timely adjustment by individual countries through policies that disrupt national or international prosperity as little as possible.

This objective is in the interest of every country and every IMF member is obligated to support it in concrete, financial terms. This is a critically important point to bear in mind. The IMF is a revolving fund of currencies, provided by every member. Every member must allow its currency to be used by the IMF, and every member in turn has a right to draw on the IMF's currency pool when in balance of payments need. When a country's currency is used by the IMF, that country receives an automatically available claim on the IMF, which it can use to get needed foreign exchange if it runs into trouble.

Financing flows back and forth through the IMF depending on balance of payments developments. There is no set group of lenders or borrowers. Many IMF members, both developed and developing, have been on both sides of the financing and drawing ledger, providing their currency at times and drawing other currencies at other times. In fact, while the U.S. quota subscription has been drawn upon many times over the years, our own drawings of $7.3 billion on the IMF are the second largest of the entire membership. As a net result of all IMF transactions in dollars over the years -- dollar drawings and repayments by others, and U.S. drawings -- the IMF's holdings of dollars currently exceed the U.S. currency subscription to Fund resources. Consequently, there has been no net use of the U.S. currency subscription by the Fund over its 35 year history.

Quotas are absolutely central in the IMF. They are the IMF's permanent resources. They determine the amounts countries can draw. They determine the distribution of SDR allocations. They determine voting power. Because of these important advantages, the competition is always for increases in shares -- not for reduction, as is the case in many other institutions.

IMF quotas are reviewed periodically and have been increased four times in the IMF's history in response to growth in the world economy and international trade and finance. These increases have been needed to keep the Fund's financing capability in some reasonable relation to demands that may arise.

The proposal for this quota increase resulted from a review that began in 1977. Quotas had fallen to an unrealistically low level, about 4 percent of world trade compared to 12 percent earlier, during a period of massive expansion of payments imbalances and international financing needs. The recognition that an increase was necessary came early in the review -- even though a long period of negotiation was required to reach agreement on the precise amount and shares.

The 50 percent increase ultimately agreed in December 1978 -- raising total quotas from about SDR 39 billion to SDR 58 billion -- will barely halt the decline in the relative size of the IMF over the next five years. Many countries pressed hard for a larger increase. The quota increase proposed for the United States is 50 percent, amounting to SDR 4,202.5 million or about \$5.3 billion at current exchange rates, and will raise our quota from SDR 8,405 million to SDR 12,607.5. This maintains the U.S. quota share intact at 21.5 percent. Given the continuing large role of the U.S. economy and the dollar in the international monetary system, maintenance of an appropriate U.S. share and influence over decisions on the international monetary system is particularly important. An increased U.S. quota will augment the foreign exchange resources available to us should we need them for balance of payments purposes. Without the proposed increase in the U.S. quota, our veto power over major IMF decisions affecting the operations of the entire system could be jeopardized.

Developments since completion of the quota review and the IMF Governors' resolution formally proposing the increase have only strengthened the need.

We are now faced with the consequence of another round of huge oil price increases and with events in Iran and Afghanistan that greatly heighten the level of world concern and tension. These developments make it absolutely essential that we have in place the institutional framework for assuring monetary stability and providing advice and support to countries as they contend with radically altered economic prospects.

Both financing and economic adjustment are going to be more difficult in this environment. The private financial markets will have to meet the bulk of expanded international financing needs -- no other source is available -- and development aid must continue to increase. But some countries will run into growing financing difficulties and pressures to bring their external balances into line with sustainable flows of financing.

Without adequate financing, the efforts of deficit countries to adjust would necessitate curtailing economic growth so abruptly that it would cause severe human hardships and could well jeopardize the political stability of a number of countries. Countries could also be forced to adopt restrictive trade policies in an attempt to ration the foreign exchange available to them, or to resort to aggressive exchange rate behavior. In today's interdependent world, the adoption of such policies -- particularly because it could lead to retaliatory policies or emulation by other countries -- could have disastrous worldwide repercussions and would be reminiscent of the self-defeating economic policies followed in the 1930's.

The task of assuring a strong and stable international monetary system in the circumstances of the 1980's will be formidable. We cannot predict the amount of IMF financing that will be needed. No one can. But we can foresee very tangible dangers to the system and to ourselves if the Fund's resources prove to be insufficient when they are called on. It is therefore critical that IMF operations in this period of stress be buttressed by prompt Congressional approval of the proposed quota increase. In so strengthening the base of the international monetary system, the United States will not only be contributing enormously to an international environment conducive to effective foreign policy but will also be strengthening a source of balance of payments financing on which it has drawn many times itself.

Before concluding this discussion of the IMF, I would like to note that the Supplementary Financing Facility, for which U.S. participation was approved by the Congress late in 1978, has proved to be an extremely important temporary reinforcement of IMF resources during a period of growing financial strain. The Facility began operation in early 1979 on the basis of financial commitments amounting to about SDR 7.8 billion. OPEC is providing over 40 percent the total with Saudi Arabia the largest single participant. To date, the facility has been used in conjunction with IMF programs totaling $3.0 billion and is assisting a wide variety of countries of special interest to the U.S. -- including Turkey, Jamaica, Peru, Korea, the Philippines and Sudan -- in dealing with severe payments difficulties. A number of countries are now discussing with the IMF programs under the Facility, and total use before the Facility expires (scheduled for early 1981 or 1982) should be substantial. This Facility, designed as a temporary bridge to the quota increase now in process, is a timely and valuable source of support for the Fund's operations in this period, and Congressional approval for it has proven to be extremely wise.

Finally, let me mention the question of the budget and appropriations treatment of this quota increase. The President's budget proposes that a program ceiling on the increase be provided in an appropriations act. We have been consulting closely on this question with interested committees, and it appears that considerable interest is developing in an alternative approach which would involve the following:

-- Appropriations would be required in the full amount of the increase, and that sum would be included in budget authority totals for fiscal year 1981.

-- Payment of the quota increase would result in budgetary outlays as cash transfers are actually made to the IMF on the U.S. quota obligation.

-- Simultaneously with any cash transfer, an offsetting budgetary receipt representing an increase in the U.S. reserve position in the IMF would be recorded.

-- As a consequence of these offsetting transactions, transfers to and from the IMF under the quota obligations would not result in net outlays or receipts.

-- Net outlays or receipts resulting from exchange rate fluctuations in the dollar value of the SDR-denominated U.S. reserve position in the Fund would be reflected in the Federal budget. These net changes cannot be projected and thus would be recorded only in actual budget results for the prior year.

We are continuing consultations on this matter. The point I would stress today is that under either the program ceiling contained in the President's budget or this alternative approach, U.S. payments on its quota subscription would not affect net budget outlays or, therefore, the Federal budget deficit.

Also under either approach, it is important that the appropriations action be denominated in SDR although I know this is a departure from normal practice. This is because our IMF quota -- and those of all other countries -- is denominated in SDR, the IMF's unit of account. We negotiated hard to maintain our quota share and influence over IMF decisions. There were many who sought increases in their own shares at our expense. We should not allow a cut through inadvertence, which could happen if the appropriation number were expressed in dollars and the dollar depreciated in terms of the SDR prior to implementation of the quota increase. An SDR denomination of the appropriation figure -- SDR 4,202.5 million -- will protect us against that danger.

III. THE MULTILATERAL DEVELOPMENT BANKS

The United States has an important responsibility in working to establish and maintain an international economic environment which furthers the process of equitable economic growth in the developing countries. This reflects the realities of economic interdependence, in which the prosperity of each nation depends upon the well-being of others. The non-oil developing countries have, for example, become the largest single market for U.S. exports. In addition the countries of the developing world are an increasingly important factor in protecting U.S. security and other foreign policy interests. It is a simple truism to recognize that the prospects for developing country support on global issues of importance to the United States will be enhanced by U.S. cooperation on issues of keen interest to them. In the case of most of the third world countries, the fundamental concern is development.

Poverty exists on a large and pervasive scale in developing countries throughout the world. There are large gaps between developed and developing countries in terms of living conditions and the quality of life; in health and nutrition, literacy and education, life expectancy, and in the overall physical and social environment. The natural growth of population and the process of industrialization have compounded already immense problems of unemployment and underemployment and fueled a rapid increase in the size of urban populations most of which are without access to rudimentary health and sanitation services. In addition to new problems generated by this rapid urban growth, the primary concerns in low income countries -- with large numbers of rural poor and heavy reliance on agriculture -- remain with the requirements of the rural economy and the need to improve production of the small farmer.

The multilateral development banks (MDBs) are at the heart of international efforts to address these development concerns. They are unique institutions by which the United States can work cooperatively with developing countries in support of their aspirations for economic and social progress.

The banks have proven themselves to be effective instruments for promoting growth with equity. Last year they made loan commitments totaling nearly $14 billion which helped to finance 425 projects in 90 developing countries. During the past five years, IBRD/IDA activities have provided the base for producing one third of all increased fertilizer production in the developing countries for the first half of the 1980s, one fifth of the total investment in rural road networks in developing countries, and one quarter of total public investment in developing country irrigation systems. Furthermore, 358 IBRD/IDA agricultural projects over these past five years have had the rural poor as their principal beneficiaries, and an estimated 60 million of the 100 million direct beneficiaries of these projects had incomes below the absolute poverty levels in their respective countries.

The banks now account for between 10 and 15 percent of the total external resources moving to the developing world. This proportion is much higher for the poorer countries which do not have access to the international capital markets.

Important as this transfer of resource function is for the MDBs, a far more important contribution to development lies in the way their projects have become the principal catalyst for growth and contributed to rational sector and macro-economic policies in developing countries. In this regard, they have organized increasing amounts of co-financing from private as well as from other public sources.

The MDBs also have a key role in the transfer of technology and in providing sound advice on economic policy associated with their lending activity. This contribution to "institution building" and "human capital formation" permeates the process of project implementation and is perhaps the greatest contribution made by the banks to the long-term economic prospects of the developing countries.

It is the combination of project financer, financial catalyst, and institution builder which makes the MDBs such unique and important agents in the development process.

Throughout the history of bank operations, the United States has supported and encouraged those adaptations in bank operations which we believed would further increase the effectiveness of bank lending. Among the more important results of past U.S. initiatives are the shift in the sectoral composition of MDB lending to those sectors -- such as agriculture and rural development -- where project benefits accrue more directly to the poor, the use of the MDBs' considerable aid leverage to promote policy changes in the borrowing countries which favor the poor, and the recently emphasized stepped-up MDB lending to increase developing country energy supplies.

Reaching the Poor

To more effectively reach the poor, all the MDBs are engaged in modifying their organizational structures and their project identification and appraisal procedures.

The World Bank has established a Rural Operations Review and Support Unit (RORSU) and an Urban Operations Review and Support Unit (UORSU) to develop poverty impact methodology and to monitor and evaluate poverty-lending projects in their beginning, intermediate, and final stages. Ninety percent of the World Bank's rural development projects have had provisions for monitoring and evaluation units. These units assist in the identification of the project's beneficiaries, insure during the project implementation stage that the benefits are actually going where intended, and, finally, evaluate the impact of the project in terms of what changes were made in the lot of the poor.

The Inter-American Development Bank has designated a specific unit within the Bank's organizational structure to define low income groups and to monitor the bank's progress in reaching its current replenishment (1979-1982) goal to provide 50 percent of total lending to low income groups. In addition, the Asian Development Bank is undertaking a major expansion of its Post Evaluation Unit to facilitate its greater attention to data collection and benefit monitoring.

Capital Saving Technology

The United States has also been successful in seeking policy decisions through which the MDBs will place increased emphasis on the use of capital saving technologies in their projects. Since these technologies involve the productive and often innovative use of small-scale and labor-intensive processes, techniques, equipment, and tools which are less complex and costly than those usually employed by more developed countries, their application generally will: (1) create employment opportunities, increase productivity, and raise the incomes of poor people at lower per capita costs; (2) ensure that the greatest number of people benefit from development projects; and (3) promote the most efficient use of scarce resources within developing countries in accordance with relative factor endowments.

By strengthening their project appraisal activities at the preinvestment stage, the MDBs have enhanced their ability to select projects which incorporate techniques most appropriate to the circumstances and requirements of the borrowing countries. This has resulted in increased utilization of capital saving technology in individual bank projects. Most recently, capital saving technology -- in addition to continuing its important role in civil works construction projects -- has become an integral element in MDB-financed renewable energy and urban and rural development projects.

Economic Benefits of U.S. MDB Membership

As the Administration's chief fiscal officer, I am committed to budget restraint. At the same time, for the reasons I have outlined, the United States must maintain a reasonable program of foreign assistance. The multilateral development banks reconcile these needs.

First, other members contribute $3 for every $1 contributed by the United States. Second, supported by callable capital, the banks finance the bulk of their lending program through borrowings in the private capital markets. The result is that U.S. budget expenditures are multiplied many times over in actual MDB lending. For every dollar the United States has paid into the World Bank over the past 35 years, for example, the Bank has lent over $50 (at no net cost to the U.S. taxpayer, because increased federal tax receipts from IBRD activities, i.e. procurement, administrative expenses, and net interest, have been more than double U.S. paid-in contributions to the bank). Our development assistance gets maximum leverage when channeled through the MDBs.

In addition, U.S. producers and consulting firms have received the largest share of MDB-financed procurement contracts. This has led to a significantly beneficial impact on U.S. employment and GNP. For every dollar we have paid into the MDBs for the years 1977 and 1978, the U.S. economy has grown by an average of $3. Over the life of the institutions, they have contributed a net surplus of $11 billion to our current account.

The cooperation among countries within the MDBs contributes significantly to the substance as well as the atmosphere of U.S. ties with developing countries. U.S. participation in the banks also reflects a successful partnership with Europe, Japan, and Canada -- with whom we work closely on MDB financing arrangements. Any significant slackening of traditional U.S. support for the MDBs would both seriously jeopardize our relations with the developing world and weaken the confidence of our allies in U.S. ability to play a cooperative role across a broad range of international activities. Undermining such a pillar of the international institutional framework would also make it much more difficult for us to get the support of the developing countries for our positions in other international bodies on issues of central concern to our own national interests.

The FY 1981 Appropriations Request and Callable Capital

For FY 1981, the Administration has requested total budget authority of $1,666 million for U.S. subscriptions and contributions to the MDBs. In addition, because of the shortfall in actual appropriations for FY 1980 from what had to be assumed when the FY 1981 budget was prepared, we will be submitting budget amendments which will increase this amount modestly. The outlay effect of the request will be spread over time and, thus, will have only a minimal impact on this year's or next year's budget.

The amount of the FY 1981 request is much lower than that for last year. This is principally because we are seeking a program ceiling rather than budget authority for the callable portions of our capital subscriptions to the banks.

The "callable capital" concept is one of the most attractive features of the multilateral development banks and results in considerable budgetary savings for the U.S. Government. With callable capital as backing, the MDBs are able to borrow most of the non-concessional funds they require in international capital markets. The cost to the U.S. Government of subscriptions to callable capital is solely contingent in nature, since callable capital can only be used to meet obligations of the

MDBs for funds borrowed or guaranteed by them in the unlikely event that the banks' other resources are insufficient to meet those liabilities.

The risk of a "call" is virtually nil. The loan portfolios of the MDBs are distributed broadly, and major defaults are almost inconceivable. In the more than thirty year history of the World Bank, there has never been a loan default. Similarly there has never been a default at the Asian Development Bank (ADB). At the Inter-American Development Bank two very small loans were defaulted in the 1960's, but this was before institution of the policy that all loans have the recipient country's government guarantee for loan repayment. (One of the IDB loans was fully recovered and the loss on the other was $1.8 million.)

Even if a number of their largest borrowers were to default, the MDBs have considerable financial assets upon which they could draw. The first line of defense of the MDBs is their paid-in capital and accumulated reserves, which total over $6.0 billion at the World Bank, over $1.9 billion at the IDB, and $1.5 billion at the ADB. Moreover, prior U.S. subscriptions to MDB callable totaling $11.5 billion have already been funded by the Congress against the potential U.S. liabilities -- and other donor countries have committed themselves to much larger amounts. It is therefore virtually certain that there will not be budget outlays resulting from the callable subscriptions proposed in the legislation before the Committee.

Unlike other donor countries, however, the United States in its budgetary procedures has heretofore treated callable capital subscriptions as though they would have an outlay impact. The issue of changing the appropriations and budgetary treatment of callable capital has been under serious consideration for over a year both within the Administration and between the Administration and Congress. The Administration has concluded that appropriation for the full amount of callable capital, and the resulting scoring of the appropriated amounts as budget authority, distort the true size of the request for the MDBs and is not consistent with the treatment of other contingent obligations of the United States Government.

The Administration therefore proposes enactment of program limitations in the FY 1981 Foreign Assistance Appropriations Act for U.S. subscriptions to callable capital instead of actual appropriation and budgetary authority. We have also submitted proposed changes in the authorizing legislation which will enable us to make the subscriptions after program limitations are enacted. Full Congressional control over callable capital subscriptions is retained both by the program limitations and because subscriptions to callable capital and paid-in -- which must be appropriated in full -- must be made in specified proportions. The General Counsel of the Treasury Department issued opinions in 1975 and 1979 that appropriations are not legally required to back subscriptions to callable capital unless and until payment is required of the United States on a call made by an institution.

The Sixth Replenishment for the IDA (IDA VI)

The background paper submitted for the record details the specifics of the Administration's full appropriations request. I would like to highlight two of the larger components of the request: the sixth replenishment for the IDA and our remaining subscription to the Special Capital Increase of the World Bank itself.

The United States has important reasons for continuing to support IDA. We have a strong tradition of international leadership in mobilizing the international community to give special attention and effort to those most in need of help, and that is IDA's reason for existence. In this context, IDA has an excellent track record as an effective instrument for reaching the poor, providing job opportunities, and helping to meet basic human needs.

IDA is, in effect, the centerpiece of U.S. North/South strategy, and the symbol of our commitment to Third World Development. It serves to undermine those in the developing world who favor confrontation with the United States, to bolster U.S. economic and political interests in North/South fora, and to improve prospects for multilateral cooperation on issues of primary importance to the United

States. At a time when global economic difficulties have exposed a large number of the world's poorest countries to serious threats of political, economic, and social instability, IDA operations make an invaluable contribution to our national security and other U.S. foreign policy objectives.

The extremely somber economic prospects for the low-income countries underscores the importance of IDA's development role in the 1980's. IDA is the world's largest source of concessional resources. It is particularly important to Black Africa, providing valuable assistance to such key countries as Kenya, Somalia, and Sudan. Egypt and Pakistan are also important IDA borrowers. IDA will be crucial in determining whether per capita food production in the poorest countries will increase and whether real progress is made in alleviating world hunger. It will also depend largely on IDA resources -- utilized within broad-based development strategies -- whether these countries will be able to improve education, health, sanitation and housing standards and produce material improvements in the lives of the poor throughout the 1980's.

IDA expresses the determination of the more advanced countries to reduce, albeit slowly, the problems of absolute poverty in the poorer nations of the world. The 54 IDA borrowers account for approximately 31 percent of the world's population but only about 3 percent of the global gross national product. Approximately 90 percent of IDA's funds go to countries whose per capita income is below $300 per year (1977 dollars). Lending is concentrated on those sectors which promise to improve most directly the lives of the very poor.

With few exceptions, IDA recipient countries lack the physical and human resources to adapt quickly to the problems confronting the global economy. Their terms of trade have deteriorated. They have not been able to attract sufficient capital to maintain imports and thus sustain even their already low growth rates. Since 1974, the real value of their imports has declined. As a result, most of the poorest countries achieved per capita growth of only around 1 percent per annum during the 1970's.

Even with a major effort by the poorest countries themselves, additional concessional resources are required to achieve both higher rates of growth and greater progress in poverty alleviation. More than one-third of the total population of the developing world -- 800 million people -- still subsist in conditions of absolute poverty.

After eighteen months of negotiation, donor countries reached agreement last December on a $12 billion IDA VI to permit continued IDA lending for the three year period beyond June 1980. Relative to donors' gross domestic products, the size of the replenishment remains at roughly the ratio of IDA V and will thus permit a modest annual growth in IDA lending.

The United States joined other donors in supporting this replenishment -- noting, however, that our support was contingent on the enactment of necessary authorization and appropriations legislation. The United States insisted on a sharp reduction in the U.S. share. After lengthy negotiation, we achieved a reduction in our share from 31 percent in IDA V to 27 percent in IDA VI. This decline continues the downward trend in the U.S. share of IDA from its initial level of 42 percent and was accompanied by a substantial increase in the shares of Germany (from 10.9% to 12.5%) and Japan (from 10.3% to 14.65%). The reduction of four percentage points in the U.S. share constitutes a very significant improvement in the distribution of responsibility for providing funds for IDA, saving us $480 million over the life of the agreement.

A U.S. share of 27 percent of a $12 billion IDA VI replenishment results in an average annual U.S. contribution of $1,080 million. This represents virtually no increase in real terms in U.S. funding for IDA -- its annual lending rises by a modest amount, but our share declines by 4 percent. All real growth in IDA lending will be financed by other donors.

World Bank Selective Capital

In 1977, Congress authorized United States participation in a Selective Capital Increase (SCI) for the IBRD. The United States has been behind in its scheduled SCI payments since the first installment, however, even though 90 percent of our subscription represents callable capital and thus no budget outlays.

Reluctance to meet our full SCI subscriptions is ironic because the Bank's great success is to a large extent due to the leadership the United States has provided in it since its creation in 1946. The shortfall in U.S. funding is particularly inopportune now that the Bank, at U.S. initiative, has mounted a major program to increase world energy supplies. The World Bank's energy program will grow to at least 15 percent of total Bank lending within five years. It will amount to $7.7 billion over the period as part of projects totaling about $30 billion for the exploration, production, and development of oil, gas, and coal, and for the construction of new hydroelectric facilities. In operation, these Bank projects will produce additional primary energy estimated at 2-2.5 million barrels of oil a day, thus reducing by that amount potential world demand for OPEC oil.

A U.S. failure to complete our SCI subscription could lead other members to insist on a significant cutback in the Bank's annual lending program because doubts would be generated about

U.S. support for Bank lending throughout the 1980's. Such a cut-back in the lending program would be disastrous for our relations with the developing world, undermining Bank programs in countries and regions of particular concern to the United States (e.g. Egypt, Turkey, the Caribbean, and Central America) and heightening international monetary problems by increasing demand on private capital markets.

Subscription of the full SCI amount is also essential to maintain United States voting strength above 20 percent and thus protect the U.S. veto in the Bank. The veto ensures that no changes are made in the Charter which would have a detrimental impact on U.S. interests.

The African Development Bank

The U.S. subscription to the African Development Bank (AFDB) is an important new component of the FY 81 appropriations request. Subject to receiving authorization for U.S. membership in the bank, an initial appropriation of $18 million is being sought.

Membership in the AFDB to date has been restricted to African nations. The limited resources of the African members have, however, severely restricted the Bank's access to the private capital markets and its lending program. As a result, in May 1979, the Governors of the Bank agreed, subject to necessary ratification by member governments, to invite nonregional countries to join their institution. The proposed U.S. subscription would represent 5.68 percent of the AFDB's total capital and 17.04 percent of the non-regional subscription. The United States will therefore have its own Executive Director on the Board of the Bank.

The United States has direct economic, humanitarian, and political interests in assuring a strong and viable Africa where poverty is reduced, the pace of economic growth accelerated, and serious financial problems avoided. While a wide range of U.S. political and economic policies already contribute toward these objectives, our membership in the AFDB, the most prominent pan-African development institution, would help strengthen our ties with African nations and meet our growing interests in the region.

Other Regional MDBs

The remainder of the Administration's request is for appropriations for capital subscriptions and contributions for the Inter-American Bank (IDB), the Asian Development Bank (ADB) and Fund (ADF), and the African Development Fund (AFDF):

-- $51.6 million in paid-in capital for the IDB and $318 million for the Fund for Special Operations, the IDB's concessional lending window;

-- $25.2 million in paid-in capital for the ADB and $111.2 million for the ADF, the Bank's concessional window; and

-- $41.7 million for the AFDF, which provides concessional financing for Africa's poorest countries.

As noted above, most of these numbers will have to be supplemented by budget amendments to reflect the shortfall in actual FY 1980 appropriations.

These regional institutions were established to complement the activities of the World Bank Group and increase the direct involvement of the recipient countries in the development process. They now provide a central element in the development strategies of many friendly nations and are unique positioned to bring to bear a special regional expertise to local problems. The regional MDBs also facilitate the mobilization of additional resources from the developing countries themselves.

The Decision-Making Process

I recognize that one of the major concerns regarding the MDBs is whether the United States has adequate influence to promote its interests effectively through such multilateral institutions. The formulation of MDB policy and the extent of influence exercised by the United States in their decision-making involve both a formal and informal process.

The MDBs are like any other bank, or, indeed, any other corporate entity. They are controlled by a board -- in their case, of member country Governors and, through them, their appointed Executive Directors. Management is hired by the national representatives of the member countries to carry out the day-to-day functions of the banks within the policy framework set for the banks by the member governments. The management of the banks executes that policy under the general guidance of the Boards of Executive Directors. Their task is facilitated greatly by the fact that there exists among bank members a broad consensus on both the aims and the most effective usage of development lending.

In practice, influence also is manifest in a variety of informal ways -- official and unofficial meetings of national officials at the bilateral and multilateral level; informal discussions among the Covernors at the annual meetings; informal meetings preceding and during the periodic replenishment negotiations; and countless exchanges between bank officials and national representatives at all stages of the formulation and implementation of the banks' lending programs. Subtly, and often imperceptibly, a country's interests are advanced in such ways, and these interests become woven into the fabric of MDB activities.

The cardinal test of U.S. influence is of course not procedure but substance -- whether the institutions have consistently pursued policies which promote the national interests of the United States. In my judgment, they clearly have done so and continue to do so. We have only to consider MDB lending programs in agriculture aimed at increasing production and providing employment, and now more effectively concentrated on reaching the poorest rural inhabitants. The expansion of developing country energy supplies is a second priority that the MDBs are employing which is also very much in our interests. The facts are that the United States has steadily reduced its share of contributions to the MDBs while preserving its influence. The MDBs are, moreover, a constructive arena for North/South cooperation on practical problems with the great confluence of interests among all MDB member countries making these institutions unique among North/South fora.

Restrictive Amendments

The majority of MDB recipient countries operate economic systems which are compatible with western oriented market systems. Moreover, most MDB lending is directed to countries which occupy strategic geographic positions, which are important sources of critical raw materials, or where the United States has other key political and economic interests.

There has understandably been serious concern however about loans by the MDBs to Vietnam and perhaps a few other countries. But this issue is largely moot, given the suspension of MDB lending to Vietnam and Afghanistan. I must urge you to oppose inserting restrictions on U.S. MDB contributions into law.

Under their charters, the banks cannot legally accept contributions which are subject to unilaterally imposed conditions from the United States or any other bank members.

Acceptance of such restricted contributions would be inconsistent with Charter provisions dealing with (1) the purposes of the banks, (2) the permitted uses of Bank resources, (3) the prohibition on political considerations affecting loan decisions, and (4) callable capital.

The fact that the MDBs could not accept U.S. contributions with country restrictions has been confirmed by legal opinions from the MDBs themselves, the Executive Branch, the General Accounting Office, the Congressional Reserach Service, the American Bar Association, and an expert group of the District of Columbia Bar. In 1975, the Inter-American Development refused to accept contributions earmarked for a specific purpose by the United States because such acceptance would have violated the charter of the Bank. The funds were accepted only after the earmarking requirement was repealed in subsequent legislation.

The imposition of restrictions by the United States would also be unwise from a policy standpoint. Other countries, which are increasingly important contributors, could well emulate the United States and impose restrictions which would not be acceptable to us. Clearly to start down this path would run the very serious risk of damaging the global development effort by crippling the ability of the MDBs to execute their operations objectively and efficiently.

The real issue posed by restrictive amendments, therefore, is continued U.S. participation in the MDBs. The adoption of such amendments would have the effect of taking the United States out of the banks. Such an outcome would have a disastrous impact on U.S. foreign policy and national interests, and would undermine greatly world confidence in the United States just at a time when we are striving to mobilize a cooperative global response to the challenges emerging in Southwest Asia and other regions of the world.

IV. CONCLUSION

In conclusion, Mr. Chairman, I would like to re-emphasize that the International Monetary Fund and the multilateral development banks are essential to U.S. interests.

The international monetary system is undergoing a period of major change and political strain. The IMF is our central institution for monetary cooperation and an important source of strength, stability, and broad direction as we try to contend with these changes. We need, of course, to recognize our own continuing large role in the world economy, and our responsibility for maintaining a strong U.S. economy and a sound dollar. But we need also to understand that a strong IMF role in guiding the system is of direct importance to our own efforts to strengthen the economy and maintain the integrity of the dollar. In strengthening the IMF, the United States will be making an important contribution to an international environment which greatly facilitates effective foreign policy.

We will also be strengthening a source of balance of payments financing on which we can and do draw ourselves.

U.S. national interests clearly require that we maintain a reasonable program of foreign assistance. Such a program directly supports U.S. economic, foreign policy, and national security objectives which we have in the less developed countries of the world. It also directly benefits substantial numbers of the most deprived and disadvantaged people in the poorest countries. Foreign assistance is a particularly important and necessary complement to other parts of the President's budget request which have been designed to enhance the protection of our national security and foreign policy interests. We need the support of developing countries on a broad range of international issues. We cannot expect this support unless we, in turn, help address their fundamental concern of development.

The multilateral development banks are the most cost-effective instrument for promoting economic growth and political stability -- and hence U.S. interests -- in the developing world. They encourage sound national economic policies and provide an effective framework for bringing the developing countries into the open market system we espouse. Moreover, the banks give us good value for our money with U.S. budgetary expenditures multiplied many times over in actual bank lending. They benefit borrowers and lenders, developing and developed countries alike. The importance of the banks have been reinforced by the fact that recent economic difficulties have exposed a number of developing countries to serious threats of political, economic, and social instability.

These problems have a direct bearing on our national security interests. They are difficult but not unmanageable. Given a reasonable degree of international cooperation, we have the resources to assure a gradual expansion of the world economy. Healthy and growing economies strengthen the foundation of the international economic system and maintain an environment conducive to multilateral cooperation on a broad range of other issues critical to the United States.

The seriousness of the current world situation leaves little doubt about the importance of a sound international structure for dealing cooperatively with vital issues. Now is clearly the time for renewed United States leadership in support of the Fund and the multilateral development banks and of the mutually beneficial endeavors which they represent. For these reasons, the Administration urges Congress to provide the necessary funding to sustain the operations of these institutions and to encourage their pivotal role in building a cohesive and stable world.