



# To Compete with China, Get the New U.S. Development Finance Corporation Right

Daniel Kliman

China's economic statecraft advances its broader vision of a future defined by great power spheres of influence, rigged economic interactions, and creeping authoritarianism. The new U.S. Development Finance Corporation (USDFC) set in motion by Congress last year could significantly enhance America's ability to compete with China. However, the staffing, organization, and activities of the USDFC remain in flux.<sup>1</sup> Congress should shape the new USDFC to ensure it will sharpen America's strategic edge by taking the following steps:

- » Encourage the creation of an office for strategic investments led by a new member of the USDFC's executive team.
- » Grant the USDFC a "surge financing" authority to capitalize on emerging windows of opportunity generated by blowback against Chinese investment in some recipient countries.
- » Provide the USDFC with the political space to make somewhat riskier investments in countries with weaker regulatory environments where China is actively competing.
- » Oversee USDFC lending to track whether sufficient resources go to commercially viable, highly visible projects that could become pivotal to U.S. diplomatic messaging.
- » Appropriate funds for a cohort of "Development Finance Fellows" who could cost-effectively provide the USDFC with an on-the-ground presence in key countries.

## U.S.-CHINA COMPETITION: THE INFRASTRUCTURE ANGLE

The United States and China are engaged in a global contest to set the rules and norms of the 21st century. A key dimension of this contest is infrastructure. Under the umbrella of "One Belt, One Road," Beijing has put forward a vision of a world connected through a web of largely Chinese-funded ports, railways, pipelines, power grids, and telecommunications networks.<sup>2</sup> Beijing has allocated significant resources to the Belt and Road: independent estimates have identified roughly \$340 billion in construction and investment by China from 2014 to 2017.<sup>3</sup>

Although the global demand for infrastructure is real, China's economic statecraft in the form of the Belt and Road is ultimately a power play anchored in Beijing's vision of a world reordered. Through the construction of dual-use infrastructure, Beijing has paved the way for its military to operate more globally. The unsustainable debt incurred by some countries receiving Chinese investment has translated into long-term diplomatic leverage for Beijing. China's often opaque financing, disregard for local environmental concerns, and willingness to import labor stand in contrast to international best practices. Lastly, investment from China, particularly in developing countries, has fueled corruption and served to export digital surveillance tools that Beijing employs at home to monitor and control its populace.<sup>4</sup>

Until mid-2018, China's use of infrastructure to advance its geopolitical ambitions appeared destined for success, with Beijing exerting growing influence over strategic ports, becoming a major player in digital connectivity, and forging close ties with local elites in many recipient

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### KEY ACTIONS

Encourage the creation of an office for strategic investments.

Grant the USDFC a "surge financing" authority.

Provide the USDFC with political space for riskier projects.

Oversee the linkage between USDFC lending and public diplomacy.

Appropriate funds for a cohort of "Development Finance Fellows."

1. This policy brief draws on ideas and several recommendations first advanced in Daniel Kliman, "Leverage the new US International Development Finance Corporation to compete with China," *The Hill*, November 16, 2018, <https://thehill.com/opinion/international/416904-leverage-us-international-development-finance-corporation-compete-with-china>.

2. Nadege Rolland, *China's Eurasian Century? Political and Strategic Implications of the Belt and Road Initiative* (Seattle Washington: National Bureau of Asian Research, 2017).

3. Cecilia Joy-Perez and Derek Scissors, "The Chinese State Funds Belt and Road but Does Not Have Trillions to Spare," (American Enterprise Institute, March 2018), 2.

4. Daniel Kliman, Abigail Grace, "Power Play: Addressing China's Belt and Road Strategy," (Center for a New American Security, September 2018).



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countries.<sup>5</sup> More recently, however, China has encountered setbacks. From Malaysia to the Maldives, a growing set of countries has begun to express concerns about the risks accompanying Chinese investment, centering in particular on debt and the attendant erosion of national sovereignty. Consequently, the United States has a strategic window of opportunity to advance a positive vision of economic development and infrastructure connectivity, while blunting and even rolling back the geopolitical gains made by China’s infrastructure push.

### A POTENTIAL GAME CHANGER

In 2018, the United States formulated and began to implement a response to the Belt and Road. Nested within a larger competitive U.S. strategy toward China spanning the diplomatic, economic, and military domains, this response has focused on U.S. areas of comparative advantage such as energy and digital connectivity, promoted capacity building in countries considering Chinese investment, and emphasized cooperation with high-capability American allies and partners.<sup>6</sup> However, the U.S. response to Belt and Road has suffered from a lack of resources, a weakness that generated concern among American allies and partners and became a talking point for China.

This could change in October 2019 when the new U.S. Development Finance Corporation opens its doors. The USDFC is the result of the bipartisan Better Utilization of Investment Leading to Development (Build) Act, which Congress passed in October 2018.<sup>7</sup> With a lending ceiling more than double that of the existing Overseas Private Investment Corporation (OPIC), the USDFC will have roughly \$30 billion in additional funds to galvanize private-sector participation in commercial projects overseas. The USDFC will also possess a broader and more agile toolkit than OPIC, including the ability to take equity in projects, loosened restrictions on partnering with non-American companies, and some private-sector-facing functions of the U.S. Agency for International Development.<sup>8</sup>

The USDFC could prove a potential game changer as America seeks to compete with the Belt and Road and offer a positive vision of development and connectivity. The additional \$30 billion in lending resources could galvanize 2.6 times that in private capital.<sup>9</sup> If focused on key countries, this combined financing could significantly expand America’s economic footprint. The USDFC could also become a focal point for cooperation with high-capability U.S. allies and partners, opening up additional public and private-sector resources for countries seeking alternatives to Chinese investment.<sup>10</sup>

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5. Devin Thorne and Ben Spevack, “Harbored Ambitions: How China’s Port Investments Are Strategically Reshaping the Indo-Pacific,” (Center for Advanced Defense Studies, April 2018); Sheridan Prasso, “China’s Digital Silk Road Is Looking More Like an Iron Curtain,” Bloomberg, January 10, 2019; and Will Doig, “The Belt and Road Initiative Is a Corruption Bonanza,” ForeignPolicy.com, January 15, 2019, <https://foreignpolicy.com/2019/01/15/the-belt-and-road-initiative-is-a-corruption-bonanza/>.

6. The U.S. Department of State, “Remarks on America’s Indo-Pacific Economic Vision,” U.S. Chamber of Commerce, Washington, July 30, 2018, <https://www.state.gov/secretary/remarks/2018/07/284722.html>.

7. Patricia Zengerle, “Congress, eyeing China, votes to overhaul development finance,” Reuters, October 3, 2018.

8. Daniel F. Runde, Romina Bandura, “The BUILD Act Has Passed: What’s Next?,” CSIS Critical Questions, October 12, 2018, <https://www.csis.org/analysis/build-act-has-passed-whats-next>.

9. Figure provided by OPIC to author on February 4, 2019.

10. “US, Japan, Australia Sign First Trilateral Agreement on Development Finance Collaboration,” The Overseas Private Investment Corporation, press release, <https://www.opic.gov/press-releases/2018/us-japan-australia-sign-first-trilateral-agreement-development-finance-collaboration>.



Yet, whether the USDFC will ultimately realize its potential to enhance America's strategic edge remains unclear. The Build Act took several steps to orient the USDFC toward the China challenge. It stipulates that U.S. policy seeks "to provide countries a robust alternative to state-directed investments by authoritarian governments."<sup>11</sup> Additionally, the Build Act designates the secretary of state as the chairperson of the USDFC's board, in order to better align investment decisions with U.S. foreign policy priorities. Beyond these measures, however, the Build Act grants the executive branch significant discretion over the USDFC's organization, staffing, and activities.

### GETTING THE USDFC RIGHT

Prior to October 2019, Congress has a window to ensure that the USDFC is positioned to backstop a more competitive U.S. approach toward China. Key steps for Congress to take include the following:

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- » **Encourage the creation of an office for strategic investments.** Without the need to compete with China baked into the internal structure of the USDFC, it will likely lose strategic focus over time. An office of strategic investments led by a new member of the USDFC's executive team would provide essential continuity of focus. The office would collaborate with the intelligence community, the Department of Defense, and the Department of State and seek to mobilize private-sector funding for commercial projects with significant geopolitical value. In addition, the office would spearhead the USDFC's engagement with U.S. allies and partners looking to jointly finance infrastructure projects.
- » **Grant the USDFC a "surge financing" authority.** Investment decisions taken by the USDFC should generally require extended time given the stakeholders involved and the need for due diligence. However, an inflexible lending timeline will prevent the United States from fully capitalizing on rapidly emerging opportunities, such as recent elections in Malaysia and the Maldives that resulted in much more scrutiny of Chinese investments. Congress should legislate a new "surge financing" authority that would permit the USDFC to accelerate investment decisions in select cases. To ensure judicious use of this authority, Congress should cap total annual "surge financing," and require a presidential letter explaining the strategic rationale for each project.
- » **Provide the USDFC with political space for riskier projects.** The USDFC's predecessor, OPIC, justified its existence to Congress in part by pointing to its positive return on investment. OPIC's returns reflected a relatively conservative investment portfolio. To compete with China, the USDFC will have to incentivize American companies to play a more active role in countries with weaker regulatory environments and greater political instability. Its portfolio will become riskier. At some stage, a project financed by the USDFC will fail. Congress should anticipate this – and convey to the executive branch that it will grade the USDFC's performance based on its contribution to American foreign policy objectives, and not solely return on investment.
- » **Oversee the linkage between USDFC lending and public diplomacy.** Beijing's propaganda effort plays up the size of its Belt and Road investments, with mega-projects reinforcing China's narrative. American economic engagement in the developing world,

11. U.S. House of Representatives, BUILD Act of 2018, H.R. 302, 115th Cong., 2nd sess. [https://www.opic.gov/sites/default/files/files/BILLS-115hr302\\_BUILDAct2018.pdf](https://www.opic.gov/sites/default/files/files/BILLS-115hr302_BUILDAct2018.pdf).



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though extensive and more attuned to local needs, often occurs in less visible forms. U.S. diplomatic messaging would prove more credible if backed by a handful of commercially viable, high-profile projects in key regions such as the Indo-Pacific, the Middle East, Africa, and Latin America. Congress should provide oversight of the USDFC to ensure that it invests sufficiently in such projects. In addition, Congress, in hearings, should encourage the State Department and the U.S. Agency for Global Media (formerly the Broadcasting Board of Governors) to leverage these projects as anchors for public diplomacy.

- » **Appropriate funds for a cohort of “Development Finance Fellows.** An on-the-ground presence in key countries would enhance the USDFC’s ability to compete with China by enabling it to spot potential projects early and create a large flow of high-quality deals. Rather than vastly expanding the USDFC’s full-time staff, a cost-effective approach that Congress could champion would be to create a new State Department “Development Finance Fellows” program that would, in partnership with major U.S. companies and top business schools, deploy newly minted MBAs to priority U.S. embassies for a gap year between graduation and private-sector employment.<sup>12</sup>

#### AMERICA’S COMPETITION TO WIN – OR LOSE

Countries across the globe have begun to awaken to the challenges associated with China’s investment in their physical and digital infrastructure. The Belt and Road has lost its initial sheen. Whether or not the United States can effectively seize this moment of opportunity will depend in part on the new USDFC. Congress can – and should – work with the executive branch to ensure that the hard-won results of the Build Act advance international development while sharpening America’s strategic edge.

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12. The author wishes to credit another participant at a non-attribution roundtable for first floating this recommendation during the course of the discussion.