Forum for American Leadership

Development Finance Must Finance Development

June 27, 2024

International finance plays a critical role in shaping 21st century global peace and prosperity. Countries seek investment to pursue economic growth, address critical infrastructure needs, and achieve development goals. America's exceptional economic strengths are models for success emulated by international policymakers and business leaders, and a key pillar of our foreign policy. The U.S has an unparalleled record of helping countries transform into robust allies that create global opportunities, and promotes development best when partnering with countries willing to reform their economies. The U.S. International Development Finance Corporation (DFC), has played a key role in catalyzing capital to improve lives worldwide while providing a clear contrast with failed authoritarian policies and practices. The upcoming DFC reauthorization process provides an opportunity to create a toolkit that is more assertive, nimble, and innovative, as well as advance reforms that ensure its investments continue to yield returns with incomparable developmental and foreign policy benefits.

Background

A strategic goal of our foreign policy must be transforming economies to create robust private sectors that create opportunities for their citizens as well as the American people. As we've seen from the Marshall Plan forward to the DFC, some of the greatest triumphs of America's foreign policy have moved fragile and developing countries to successful societies, which have become economic partners and allies, not vassal states. Nowhere is the line between abhorrent and sound policies more pronounced than the Korean Peninsula: North Korea seeks autarky and gets poverty, while South Korea transformed into a major trading partner, technology powerhouse, and a strong ally in a generation. Clearly, strategic development policy aligns with strong foreign policy.

To seize on the unprecedented opportunities ahead, the U.S. Government must transform not only its development tool kit, but its investment framework. The U.S. should continue to invest where taxpayers can expect mutually beneficial development, foreign policy success, and a financial return. America must also insist that partner countries reform their own economic policies to forge equitable and flourishing societies. Without these reforms, development finance does not finance development.

Traditional aid, which is often focused on providing humanitarian assistance, reducing poverty, or addressing immediate crises, is often a crucial first step in stabilizing an economy. The goals of aid then must be to help people progress beyond assistance. As assistance ebbs, development finance should flow to provide catalytic and transformational financing for local businesses, infrastructure projects, and other economic initiatives that promote long-term sustainable development. American investment can help improve local business conditions, connect countries with global markets, reduce dependence on aid, create jobs in America and the host country, and enhance environmental standards. In a world facing challenges that far exceed the resources of governments, U.S. investment provides a signal that rewards can outweigh risks of investing in foreign economic environments to help build a private sector that can integrate into the global economic system.

First and foremost, countries need to realize that private sector investors look for bankable projects in investable economies. The USG helps catalyze capital, but the host countries play a crucial role in attracting investment. Beyond a compelling infrastructure plan or a solid company, a country needs pro-growth policies for citizens to enjoy an opportunity-based society. After Georgia repelled the Russians from Tbilisi in 2008, the Georgians implemented reforms that created one of the best investment climates in the world: U.S. development finance responded with more investment per capita than anywhere else in the world. American investment took rubble from buildings destroyed by Russian tank attacks and created infrastructure that powered prosperity.

The DFC Reauthorization and Strategy Must Promote Effective Development & Sustainable Investment

The DFC's investments directly contribute to improving living standards in lower- and lower-middle-income countries. Along with developmental goals, the DFC is also a vital element of the U.S. Government's effort to counterbalance the influence of state-directed investment efforts by China and other actors that distort markets, promote dependence, and raise other red flags. An investment by the DFC catalyzes investment that promotes tangible and lasting development outcomes, local employment and skill development, environmental protections, and transparency. By providing innovative financing for critical sectors and achieving development goals, the DFC strengthens U.S. ties and influence in key regions.

The 2018 BUILD Act created the DFC and provided additional tools for the U.S. Government to deploy catalytic capital. With a reauthorization, Congress and the DFC management team have an opportunity to assess areas for improvement. The discussion must not merely revolve around tactical authorities or simply more funding, people, and offices. Of course, reauthorization of the BUILD Act should increase the ability for the agency to underwrite projects. Yet more important than the DFC's investment limits, and the U.S. government's innovative efforts to deploy capital, is for host countries to develop business environments that are conducive to investment. While an enhanced DFC cannot mandate other countries' policies, it must strategically invest in countries that prove they are true partners with the USG and global investors. To these ends, the DFC management must think strategically beyond what a reauthorization can accomplish and empower the DFC to uphold and advance the following principles:

1. **Partner with countries that need support and support American national interests**: The DFC's investments must bolster global economic stability, security and development in alignment with U.S. strategic objectives. Whether it's creating jobs in countries to stem illegal immigration, building critical energy infrastructure, or providing alternatives to predatory lending practices, the DFC provides tangible and transformative capital. While the DFC must continue to prioritize the poorest countries where development is sorely needed, it must also support projects in countries with strategic importance. For instance, limiting the DFC's investment to the low- and lower-middle-income countries leaves only a handful of countries in the Western Hemisphere eligible for support and misses the opportunity to support projects in impoverished regions of middle-income countries.

2. **Champion pro-growth policies that actively improve economies**: Countries should not expect endless aid or taxpayer investment if they do not make the necessary reforms to create the conditions for economic opportunity. The DFC should evaluate not only the projects it seeks to

support, but a country's demonstrated willingness to pursue economic reforms. Such policies, including workforce development, business formation, competition, innovation, licensing, taxation, trade, dispute resolution, property rights, and reducing corruption, create an environment for the investment and entrepreneurship essential for stimulating economic growth. The longstanding debate over trade-offs between financial returns and developmental goals can be solved when countries are improving their economic environments. These reforms are monitored by the World Bank and many other public and private institutions, and these measures should be part of the DFC discussion in approving and implementing investments. By fostering open and competitive markets, pro-growth policies attract foreign investment as well as empower local businesses, leading to sustainable development and improved living standards.

3. **Invest for sustainable and transformative development**: The DFC enjoys bipartisan support in part because it returns taxpayer dollars through successful financial investments. The DFC must prioritize development outcomes that focus on the impact of each dollar, rather than simply the amount invested. For returns and impact, the DFC should focus on transformational and strategic sectors, including education, healthcare, all forms of energy, critical minerals, as well as digital and traditional infrastructure. The DFC should support mechanisms such as The Blue Dot Network to help ensure projects meet robust international quality standards and that countries are working to ensure better economic, labor and environmental conditions. Often the most transformative investments promote inclusive economic growth in the least developed countries, where each marginal dollar has outsized impact, but as new issues arise and U.S. policy priorities shift, the DFC must be empowered to mobilize capital to support U.S. interests globally. The DFC portfolio must continue to generate investment returns for the taxpayers while seeking maximize developmental and foreign policy impact, with all reported transparently for accountability. Impact investment is also a critical tool to help countries move up the development curve to the point where they are attractive to traditional investors, and DFC can help catalyze impact investment so that USG resources are leveraged by the trillions in impact investment out there looking to pair purpose with profit.

4. **Promote innovation and flexibility to catalyze global capital**: Any Reauthorization should grant the DFC wide latitude on deal terms, approvals, and organizational structure. Innovation is difficult to mandate, and a reauthorization should avoid designating unwieldy earmarks, processes, or organizational structures. Instead, give the DFC flexible tools and hold leadership accountable to achieving impact and financial results. Some policies and principles Congress should consider during reauthorization:
    - The DFC should not be mandated to have ancillary statutory offices, or open overseas offices.
    - Congress should increase the contingent liability maximum to at least $100 billion.
    - Reauthorization should address the problem of how equity investments are "scored," which today discourages their use based on an inaccurate accounting assumption that all of these investments will lose all their value.
    - Allow the DFC to partner with private sector firms to leverage their lending and investment capacity, including lending in local currencies and developing innovative new financial instruments that help reduce investment risk.
    - Maintain flexibility to invest in poorer regions of developing countries, rather than strict country-level income limits.

- Streamline the DFC's operations by relaxing requirements for smaller deals, while increasing Board approval limits and the Congressional notification threshold for projects.
- Meet urgent needs through "notwithstanding authority."
- Give the DFC a 10-year reauthorization to provide stability and bolster market confidence.

5. **Streamline the USG Approach**: The U.S. has established a unique development architecture where countries should transition to market-based economies using a whole-of-government approach. The DFC should leverage the reach of the existing in-country teams of the U.S. Commercial Service of the Commerce Department, as well as coordinating investment efforts and policy with the State Department, Treasury, Commerce, MCC, USAID, EXIM, TDA, and other relevant USG agencies. Having a strategic plan in place within DFC and across these agencies allows teams to set priorities, and not waste time on deals that do not advance the USG and host country's mission. Beyond coordinating with the U.S. Government, the DFC should also seek to build and strengthen partnerships with other development finance institutions, multilateral banks, NGOs, and private sector players. These synergies could include sharing deal pipelines, due diligence and monitoring, making the entire development process more effective and efficient, rather than each institution adding more overhead. The USG will miss opportunities if our agencies don't move at the speed of the private sector, remaining flexible and nimble to serve markets and entrepreneurs in transitioning from aid to trade.

DFC's seven-year authorization expires in September 2025. A robust reauthorization presents an opportunity to reinforce the U.S. commitment to global development, strategic engagement, and the promotion of sustainable and inclusive economic growth. However, the reauthorization should resist efforts to mandate organizational and investment parameters.

The DFC should support countries that are working to transition into the global economy. The DFC, along with counterparts in the United States government and its allies, must hold countries accountable to encouraging and rewarding investment. By catalyzing private investment capital to countries that share our interests and help themselves by creating the conditions for lasting economic growth, durable development outcomes, and sustainable investment, the U.S. can promote its exceptional economic model and values abroad, build strategic relationships with allied countries, and create American and global prosperity that address the greatest challenges of the 21st century.

This paper was authored by a member of FAL's Geoeconomics Working Group.

The Forum for American Leadership (FAL) is a non-profit organization that presents expert analysis and national security recommendations to policymakers in Congress and the Executive Branch.