



## DEPARTMENT OF THE TREASURY OFFICE OF PUBLIC AFFAIRS

**EMBARGOED UNTIL 10:00 AM  
October 28, 2003**

**Contact Tony Fratto or  
Taylor Griffin at 202-622-2960.**

**Testimony by Deputy Assistant Secretary of Treasury William E. Schuerch  
before the House Financial Services Subcommittee on Domestic and International  
Monetary Policy, Trade and Technology  
October 29, 2003**

### **Implementation of United States Policy on Multilateral Development Bank Lending to Iran**

Chairman King, Ranking Member Maloney, and distinguished members of the Subcommittee, we welcome the opportunity to testify today on the implementation of United States policy on Multilateral Development Bank lending to Iran. As you know, this is not a new policy and this Administration agrees with Congress that Iran should not have access to multilateral development bank resources. I want to assure you that the Treasury Department and the U.S. Executive Director at the World Bank, while not fully successful, have consistently and actively sought to block all proposals for World Bank Group assistance to Iran.

**World Bank Role:** Before discussing lending to Iran, there are a few points to be made about the critical role of the World Bank Group itself. First, the Bank plays a role in helping the United States achieve its efforts to increase world economic growth, reduce poverty, build open market economies, and encourage the growth of civil society. Second, the Bank is an important foreign policy tool for the United States, and is a vehicle for leveraging our foreign assistance resources throughout the globe. The Bank has played a critical role in responding to the democratic and market openings in Central and Eastern Europe and in what we used to call the Newly Independent States of the Former Soviet Union, in Bosnia, in Afghanistan and in combating terrorist financing. Concerning Iraq, it has completed a needs assessment; it will manage a trust fund for other donors, and it has recently pledged significant resources for rebuilding.

**Afghanistan:** In addition to committing \$500 million in concessional loans and grants over a four-year period beginning in 2002, the Bank is playing a key role as the administrator of the Afghanistan Reconstruction Trust Fund. Projects funded by the Bank so far include the rehabilitation of crucial transportation infrastructure including the Kabul-Doshi road, the Kabul airport, and the Salang Tunnel, as well as other public works, power supply, and emergency infrastructure work. The International Finance Corporation (IFC) has committed to finance two projects in Afghanistan, a \$1.25 million equity investment in October 2002 to support micro-financing and a \$7 million loan in June 2003 to support a hotel project.

**Combating Terrorism Financing:** At the request of the United States, following September 11<sup>th</sup>, the World Bank increased its efforts to ensure that Bank funds are not diverted to terrorists or their agents. The Bank is working with borrower countries to clarify its due diligence requirements. The Bank also has been increasing technical assistance and support for capacity building; working to improve understanding of the development cost and governance impact of money laundering and financial abuse; working with relevant anti-money laundering groups; and enhancing anti-money laundering (AML) diagnostics.

**Iraq:** Most recently, we are working with the Bank and other donors to ensure financing for Iraq reconstruction. The Bank, along with the United Nations, joined the Iraq International Advisory and Monitoring Board (IAMB) and played a central role in carrying out the development needs assessment over the past summer – in the process, losing a member of Bank staff in the attack on UN headquarters in Baghdad. Last week, the Bank publicly committed at the Madrid pledging session that, once other factors including debt sustainability, settlement of arrears, the security situation on the ground, and governance issues are resolved, we could anticipate as much as \$3 to \$5 billion in reconstruction assistance.

**Iran Lending:** Now, as concerns World Bank Group lending to Iran and U.S. policy; our efforts to block these resources is consistent with Congressional intent on both terrorism and human rights. We share Congressional concerns about terrorism and abuse of human rights, Iran's WMD programs, particularly nuclear, which are currently being investigated by the IAEA, and also believe that Iran needs to aggressively pursue economic reforms.

Regarding economic reforms, we believe that while Iran has recently undertaken exchange rate and trade liberalizing measures, the authorities have failed to take full advantage of historically high world oil prices to implement much-needed macroeconomic and structural reforms. The economy continues to suffer from over-centralization, structural weaknesses, excessive expenditures on non-productive activities, and poor governance. To address these problems, Iran must broaden, deepen, and accelerate the reform process. Although some progress has been made to cut subsidies in retail gasoline prices and certain food staples, the system of poorly targeted subsidies, especially energy subsidies, continues to place a significant burden on the fiscal deficit and must be overhauled. Administrative controls on production, credit and exports should be rolled back substantially. More aggressive financial sector reforms are needed to modernize banking supervision and the payments clearing system, to begin taking concrete steps to privatize state banks, and to reduce directed credit. In addition, labor market reform should be pursued to make it easier to hire and fire workers by reducing high dismissal costs and excessive

regulation, and to allow markets, as opposed to the government, to determine salaries in various sectors.

The United States' efforts to block World Bank Group assistance to Iran were fully successful for seven years, from July 1993 to May 2000. During this time, we developed a consensus among the G-7 nations enabling the blocking of all World Bank lending to Iran. Unfortunately, by May 2000 the coalition split when other members of the G-7, particularly the Europeans, began supporting re-engagement with Iran. Some of this re-engagement was due to their expressed view that engaging with Iran's "reformers" would support them in their efforts against Iran's hardliners – a view which is still evident as the Europeans negotiate with Iran over their nuclear program. In addition, the commercial opportunities in Iran, where U.S. companies could not compete due to U.S. sanctions, have been enticing to many of our G-7 partners. Thus, despite U.S. "no" votes in May 2000, and abstentions from France and Canada, the rest of the World Bank Executive Board approved two loans to Iran: a \$145 million loan for the Tehran Sewerage Project and an \$87 million loan for the Second Primary Health Care and Nutrition Project. Later, in May 2001, the World Bank Executive Board also discussed an Interim Assistance Strategy for Iran. The strategy proposed lending during the following two years for low income housing, sewerage, urban upgrading, and community-based infrastructure and employment creation schemes for the poor. We opposed the strategy, again raising our serious concerns about the Bank's engagement with Iran. Since then, and despite our ongoing efforts to convince other World Bank shareholders not to support further lending to Iran, the World Bank Executive Board approved additional projects for Iran: a \$20 million loan for an Environmental Management Support Project in April 2003 and a \$180 million loan for the Earthquake Emergency Recovery Project in June 2003.

Following this new lending in the World Bank, the IFC Executive Board, in December 2002, approved a \$5 million investment in a joint venture between a private Iranian bank, a major French bank, and the IFC. This was the first IFC investment in Iran in 25 years. Again, the United States voted "no" and lobbied other countries to join us in opposing the loan.

While this is the full picture of MDB lending to Iran since 1993, in the interest of full disclosure, I want to point out that there are currently four additional projects in the World Bank pipeline for Iran: an \$150 million project to establish a local development fund, an \$80 million project for low-income housing, an \$120 million project for water supply and sanitation and an \$295 million project for urban "de-urbanization."

In summary, from July 1993 to May, 2000, U.S. efforts to block World Bank Group assistance to Iran was fully successful because our G-7 colleagues shared our view that not engaging with Iran was the appropriate policy stance. However, since May 2000 our colleagues have taken a different view, lending to Iran has totaled \$432 million primarily for basic human needs and aimed at lower income levels.

I want to emphasize that the lending to Iran that has occurred is from the World Bank's International Bank for Reconstruction and Development (IBRD) window and from the IFC. It is not from the International Development Agency (IDA). As such, lending to Iran is provided at

market rates, not concessional rates and maturities. The IFC funding, while supporting investments in Iran, is not provided to the Iranian Government itself, but to private companies.

### **Conclusion**

The World Bank has 183 member countries. The U.S. is the largest single shareholder with a voting share of 16.4%, but does not own a controlling interest in the institution or a veto on specific lending decisions. Blocking MDB support for a country is difficult, but occasionally has been possible when there is substantial international outrage following specific events. Some examples are the 1989 events in China's Tiananmen Square, nuclear testing in 1998 by India and Pakistan, and, beginning in 1987, the repression and house arrest of opposition leaders by the military junta in Burma. Inevitably, however, as the force of immediate international outrage wanes, it becomes difficult to sustain the international consensus that is needed to continue to block lending to a country.

Finally, Mr. Chairman, I would like to emphasize this Administration's consistent voting record against assistance to Iran and our continued efforts to discourage World Bank engagement with Iran. The Administration will continue to oppose Bank lending until meaningful political, economic, and human rights reforms have taken place. We will also continue efforts to marshal support among other donor countries, with Bank management, and other shareholders to limit World Bank Group support to Iran.

Thank you.