THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM—IMF REFORM AND COMPLIANCE WITH IMF AGREEMENTS

HEARING

BEFORE THE

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FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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Tuesday, May 13, 2003

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THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM—IMF REFORM AND COMPLIANCE WITH IMF AGREEMENTS

Tuesday, May 13, 2003

U.S. HOUSE OF REPRESENTATIVES,
FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to call, at 4:05 p.m., in Room 2128, Rayburn House Office Building, Hon. Michael Oxley [chairman of the committee] presiding.

Present: Representatives Oxley, Leach, Bereuter, Castle, Royce, Manzullo, Biggert, Tiberi, Feeney, Hensarling, Brown-Waite, Harris, Renzi, Frank, Waters, Sanders, Maloney, Velazquez, Watt, Sherman, Inslee, Capuano, Lucas of Kentucky, McCarthy, Emanuel and Davis.

The CHAIRMAN. [Presiding.] The committee will come to order.

We are pleased to welcome the Secretary of the Treasury, Mr. John Snow, for his annual testimony on the international financial system and international monetary fund.

We would like to welcome you, Mr. Secretary, to the first hearing and your first appearance before this distinguished panel.

This hearing is mandated, as you know, by the 1999 Foreign Operations Appropriations Bill, which provided an $18 billion funding increase to the IMF. We had planned on holding this hearing early March, however the events in Iraq, obviously, demanded your time and oversight. And, for that, we appreciate your good work.

The IMF plays an important role in ensuring economic stability around the world. As the largest contributor to the IMF, the U.S. provides this institution with over 17.5 percent of its total resources. As a result, it is critical for Congress to ensure that the taxpayer dollars spent on IMF programs are spent wisely and in accordance with the goals and objectives of the U.S. government.

Today's hearing will give members of the committee an opportunity to learn more about the activities of the IMF and the reform sought for this institution. In addition, I look forward to a dialogue on the state of the international financial system in general and the Treasury Department's activities.

Mr. Secretary, we have seen the success of our military in toppling a corrupt regime that oppresses people and threatened the security of its neighbors. Now that military activities have slowed, I am interested in learning more from you about the rebuilding of

Iraq. Last month, subcommittee Chairman King and I sent a letter to the President of the World Bank strongly urging him to commit staff and resources to the rebuilding of Iraq.

I am deeply concerned that any delay in the commencement of activities in this country for purposes of gaining United Nations support could result in a missed opportunity for the people of Iraq.

The World Bank and the other aid institutions must act quickly to help bring stability to this country and restore freedom and prosperity to the people of Iraq. I understand that the Treasury has sent many technical advisers and contractors into Iraq to help restart the economy. I am very interested in learning about the status of these efforts and to what extent the IMF will participate in the development of monetary policy for the newly liberated Iraqi people.

Debt relief is an issue that we have been examining here on the Hill for many years. There are a number of proposals that have varying costs and varying amounts of empirical data on their effectiveness. The Administration has requested $75 million in additional funding for the HIPC trust fund. I believe that we must live up to our commitments in the HIPC program, but there seems to be a growing consensus that more debt relief will be needed in the future.

Can you share with the committee your thoughts on the HIPC program and what additional debt relief measures you think are needed as appropriate? The committee looks forward to working closely with you in developing an effective and workable debt relief strategy.

I would like to address the recently proposed Millennium Challenge Account. This account will direct bilateral assistance to countries that are committed to ruling justly, investing people and promoting economic freedom.

As proposed by the President, the Secretary of the Treasury would sit as a member of the Board of Directors overseeing the account and would play a key role in setting the performance standards for the distribution of aid. If this board becomes the primary body in which U.S. bilateral aid policy is developed, I will be interested in hearing what role it would be expected to play in development of U.S. multilateral aid policy. It makes sense to me that U.S. bilateral and multilateral policy should be as consistent as possible.

Finally, Mr. Secretary, I would like to address the Development Bank authorizations before this committee. Congress appropriated $959 million for U.S. participation in the international development association, the Asian Development Fund and the African Development Fund; however, the expenditure of those funds has not yet been authorized. In the 107th Congress, this committee and the International Monetary Policy and Trade Subcommittee held eight hearings related to the authorization of these institutions.

I want to thank you for working closely with the committee on a bipartisan basis to formulate an authorization package for these institutions. And I look forward to finalizing a proposal soon. Secretary Snow, welcome and I look forward to your testimony. I now yield to the Ranking Member of the committee, the gentleman from Massachusetts, Mr. Frank.

Mr. FRANK. Thank you, Mr. Chairman.

Mr. Secretary, one of the concerns I have had has been the insistence of the U.S. government, over the objection of our trading partners, certainly Chile and Singapore, in including in free trade agreements a requirement that they agree, in effect, never to use capital controls, no matter the circumstance even if there are emergencies that arise and even in those cases, and we have a right to insist on this, where Americans are treated entirely fairly and there are no discriminations.

I know as a fact that neither Chile nor Singapore wanted to sign that. They requested, not want to pass up the chance to have the access to the American market. What I have been struck by, is the number of people who are very devoted free traders, Professor Bhagwati of Columbia or the Economist magazine who have made the point that capital and goods are somewhat separate and having an American insistence on no capital controls ever without them paying penalties seems to me to be a grave error.

And I have to say, as you contemplate a broader set of free trade agreements, it is going to be a very complicating factor. And I am going to ask to put into the record at this point the editorial from the Economist of May 3 talking about what a grave error it is. And the Economist points out that if any cause commands the unswerving support of the Economist it is that of liberal trade. And they then go on to say that this insistence on imposing these requirements in capital are a mistake.

The CHAIRMAN. Without objection.

[The following information can be found on page 62 in the appendix.]

Mr. FRANK. Thank you, Mr. Chairman.

Secondly, I was glad that the chairman mentioned the highly indebted poor country effort. I would hope it would simply be a matter of policy that we would put enough money into that account so that any country that complied would get its money. Nothing could be—not its money in the legal sense, but in the sense that we promised.

We did a lot of work and this committee did a lot of work in shaping that HIPC. And there was a promise there made by the U.S. that countries that complied would get the debt relief. I think it would be a very grave error from a number of standpoints if we were to run out of money. And whatever has to be appropriated I hope it would be a sufficient amount. There ought not to be anybody left in doubt about that.

Now, I was also struck by the Chairmans' reference of the Millennium Challenge Account and I thought that was another good initiative, as is the AIDS initiative. Some of us are concerned that there may be a little borrowing from Peter to pay Paul here and I hope you can assure us that these are added there and that we are not going to be playing games and taking money away.

There was one interesting part about the Millennium Challenge Account and I would be interested in your view on this. Not just for the Millennium Challenge Account, but I notice in general in international economic relations, one of the things we, and those of us who have argued, is that how people ought to be reducing their budget deficits. Now, I understand that budget deficits can be somewhat differently viewed depending on whose they are.

But it does strike me that there has been a kind of a change in the U.S. position here. And I am interested in your view as to how our own budgetary situation affects the credibility with which we preach deficit reduction to others.

Now, I know we have said, well, we do not worry about a deficit now because we have got economic slow downs, we have got unemployment. But, of course, many of the countries that we are preaching deficit reduction to have economic problems and social problems far greater than ours, unemployment far greater than ours, social deficits far greater than ours.

And so, I am interested in the consistency of our message there. And I want to be honest, Mr. Secretary, I hope you will be able to reconcile some of your earlier comments on this regard. It did seem to me, as I read the comments of yourself and some other high-ranking economic officials in the Administration, that there has been a kind of born-again phenomenon that has gone beyond into the economic.

And I guess I am reminded, I know that in this Administration French references are not popular, but Henry Navarre, when he became King of France to become King of France, converted from Protestantism to Catholicism and when asked about the conversion, said, "Paris is worth a mass." I need you to reassure me that we are not now governed by people who believe that Washington is worth a deficit. And the adhesion of power is not the reason that we have seen this kind of change.

Finally, and I appreciated your conversation earlier when you called my colleague Congresswoman Lee and many others on this committee have a particular concern about the very dire situation of the people of Haiti. And I hope that we would be able to continue to work to alleviate one of the worst cases of human misery in the hemisphere and show to the people of Haiti the kind of compassion and understanding that I think good policy calls for.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time is expired.

Any other opening statements on the other side?

Before I recognize the gentleman from Vermont, I would like to welcome our guests in the audience from the Philippine government study tour led by the Honorable Emilia Boncodin. I hope our friends enjoy their visit to the United States and welcome.

The gentleman from Vermont?

Mr. SANDERS. Thank you very much, Mr. Chairman.

And, Mr. Secretary, thank you very much for being with us today.

My opening remarks are going to touch on two issues. Number one, I would like you to explain to the working people of this country, especially those people who work in manufacturing plants why you think our so-called free trade policy has been a success, when all of the facts seem to indicate that it has been a dismal failure.

As you know, we now have a record breaking $435 billion trade deficit, including a $100-plus billion dollar trade deficit with China. Now, what that translates into is that from 1994 to 2000 we have lost 3 million manufacturing jobs due to NAFTA and the WTO trade agreements. During the last two years alone, under the Bush

Administration, we have lost 1.7 million more manufacturing jobs representing 10 percent of the total industrial sector.

In the last two years we have lost 10 percent of our manufacturing jobs and at 16.5 million jobs, we now have the lowest number of factory jobs since John F. Kennedy was President.

So, I would like you to explain to working people all over this country why the loss of 2 million manufacturing jobs in the last couple of years is good and why our trade policy is working for them. And I would also like you to tell the American people why 15 or 20 years ago the largest employer in this country was General Motors.

And with a good union, the General Motors workers there then and now, earn a living wage. As you know, the largest employer in America now is Wal-Mart, which is now being sued by 27 states for exploiting their workers in terms of overtime pay.

In terms of our trade policy, it seems to me the situation is not only bad, it is likely to get a lot worse. According to Forrester Research over the next 15 years, 3.3 million American service industry jobs and 136 billion in wages will move offshore to countries like India, Russia, China and the Philippines.

There was a big article in the New York Times the other day about jobs where you call up, you make a phone call, how can I help you and that somebody in India is answering that call. I would like you to talk about that later.

And the other issue, Mr. Secretary, that I would like you to address and we discussed this with your staff, is the issue of cash balance conversion plans.

On January 30 I sent a letter to the President signed by 217 members of the House and the Senate urging the Treasury Department to immediately withdrawal the proposal which they had brought forth and issue new regulations to protect older workers. Now, I think you are familiar with this issue.

When you were chairman of CSX, if I understand it, you gave your employers a choice when you converted from a defined benefit pension plan to a cash balance plan. The Bush Administration, before you became Secretary of the Treasury, brought forth a plan, which would make it easier for companies to go to cash balance.

I hope that you will tell us today that you are prepared to give workers in this country a choice so that they will not lose up to 50 percent of the pensions that have been promised to them. And we are talking about millions of workers.

The CHAIRMAN. The gentleman's time is expired.

Mr. SANDERS. Thank you very much, Mr. Chairman.

The CHAIRMAN. We now turn to the Honorable Secretary of the Treasury, Mr. Snow?

STATEMENT OF HON. JOHN W. SNOW, SECRETARY OF THE TREASURY

Secretary SNOW. Mr. Chairman, Representative Frank and members of the committee, I am delighted to have this chance to appear before you today and try and respond to the questions that you will have for me and in particular the questions that have been put to me already.

This, of course, is my first opportunity to be here. I am still waiting for the wisdom of Alexander Hamilton to descend on me in full, but I am hopeful.

I appreciate the chance to appear before you today and talk about the international agenda of the Administration. Give me an opportunity to describe where we are today in advancing that agenda and what are priorities are for the future. I would like to make a brief oral statement, Mr. Chairman, and ask that the longer formal statement be submitted for the record.

The CHAIRMAN. Without objection.

Secretary SNOW. The President is deeply committed to promoting growth and stability worldwide, especially where poverty is most serious and most acute.

As he has said, quote, persistent poverty and oppression can lead to hopelessness and despair and when governments fail to meet the most basic needs of their people, these failed states can become havens for terror. Last year the President set a goal of doubling the size of the economies of the world's poorest countries within a decade. And he is proposed several programs to move us toward that goal.

One of those is the President's proposal to establish the millennium challenge account that was mentioned in the opening statements. It seems to me this is one of the most promising and most innovative development assistance programs in the history of such endeavors or such undertakings.

The MCA creates real incentives for nations to govern justly, invest in their people and encourage economic freedoms, in other words, to lay in place the foundations for long-term economic success. More recently the President announced the emergency plan for AIDS relief, an effort that goes well beyond existing efforts to help countries in Africa and the Caribbean wage and win the war against HIV/AIDS with an emphasis, though, again, on accountability and real measurable results.

The Treasury Department is closely involved with both of these programs, MCA and HIV/AIDS, as well as the President's new economic growth agenda for the multilateral development banks.

His agenda focuses these institutions on raising productivity and measuring results by channeling more funds to those countries that follow good economic policies, pro-growth policies. And by structuring our contributions to create incentives for such policies.

He is called on the development banks to increase their use of grants rather than loans for the poorest countries and the banks, I am pleased to say, are already beginning to respond to this call.

The Treasury's international programs are crucial instruments in promoting our international economic agenda. They also help pursue specific U.S. foreign policy objectives, such as supporting economic assistance to key countries in the war on terrorism and combating money laundering and terrorist financing, all important objectives.

Similarly, Treasury's international debt programs help support good policies in reforming countries while technical assistance programs help performing countries put in place the sound budget and financial systems needed for long-term growth.

The Treasury is also a key participant in the urgent reconstruction efforts that are going on now in both Iraq and Afghanistan. For Iraq, we have formed a task force at Treasury, which is broad representation from the U.S. government agencies to help address financial and economic aspects of Iraq's reconstruction and we now have, I guess, about 20 people over in Baghdad pursuing those activities.

Among other tasks, we will focus on restoring essential operation of the finance ministry, the Central Bank, commercial banks and the stock market, recognizing that the task ahead is more than dealing with 2.5 weeks of conflict, it is really two and a half decades of mismanagement and misrule.

In Afghanistan as well the Treasury Department is playing a major role in addition to sending technical advisers to the country Undersecretary Taylor, who I think testified recently before you, has marshaled international financial support for the Afghan government's day-to-day expenses through the World Bank administered Afghanistan reconstruction trust fund.

We are committed to ensuring that the U.S. taxpayer resources are put to good use and get good results. Treasury will continue to press its pro-growth agenda in the multilateral development banks and I am pleased to say I think we are making some pretty good progress.

Our role includes holding these institutions accountable for achieving significant and sustainable improvements in the daily lives of people in poor and developing countries. We have made real progress in the past year, but our work must continue until our objectives are fully achieved.

I ask for your support as we strengthen these institutions in an effort to increase global economic growth, reduce poverty in the world's poorest countries and support key U.S. foreign policy objectives.

I thank you and would be happy to try and respond to your questions, Mr. Chairman.

[The prepared statement of Hon. John W. Snow can be found on page 53 in the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary. And we appreciate your testimony and the opportunity for questions. Let me first begin with the situation in Iraq. As you indicated, you have created this task force at Treasury and at—you have some 20 people on the ground in Iraq.

I know that you highlighted the fact that Afghanistan is receiving assistance currently from Treasury, the World Bank and the Asian Development Bank, and I am concerned that it has been slow to reach Iraq.

And, I am wondering what we would expect from the United States, and particularly from Treasury to work with the World Bank and the IMF to speed the necessary aid to the people of Iraq. Are your folks on the ground in Iraq, as well as folks in Treasury working with IMF and the World Bank towards that end?

Secretary SNOW. Yes, yes they are, Mr. Chairman. I think through some initiatives of ours that grew out of the last G-7 meeting in Washington several weeks ago, both the IMF and the World Bank agreed to get engaged.

And, the World Bank is putting together a task force of people who will do the preliminary assessments of the needs, sanitation, health care, roads, highways, bridges and so on while the IMF will assist with undertaking this assessment of the state of the financial institutions, working with the Treasury people who are already there.

As I say, we have roughly 20 people on the ground in Iraq today, headed by a former deputy secretary of the Treasury Department, Peter McPherson, whose on leave of absence from Michigan University where he is the President. And I was pleased to have a chance to speak to our group several days ago as they were taking up their new responsibilities to urge them well, and, as it turned out, Alan Greenspan was in the building that morning to meet with me and Allen—the Chairman also offered them his best wishes.

I would say we are anxious to get the World Bank moving faster. But, they are engaged. And I talked to Mr. Wolfensohn, the President of the World Bank and he is committed to making a great success of the talents that the World Bank has to assist in doing these assessments. I have talked to Mr. Kohler, the head of the IMF and he is in the same position. So, I would answer your question, yes, we are engaged in a cooperative venture with both the IMF and the World Bank.

The CHAIRMAN. Could you add some sense as to the time line here, say compared to Afghanistan. Obviously, Iraq presents some unique and different issues than Afghanistan, but at the same time Iraq has much more potential in terms of wealth, obviously, the oil deposits. Do your people in Baghdad give you any indication of when we could expect some major developments?

Secretary SNOW. Mr. Chairman, I think it is a little early for that. But, I am told the oil revenue should be flowing within the next two or three months at volumes or levels that would be quite meaningful. And, of course, as you suggested, Iraq is quite different than Afghanistan in having a very rich resource base.

And, as those oil revenues begin to flow, we want to see their use for the benefit of the Iraqi people for the rebuilding and reconstruction of the country. But, it is a very significant resource base. Iraq is inherently a very wealthy country and our technical assistance people are over there to make sure they do what they can working with the Iraqis to put in place the foundations for long term economic success.

But I would add they have got to dig out of a big hole. Today there is no financial system as such. There is no set of national accounts. There is no budget. There is no central bank that functions as a central bank, the central bank functions as a—the hand maiden of the regime.

There are no private financial institutions. There is a command and control set of banking practices there. So, we have a long way to go. But, we have a group of very dedicated people ably led by Dr. McPherson and I will be able to tell you more as we get into this further. They have just really gotten on the ground. But, the outlook is certainly hopeful because the resource base is so significant.

The CHAIRMAN. Thank you, Mr. Secretary.

Mr. Frank?

Mr. FRANK. On the capital controls issue, Mr. Secretary, you add here is what the Economist had to say, they talked about past history and note that the problem of short-term capital, not foreign direct investment, which they say should not be restricted, but short-term capital, bank loans and other short-term paper that floods in has caused problems in past and was sharply pulled out.

And what they say is for the capital into an economy with immature and poorly regulated financial institutions can do more harm than good. And they are critical of the U.S. insistence that countries not prevent that. They point to Chile's past experience. Now Chile and Singapore disagree that those are over.

We are talking now about a Central American free trade agreement, I wonder do you agree that a flood of capital to an economy with immature, poorly regulated financial institutions can do more harm than good?

And, if you do, are all of the Central American countries with which we are seeking a free trade agreement, do they all have mature and well regulated financial institutions?

Secretary SNOW. Well, I think what we need to do here, Congressman Frank, is understand the relationship between restraints on capital and what effects they have on long-term capital flows. And by restraining flows or making flows difficult, by putting barriers into any market place you always raise the risk of contracting the amount of flows that exist. And, what we are interested in is seeing a well functioning, both capital and good flows into——

Mr. FRANK. Let me try again. Mr. Secretary, they are talking specifically and I am about—for instance, an effort by a country precisely to lengthen the terms of the flow, countries have had bad experience about and Chile tried to give short terms inflows of capital.

What is wrong with a country, particularly if it is not totally confident in the maturity of its financial system, in trying to lengthen the term with the kind of tax that decreases to a point of disappearance when you reach the same point, because we are not—why is that a bad thing and why should we insist, as a matter of—as the price of getting a free trade agreement, people say we will never do it?

Secretary SNOW. Well, because, as a general matter, I think it is better to allow free flows of capital.

Mr. FRANK. Even short-term, unrestricted short-term flows? And what harm is done——

Secretary SNOW. As a general matter that is coming out in the case of both Chile and Singapore, I think we lengthened that dispute resolution period from six months——

Mr. FRANK. No, what you lengthened, Mr. Secretary, was the period before which competition kicks in. But, they had no grace period as to how long they can restrict it. I mean, that is simply how long it takes them for they collect the money. If you are suggesting that there would be a willingness to say, okay, short-term capital controls that restricted—that said that you wanted to get foreign direct investment to be for more than a year, then I think you would have no dispute.

I mean, what about the Central American countries, is it reasonable to say that none of them should try to lengthen—and we are talking about with Chile here, the tax that decreases as your investment expires, and we are not just talking about general rules, we are talking about the specific countries.

Secretary SNOW. Well, the general proposition that I think makes the most sense is to have the fewest restrictions on capital flows, both in and out.

Mr. FRANK. Okay. Mr. Secretary, I would subscribe to that.

Secretary SNOW. All right.

Mr. FRANK. But, that does not encompass no restrictions in the immature countries, immature systems. And the question is what about a country which falls on its financial regulatory system is not fully developed and they want to try to say that they do not want any short-term investments, they want to get it to be at least a year, not foreign direct investment, but the flow of capital, is that wrong?

Secretary SNOW. Well, as, I think it was Oliver Wendell Holmes observed, broad principles do not always solve concrete cases.

Mr. FRANK. I understand that, is why I keep asking you——

Secretary SNOW. And——

Mr. FRANK. ——and you keep giving me broad principles.

Secretary SNOW. ——that is why I was about to tell you that, while we have broad principles, we also have a case by case look at these things.

Mr. FRANK. So, with regard to Central America there may not be this insistence on banning on capital controls?

Secretary SNOW. Right now, there is a broad principle and broad principles get applied in individual cases.

Mr. FRANK. Well, I hope so, because—thank you, that is reassuring to me. My fear has been that the Administration was not listening to another Holmes' quote in a different context that the life of the law has not been logic. It has been experienced. And in this case, I think it was the somewhat rigid logic of free enterprise under all circumstances that being called. Let me just ask one other——

Secretary SNOW. ——a page of history is sometimes worth a volume of logic. And we are going to use both history and logic.

Mr. FRANK. Good. If I could just ask one last question here to submit for the record, our colleague, Congresswoman Lee, as I mentioned is particularly interested, and I know this is shared by a number of members of our committee on Haiti, I am going to submit a question, it will be in the record and we would appreciate if you could respond. It has got some fairly——

Secretary SNOW. Sure.

Mr. FRANK. ——specific efforts towards the policy.

Thank you, Mr. Chairman.

Secretary SNOW. I would be pleased.

The CHAIRMAN. Without objection.

The gentleman from Delaware, Mr. Castle?

Mr. CASTLE. Thank you, Mr. Chairman.

And, thank you for being here, Secretary Snow. We appreciate your testimony. I would like to return to Iraq if I could. And I want to approach this with nowwhere near the knowledge that you have, but I guess I have developed a little bit of skepticism concerning international organizations, the United Nations conduct in the war on Iraq.

And I really would like the World Bank and the IMF, I have a tremendous amount of respect for Mr. Wolfensohn in the World Bank and the IMF. But, I am somewhat concerned, in your written statement, at least, where you say that they—and I think you said it last week, they have agreed to study this and to, you know, come up with recommendations or something of that nature.

I mean, it was pretty apparent the last seven or eight months that this was going to take place. It was also pretty obvious that it would take place pretty much as it did, that it would go quickly and we would be in this rebuilding phase and there are many people, including me, I believe, who believe that the rebuilding phase is as important as anything we are doing there.

And, I am just worried about international organizations that are sort of stepping back and looking at what should be done. You have 20 people on the ground, you probably need a lot more than that to get things going in Iraq. But, are you satisfied with that? As I said, I have respect for the organizations, but I mean to me this is—there are immediate problems in Iraq.

All you have to do is turn on the television and see all the young men and women who clearly are not working and then the huge disruption, which is there. Are we harboring all the assets we have to do what we can in Iraq? And, I do not mean the United States assets necessarily, but all the international assets?

Secretary SNOW. Well, it is an immense job that lies ahead.

Mr. CASTLE. A huge job.

Secretary SNOW. Yes, I will certainly agree with you fully on that. The people we have in Iraq, supplemented by the work that the World Bank and the IMF will do is essentially doing assessments of what is needed and how difficult are circumstances today, what sort of banking operations exist, what sort of payment systems exist.

I think that the fact is right now the economy is broken and not functioning. And we got to put in place the most rudimentary elements of a well-functioning system. The people we have there are very good. They have done this in Afghanistan. They have done this sort of work in other places. The World Bank has people like that, the IMF does. I think we can get a good assessment of where things are what needs to be done.

Mr. CASTLE. Well, let me ask you if this has—not to interrupt, but we only have five minutes here. Let me ask you precisely are you satisfied with where the World Bank and the IMF are now? And what they are doing?

Secretary SNOW. Well, I wish the World Bank were over there already.

Mr. CASTLE. That is my impression is they are a little bit slow in terms of getting there.

Secretary SNOW. Yes, the IMF I think is somewhat ahead of the World Bank in getting people over there and doing these monetary systems, central banking, currency assessments. We need to think about what is the appropriate currency over there and get an effective currency system put in place.

So, no, I wish it were moving faster, particularly on the World Bank side. But, I do have the commitment from Mr. Wolfensohn, the chairman of the World Bank, that this is a top priority and that the people are on the way.

Mr. CASTLE. Let me ask in a broader—broadening it a little bit, if you can possibly broaden this throughout a difficult subject, but what is your own confidence level in our ability to reestablish the economy in Iraq, the monetary systems, the economic systems, the various other components?

I mean in your written comments, I mean, there is a huge agenda here in terms of dealing with civil servants and teachers, schools in general, pensioners and a fair and transparent federal budget responsible system, regulation and supervision for financial institutions and it goes on.

All these tasks, to me, would involve incredible numbers of people and sums of money. I mean, to me this is an important mark that America do this law. Are you satisfied that we have—I have a lot of confidence in you, but are you satisfied that we have the resources to do this?

That we are committed to do it, that all of our agencies are committed to do it? That we are really engaging the international agencies in order to make this happen? Or do we have to do more? Do we have to speed it up or put more assets into it?

Secretary SNOW. Governor, I think this is more than reestablishing, because I do not think, in many cases, it ever existed at least in the last 25 years. So, it is an immense undertaking. I—you know, these resources may need to be augmented. I certainly agree with that. I will be in regular contact with Mr. McPherson.

I have told him if he needs more resources. Let me know. If he needs a bigger budget, let us know. I have talked to Mitch Daniels at OMB and said this may require more than we have presently available.

I want to put a marker in that we may need to come back to you out of the supplemental that was recently passed and lay claim to more of those resources and Director Daniels was very responsive when I told him the sort of thing you just told me, that this is an immense undertaking and it is really putting in place something that is not been there. It is more than reestablishing and recreating, it is building from the ground up.

I mean, I fully agree with the tenure of your comments.

The CHAIRMAN. The gentleman's time has expired.

Mr. CASTLE. Thank you, Mr. Secretary and good luck.

The CHAIRMAN. Mr. Secretary, we are certainly glad you chose somebody from the big ten conference at least to——

Secretary SNOW. Not Ohio State, but at least the Big Ten. Right.

The CHAIRMAN. The gentleman from Vermont?

Mr. SANDERS. Thank you, Mr. Chairman.

Mr. Secretary, as I mentioned a moment ago, I am very concerned about the fate of millions of American workers who may be forced to go into cash balance payment schemes, which will result in, perhaps, as much as a 50 percent reduction in the pensions that they have been promised by their workers. Let me read something to you and then I—we only have five minutes, so if you will bear with me I would like to read you something and you respond, okay?

Mr. Secretary, before the Senate confirmed your nomination you met with Senators Harkin and Durbin about this issue. Do you recall that, sir?

Secretary SNOW. Yes, I do.

Mr. SANDERS. Okay. And, in a speech that Senator Harkin gave on the floor of the Senate on January 30, this is what he said, and I quote from Senator Harkin. “I wrote down exactly what Mr. Snow said, he said,” and this is you, “I believe we should protect the basic rights of workers and if a rule does not meet that test it will not move forward,” end of your statement, according to Mr. Harkin. “Fundamental fairness will be the center of any policy.”

Mr. Snow—and now I continue with Mr. Harkin’s statement, “Mr. Snow has said he would agree to meet with people, employers, representatives of labor groups, representatives of elderly groups to get their input on this approach and hopefully are perhaps having a new rule.” Let me start off, my first question is you have now been in office, I know not for a terribly long time, but presumably you have had time to study this issue.

Are you now prepared to support legislation that would do for millions of American workers what you, as I understand it, did as the CEO of CSX Corporation and that is give workers the choice when a conversion takes place so they do not see their pensions slashed in front of their face. Could you respond to that, sir?

Secretary SNOW. Yes, yes, Congressman, I would be pleased to. I think you quoted me properly or Senator Harkin did more appropriately, when I met with him and Senator Durbin some months back, three or four months back, and they expressed to me then, as you are now, concern about a cash balance plans, the movement towards cash balance plans. And I committed to them that there would be no chance in the existing rule until I had a chance to review it.

In other words, we would leave the existing rule in effect through this rulemaking process and not institute any interim rules. I further told them that I was committed to this principle of fundamental fairness in the rule and pointed out as well that there was merit, particularly for younger workers, in creating access to cash balance plans because so many of these younger workers do not contemplate being with the existing enterprise or firm for 30 or 40 years like the fire——

Mr. SANDERS. I only have five minutes. So, my question was will you give older workers, will you support the concept and legislation giving older workers the choice so that they do not see their pensions slashed? Can you respond to that?

Secretary SNOW. I think this is better handled through regulatory policy than legislative policy. And in implementing that notion of fundamental fairness, I am committed to seeing that we protect the fundamental interests of older workers so they are not prejudiced or treated prejudicially as a result of the new rule.

But, I do think this is a matter that is probably better handled through regulatory process than trying to put it into a rulemaking process.

Mr. SANDERS. Well, the reason we have introduced legislation is we are concerned that the Administration will not do the right thing. So, if you could assure me and the other 130 co-sponsors that you will do for the American worker what, as I understand it, you did for CSX workers, we can talk about the way you do that.

Secretary SNOW. Well, Congressman, I am not sure that what we did in the circumstances of CSX is the best for every company. But, what I am committed to is making sure that we weigh the interest of senior workers, older workers, who have expressed concerns about losing out or that their interests are well protected under the rule, while the rule also accommodates the flexibility that I think companies need and younger workers need.

Mr. SANDERS. Okay. Mr. Secretary, in your discussions with Senators Harkin and Durbin, with whom I work on this issue, you also promised that you would be meeting with workers and senior citizen groups. Have you done that yet?

Secretary SNOW. Well, I have met with some, yes. I have met with——

Mr. SANDERS. And Senators Harkin and Durbin together with those groups?

Secretary SNOW. They have not been with me at these——

Mr. SANDERS. Would you tell us now that you would be prepared to meet with Senator Harkin, Durbin, myself and other members, I know Mr. Emanuel is concerned about this issue, others are, along with labor groups and senior groups so that we can talk with you about the concerns that we have. Is that something you would agree to now?

The CHAIRMAN. The gentleman's time is expired.

Secretary SNOW. Well——

Mr. SANDERS. If the gentleman could answer.

Secretary SNOW. If that can be arranged, I would certainly be amendable to it, sure.

Mr. SANDERS. Okay. Thank you.

The CHAIRMAN. The gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

Thank you, Secretary Snow.

An analyst I know was arguing the point that the decline in the dollars real exchange rate could be viewed in his view as a real plus for the economy. He said, you know, the Federal Reserve's own economic model shows that a sustained 10 percent decline in the dollar boosts GDP growth by 4 percent after the first year. And, furthermore, after the second year, it would increase that GDP growth to 1.6 percent.

Such a decline in the dollar over two years produces as much impact, according to this fed model, as a $10 a barrel decline in oil price and a tax cut of 1 percent of gross domestic product combined. So, I guess my question is does the Treasury more or less agree with that fed model and what that implies?

And, if so, is this analyst right that—when he argues why support a strong dollar when the fed is, in fact, concerned about deflation?

Secretary SNOW. I have not seen that study and I probably should not comment on any given study that I have not, myself, reviewed, analyzed and studied. But, clearly, as I was asked yesterday somewhere, there is a relationship between exports and the value of the exchange value of a currency. That is Economics 101.

Our policy, though, has been reaffirmed over and over again, it is to focus on the fundamental of the characteristics of the currency. We want a currency that is a good medium of exchange. We want a currency that is a good store of value, that introduces stability into the international, global trading system. We want a currency that is widely accepted and used for investments and as a store of value.

Mr. ROYCE. A stable monetary unit.

Secretary SNOW. Yes, a stable monetary unit, all those things, and we want a currency whose value is set through open competitive markets processes. In fact, I think that is the best policy for currencies generally. It is the best currency regime generally. So, those policies we have affirmed for a long time.

Mr. ROYCE. I guess my only point, though, is that if the fed is concerned about deflation this certainly becomes a part of a solution if economic forces continue—if the market continues to dictate a weaker dollar.

Well, let me go to another question that I have and that is your view of our G-8 allies, are they doing enough in the form of economic stimulus themselves?

There is a noted British investment manager and writer, Andrew Smithers, who said the other day, without strong fiscal stimulus worldwide, we feel demand will remain depressed.

He believes that, quote, fiscal stimulus in the U.S. alone seems likely and will probably be insufficient to set off a sustained recovery worldwide.

So, I guess one of the questions I have is whether you will be pressing your G-8 colleagues in any way to implement pro-growth stimulus in their respective countries in order to try to get the world economic engine moving, since we are all tied together these days?

Secretary SNOW. Absolutely, Congressman. That is one of the themes that I intend to continue reiterating to our colleagues in the G-7, G-8 this time, because Russia's going to be joining us.

But, absolutely. Absolutely. We are taking steps here in the United States to get our growth rates up, to get greater prosperity here as we get our domestic economy stronger we are able to buy more from abroad. One of the problems with the world economy is that the domestic economies of so many of the G-7 countries are weak and do not have real growth. And the United States then becomes the market for their products, but there has not a counterpart market in their countries.

So, what I have tried to urge on my brethren in the G-7 is that we have a concerted effort among the large economies of the world to promote growth. And that while in the United States I think what we need now is fiscal policy and some of those countries they need something else. They need to fine tune their economies to deal with the issues that stand in the way of growth there. But, absolutely, I am fully committed to doing that.

The CHAIRMAN. The gentleman's time is expired.

The chair is now pleased to recognize the gentlelady from New York, the Ranking Member of the subcommittee. I was going to go to Ms. Maloney, the Ranking Member of the Domestic International Monetary Subcommittee.

Mrs. MALONEY. Actually, I just flew home from New York and my cab driver was talking about the declining dollar. He is from Morocco and he said it used to be eight Moroccan dollars to the American dollar. It has now slipped to five Moroccan dollars to the American dollar. And he said this was causing him a lot of trouble. And I said well maybe it will help our exports.

So, I want to ask you there is some speculation that your recent comments may be an attempt to talk down the dollar and to boost the U.S. exports and reduce the trade deficit, and the trade deficit in 2002 was 436 billion, and given the ballooning U.S. federal government deficit, it is possible that these twin deficits could add up to 1 trillion combined this year.

And is this a policy of the Bush Administration? And, if not, to what do you attribute the recent weakening of the dollar? And I might note that today in the Wall Street Journal they are talking about the dollar dilemma, a weaker currency helps the economy.

And I know you have commented in your comments, but I would like to hear more that it is literally the talk of the taxicab drivers now, the declining American dollar.

Secretary SNOW. Well, the dollar, you know, against the euro is about where it was when the euro came out. And we have a system of freely fluctuating exchange rates where predominantly the value of currencies is set, is set through open competitive market forces.

There is no conscious policy on the United States, I want to assure you, to move the dollar at all. We have a strong dollar policy. We have had it forever in this Administration and in the prior Administration, going back, I think it has four secretaries.

But, the strong dollar has those characteristics that I talked about, a good mean of exchanges, store of value, something people are willing to hold, stable and set in competitive currency markets with devaluations held to a minimum. That is the sort of regime that I think supports the strong dollar and reflects the strong dollar.

Nobody is very good at telling you why currencies go where they go in the short-term or maybe in the long-term. They are the product of a multitude of very complex economic forces.

You know, Lord Keynes, who many think was the greatest economist of the 20th century, almost took himself and his college down when he was the college treasurer and decided to do currently arbitrages.

Fortunately, he said some wealthy alums who helped bail him out. The currency is an extraordinarily complex phenomenon and if anybody really knew where currencies were going they would be richer than Croessus, you know? We do not. We do not.

And, those who make a living out of trading currencies end up with zero profits as a whole because on every transaction there is somebody on the other side of it whose win is your loss or whose loss is your win. So, it is what economists call a zero sum game.

And I think economists are quite frank to say they cannot tell you at any one time why currencies are going this way or that. But, it is the interaction of this multitude of interactive forces. And the better reading, I think, of modern economics is that countries do not have much ability to control the value of their currency because of all these complex web of——

Mrs. MALONEY. One of the impacts on this is the growing deficit, combined with the ballooning trade deficit. And you have known many people equate you as a strong deficit hawk before becoming the Secretary of the Treasury. You were often warned of the dollar consequences of government deficits. And without commenting on the President's economic plan on which we disagree, what are the global economic consequences of increasing the U.S. government deficit in the IMF and also the impact on our constituents' mortgage loan, credit card payment, interest rates.

Secretary SNOW. I would say basically negligible given the budget, which brings the deficit down to basic balance over the budgetary period. Deficits create problems when the deficit is large relative to the GDP of a country, not all that different than a family's budget, if your income is double X you can afford debt of X.

If your income is X, you have got a tough time affording a debt of X. So, it is that relationship that is more important rather than the absolute size. The deficit will be is relatively modest, it is higher than I would like to see it, but it is manageable.

And the concern about deficits has to do with crowding out private capital, that is not happening today. The concern about deficits has to do with driving up interest rates and yet we have the lowest interest rates in 40 or 45 years.

The deficits become troublesome when they are seen as large and growing, large relative to the GDP and get built into the financial fabric of the country. They get built into the financial fabric of the country if lenders, if financial markets begin to perceive them as, as I say, rising with time and becoming large.

The CHAIRMAN. The gentlelady's time is expired.

Secretary SNOW. That is not the case here.

The CHAIRMAN. The gentleman from Arizona, Mr. Renzi?

Mr. RENZI. Thank you, Mr. Chairman.

I have two questions I want to try and sneak in here, one on Afghanistan and the other on micro-financing. On Afghanistan, I listened to your vision on Iraq and I can see in the future how Iraq can pull itself out using its own depth of natural resources.

When I read your comments on Afghanistan I worry a little bit more that not only is the focus obviously on Iraq now, maybe Afghanistan is a little bit more on the back burner, not that America has done that, but in a sense that what natural resources—and I think we are talking about an agriculture based society, we hear reports of then moving back to more poppy growth and the drug trade. We have reports of the war lords moving in a little bit in certain areas.

I saw President Clinton the other day at a commencement address talked about the fact that American and French served was still there working side by side on the commodity that exists.

Has the world, particularly those countries who may not be assisting in Iraq, are they pouring the kind of efforts in to Afghanistan that we need in order to bring that nation out? And where is it the future what vision do you have as far as what kind of exports or where is their economy going, just real quick?

Secretary SNOW. Well, I think the commitment was made for $4 billion or $4.5 billion growing out of that Tokyo conference back in January of 2002. The United States made a commitment is on the record for a commitment of some 900 million. So, there is substantial multilateral commitment here of funding for agriculture and health and education and the foundations for a stronger economy in the future.

But, infrastructure and that ring road that we are involved in that Secretary O'Neill went over and got involved in and so on. So, I think there are a lot of positive things going on. I met with President Karzi and his cabinet here just a month ago when they were in town and we talked about these things.

There is clearly concern about the warlords. And there is clearly concern about the things that need to be done to get this economy into higher gear, that ring road is one of them. And I am pleased to say it is beginning to show some progress of really being put in place. But, it does not have the sort of natural wealth; I would agree with you that——

Mr. RENZI. Well, if there is, it is an agriculture-based society.

Secretary SNOW. It is an agricultural-based society. Right.

Mr. RENZI. Okay. I am going to move to micro-financing if you do not mind real quick. The idea that the World Bank and the IMF have targeted a lot of their resources towards governments, American being a very small business driven economic engine, particularly in rural Arizona where I am from.

Is there thought to more emphasis that it will be placed on the idea that small businesses and individuals should be the recipients rather than directing that monies to major government organizations?

Secretary SNOW. Absolutely. And I think that is one of the reforms that the Treasury Department, under Undersecretary John Taylor has been pushing that the money go directly to these small businesses because they are so fundamental, so critical to a country's development. So, we have put that as one of the three major initiatives that we are pushing. So, absolutely, absolutely, I agree with you.

The CHAIRMAN. Does the gentleman yield back?

Mr. RENZI. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Illinois, Mr. Emanuel?

Mr. EMANUEL. Thank you, Mr. Chairman.

I have a question, Mr. Secretary, about reconstruction in Iraq. But, before I get to that, I would like to add my voice on the cash balance savings plan just so you know I happen to think they're a good instrument.

And I happen to think the rules making processes is the right venue. And having testified in front of the IRS with Bernie Sanders, and with my colleagues, I believe that you can create a win-win situation rather than a win-lose situation if you have a grandfather clause. So, I will add my voice to that. They are a good instrument. Companies should be allowed to do it, but not freehandedly where they hurt the older workers. And you can create a win-win situation rather than a lose.

On reconstruction, earlier you had two members, the chairman asked you about reconstruction and the use of oil, not use of oil, but you answered it oil in Iraq, it is a oil rich nation, yet the Wall Street Journal yesterday said that, although there could be $15 billion a year in revenue from Iraq's oil that that will not be enough to solve Iraq's economic needs and reconstruction needs.

And we have a plans, I pulled them up from the USAID on housing, health care, education for Iraq. What is your estimate, and I say you, both the Treasury and the State, for the cost of the United States for the reconstruction?

It is clear that the oil in Iraq will not cover it all. And it is clear we are going to need others and we are out right now soliciting other nations to contribute and I know we have a, like any good business, you have a low estimate and a high estimate, depending if the United Nations turns over the oil rather than them controlling for their oil for food program.

There must be an estimate. What is the estimate now between the two different agencies or just the Treasury agency of what the U.S. will be asked to put in over the next three years given the estimates as low as 60 billion to as high as a $100 billion?

Secretary SNOW. I actually do not have that estimate. And I do not know, maybe OMB has that estimate, but I do not. The oil will be a huge part of the whole picture.

In addition, there will be the Iraqi assets of the Saddam regime; it should really be given to the Iraqi people for the purposes of reconstruction. We vested, I think, it was a billion seven in those assets recently back in march in other countries. And I think there is an additional billion two or so. I think appropriated are a couple of billion.

Mr. EMANUEL. We gave in the supplemental 1.7, which is only the first of a series of down—1.76, I think, to be exact.

Secretary SNOW. Right.

Mr. EMANUEL. But, I know there is. Look, they do have oil. It is going to be important to their oil, it is going to be important to the reconstruction.

But, if you look at USAID plans, 20,000 units of housing in Iraqi is planned, 13 million Iraqis will get universal health care, 100 percent maternity coverage in Iraq, 12,500 schools will be given basic supplies, 12 million Iraq children will be given an early childhood education.

And, if we compare that to here in the U.S. we do not have anywhere the estimates are like that. And I know there is a plan for Iraq reconstruction. We have estimates, but we have goals and targets. What is the U.S. contribution towards that $60 billion?

And 1.76 is not alone, do we apply 20 billion? 15 billion? The low end is 10, the high end is 25?

What is the guesstimate of what we would ask the taxpayers to pay for reconstruction?

Secretary SNOW. Well, as I say, I do not know that. I know that oil will be a big part of it. You say 15 billion, I have heard much higher estimates on that. We have the vested assets.

We have the concealed assets that we are going after. And we also have, and I intend to take this up with the G-7 ministers when we meet here, I guess it is Friday, the donor funds and I would hope we would have a robust response to our request for donor funds, just as we have had in Afghanistan. But, I am not privy to whatever those numbers are, if anybody has pulled them all together.

Mr. EMANUEL. My colleague from Delaware asked a good question and he said the reconstruction is going to be as important, if not more important than the military plan. We had a military plan within Turkey at letting us move in, if Turkey did not let us move in. We have estimates now what we want to do for reconstruction.

We know that the revenue from oil is only going to produce X amount of cash. We know what we want to get towards. We have a plan. We must have some guesstimate. If you cannot provide it today, and I am not saying you are privy to it, could you help get the answer, what are the taxpayers of the United States going to be asked?

How much of the tab to the taxpayers over the next three years for the $100 billion or $60 billion?

It is only 5 billion, 10 billion?

I cannot imagine we would go to a war without a plan for different scenarios. And my guess is somewhere within the agencies of State and Treasury exists a plan of how much we are going to ask the taxpayers of the United States to flip for this?

Secretary SNOW. Well, I doubt that there is——

Mr. EMANUEL. I just know it is good management. You would have it. I am not saying you, but somebody has a plan, somebody is working on it.

Secretary SNOW. It may exist. But, it is—you are dealing here with extraordinary set of imponderables. We have not even gotten, as I said earlier, the World Bank fully engaged yet in doing their preliminary assessments. And until we get those preliminary assessments and get some sense of what the state of infrastructure is, sanitation requirements, power company requirements, electricity, pipelines, on and on and on. You know, I think it is important to get the facts before I try and answer your question.

Mr. EMANUEL. Well——

The CHAIRMAN. The gentleman's time has expired.

Mr. EMANUEL. Thank you.

The CHAIRMAN. The gentleman from Texas, Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman.

Mr. Secretary, in your written testimony you stated that trade liberalization is one of the most fundamental steps that countries around the world can take together to achieve growth and reduce poverty.

One of my colleagues earlier, I think, questioned the benefits of free trade, particularly as it related to industrial sector jobs in America. Reports I have seen concerning the two large trade agreements of the 1990s, the Uruguay Round of trade negotiations and NAFTA, have data published by the previous Administration saying that a family of four benefited annually about $600 to $800 through the Uruguay round of trade negotiations and the annual benefit to a family of four from NAFTA was about $140 to $720.

So, if the reports of the previous Administration are true, it would seem to indicate that consumers at least are a big winner under free trade.

I am curious whether this Administration agrees with the assessment of the previous Administration? And whether or not you believe that trade has also created more jobs in America as opposed to the absence of globalized trade?

Secretary SNOW. I am not familiar with those estimates of the prior Administration, but I certainly agree that trade promotes jobs and promotes wealth.

Mr. HENSARLING. With respect to the IMF I am somewhat concerned about the whole issue of moral hazard. I have seen a report where 70 nations have depended upon the IMF aid for over 20 years. Twenty-four countries have received loans for over 40 years. And, perhaps, my numbers may be a bit dated, but the United States still appears to be one of the largest contributors via its line of credit to the IMF.

I guess my fundamental question would be what is the federal taxpayer getting for his money and his risk?

Secretary SNOW. Well, we are trying to make sure he gets more. And clearly moral hazard is an issue with respect to this. That is one reason that the Treasury Department has taken the lead in trying to focus the attention of these facilities, these financing facilities, to emerging countries on real bottom line results. So, that they do not need to keep coming back and back and back, that is the problem you are getting at and I agree with you. It is an endemic problem of the history of these institutions.

But, by focusing on real results, and by real results I mean putting in place the foundations for economic sustainability where you gain the financial strength and the financial degrees of freedom to go into the private marketplace.

We would hope that the number of these countries would not just be emerging, but would eventually emerge, because that should be the end of this exercise. Not perpetually emerging, but eventually emerged, but to emerge they have got to put in place the foundations for economic successes. And if you put in place the foundations for economic success then private capital will come in and the private financing markets will give you credit. And that is where this all should point towards. So, I agree with where you are going.

Mr. HENSARLING. In your testimony you talk about the President's initiative on the Millennium Challenge Account, and our commitment to the IMF compared to the Millennium Challenge Account. If that program is successful will it lessen the taxpayer commitment to bodies like the IMF?

Secretary SNOW. Well, I think if our policies are successful that we are advancing with the IMF, this focus on measurable results, encouraging small business, anti-corruption, law and order, budgetary responsibility, if all those things, respect for private property, encouragement for foreign investment and so on, if those initiatives are followed then we should reduce significantly our call for funding for those institutions because these countries, as I say, will emerge.

They will be able to get their funding from private markets and reduce the call on the IMF. The MCA, the Millennium Challenge Account, builds on those basic principles, but it does so with the poorest countries, the very poorest countries and says that we should look at the poorest countries and say that those among the poorest countries who are adopting the right policies, who are really making commitments to the right things, should be rewarded.

So, the IMF is dealing more with the emerging countries and the MCA is dealing more with the very poorest countries.

The CHAIRMAN. The gentleman's time is expired.

The gentlelady from New York, Ms. Velazquez?

Ms. VELAZQUEZ. Thank you. Finally, Mr. Chairman.

Mr. Secretary, as you know, the reconstruction of Iraq will cost many millions of dollars. And, while this reconstruction effort will directly benefit the Iraq people, it will also benefit the American companies fortunate enough to be awarded the large contracts from the U.S. government.

As ranking member of the Committee on Small Business, I am particularly concerned that small businesses will not be given the opportunity to participate in this reconstruction effort. What is the Administration doing to ensure that small businesses will be afforded an opportunity to be our newest government contracts for the reconstruction of Iraq?

Secretary SNOW. The contracting for the reconstruction of Iraq will be done primarily by people who are not in the Treasury Department. So, I am not in a very good position to answer that. But, I will certainly look into it and see if I can give you a more detailed answer.

Ms. VELAZQUEZ. So, you are not in a good position to tell the Administration that small businesses play an important role in our economy and as such, they should be given an opportunity to be on those contracts.

Secretary SNOW. Well, I agree with you very, very much about the——

Ms. VELAZQUEZ. Thank you.

Secretary SNOW. ——role of small business.

Ms. VELAZQUEZ. Following up on Mr. Renzi's question about micro-enterprises, as you mentioned, as a result of the 1998 reforms, the Administration is required to promote certain economic policies in our interaction with international financial institutions.

One such provision directs the Administration to promote structural reforms that facilitate the provision of credit to micro-enterprises. And your response to him was that you recognize the important role of micro-enterprises and small businesses.

But, I would like for you to do more than that, would you please provide the specifics about what is it that the Administration is doing?

Secretary SNOW. Well, we are encouraging them to focus heavier attention on the micro-finance. We are pointing out the importance of these smaller enterprises in being engines for economic growth. We are making technical assistance available to those smaller businesses and trying to make support for micro-enterprises a part of the basic policies of the IFIs.

I was down in, I think it was Honduras and Brazil, just the week before last and spent a considerable amount of time with micro-finance issues and micro-business issues. And this was all part of the Inter-American Development Bank's set of activities. And they sponsored the conference with the micro-finance providers. The micro-finance is a big part of this, too.

But, you are actually right, we need to get these international financing organizations more focused on the role of small, small business.

Ms. VELAZQUEZ. But, there is a concern that systematic effort from the Administration to promote through these financial institutions the structural reforms that are needed.

Secretary SNOW. Well, we are making that a part of our message to all the IFIs.

Ms. VELAZQUEZ. I would like——

Secretary SNOW. A very important part of our—it is really a very important part of the message. It is a new message that we are taking to these international financing institutions.

Ms. VELAZQUEZ. I would like to follow up on Mr. Royce and Ms. Maloney's question regarding the weakening of the dollar. As she stated, and we have been reading, the dollar has recently weakened substantially, hitting all time lows against the euro, five-and-a-half year lows against the Canadian dollars and 10-month lows against the Japanese Yen.

As you know, both strong and weak dollars have their pluses and minuses. A weak dollar, while grateful for those that sell their goods abroad, may provide an incentive for a foreign investor to pull out of U.S. markets, because interest rates are apt to rise and limit economic growth.

A strong dollar has the opposite effect, dampening inflation and encouraging foreign direct investment, but increasing the prices of U.S. export abroad.

While I understand the effect of strong and weak dollar policies, I would like your opinion on what effect such a humanly, disorderly decline of the U.S. dollar will have on the U.S. financial markets and the economy more generally?

Secretary SNOW. Well, as I said earlier, the relative value of currencies is one of the most complicated and I guess the word might be, annexable, annullable phenomena in modern economic life.

And the nature of a freely fluctuating currency regime is that demand and supply forces will dictate what the currency's value is relative to other currencies. It is always a relative valuation.

The important thing, I think, is that the currency's valuation reflect real demand and supply forces. And that it not be held through interventions to a level that is above its natural market rate or below its natural market rate because when the currency is propped up or suppressed it introduces a lot of other negative conduct and behaviors into the economy.

So, that is why we talk about the wanting a strong dollar that reflects these key characteristics, stable, good store of value, good medium of exchange, because that promotes trade on a world basis. We want people to have confidence in the currency. And we want the currency set through a regime of open competitive markets with interventions kept to a minimum. That sort of regime I think will serve the best long-term interest of the United States.

The CHAIRMAN. The gentlelady's time has expired.

The gentlelady from Illinois, the Vice Chair of the International and Domestic Subcommittee on Monetary Affairs.

Mrs. BIGGERT. Thank you very much, Mr. Chairman.

My first question, I hope you can help me with since the Treasury Department is playing a key role in the rebuilding of Afghanistan. In the fiscal year 2003 foreign ops appropriations bill, the women of the House and the Senate requested monies to build women's centers in Afghanistan.

There was to be one each in the 31 provinces. A center where women could find health care. They would have education for the women and the children and then a place for economic development or trades, such as quilting or chicken farms or whatever.

And this was loosely left for who was to administer that, probably USAID. And we worked with the women ministers of Afghanistan. But, we have not heard much about what has happened to that money and I wondered if the Treasury Department is playing any role in that development?

Secretary SNOW. Not to my knowledge, Congresswoman. I will check and see. But, it has not hit my radar screen yet.

Mrs. BIGGERT. Well, nothing has happened, I think, because of the fear of, you know, some of the warlords. I would appreciate that if you know anything about that.

Secretary SNOW. We will look into it and respond.

Mrs. BIGGERT. Thank you. And then next I would like to just commend the Treasury Department for its efforts in negotiating the strong trade agreements between the United States and Chile and Singapore.

And maybe you could just comment on some of the greatest breakthroughs in those agreements for U.S. financial services providers?

Secretary SNOW. Well, it is the free flow of capital. It is the ability for capital to be honored and respected without prohibitions on its free movement, just like the movement of goods and services. The mobilization of capital, both domestic and international, is really an essential component of a well-functioning economic system.

You got to have capital flows. And using borrowed capital effectively and attracting foreign direct investment are hallmarks of countries that work, countries that get their economies functioning the right way, who get it by economic development and growth. So, I think clearing the wave of barriers there for this free flow of capital is a real milestone.

Mrs. BIGGERT. Okay. And then in the——

Secretary SNOW. And I would say not having capital controls and I would respectfully disagree with Congressman Frank on that. The evidence is pretty clear that capital controls inhibit capital flows. If you cannot get your capital out of someplace, you are not as likely to put it in.

So, having good capital flows in and out requires the absence of constrictions on capital flows. So, getting agreements without those constrictions or inhibitions or prohibitions, I think, is very positive.

Mrs. BIGGERT. Okay. Then we just had the HIV/AIDS bill in the House and part of that would allow private contributions to be made to the global fund, by the private sector. We have had one contribution from one group that I think was $100 million.

Do you think that this is beneficial and that the World Bank has the capability to accept these contributions?

Secretary SNOW. Well, yes, I would certainly think so. I certainly think it is a funding for AIDS has to be in—HIV and AIDS has to be a real priority. It is why the President advanced that initiative.

And with real dollars, I mean a very substantial amount of dollars and we are, I guess, President Wolfensohn of the World Bank has indicated that no country with an effective HIV/AIDS threat issue should go unfunded. And we are very supportive of that full funding for countries that have those effective strategies.

Mrs. BIGGERT. I would think that—I will agree with you and I think that part of the amendment also will allow for more publicity or a PR campaign to let people know that even a small amount is very helpful to this fund.

Secretary SNOW. And I think the World Bank has set up a task force for more rapid implementation of that funding, which is a positive thing, because I think some of the implementation had been slower than it should have been.

The CHAIRMAN. The gentlelady's time is expired.

The gentleman from Alabama, Mr. Davis?

Mr. DAVIS. Thank you, Mr. Chairman.

Mr. Secretary, good evening to you. Let me, if I can, turn to the subject of Mr. Hensarling's questions earlier about the Millennium Challenge Account. When I listen to your testimony and I look at some of the things that I have read about it, it certainly is a very noble sounding concept.

But, the criteria that are laid out governing justly, investing in people and promoting economic freedom, my guess, is that Dick Gephardt and George Bush could both run on that platform and they would probably have a very different interpretation of those phrases.

At one point, during your testimony you said that one of the goals of the challenge account is to promote companies following the right policies, quote, unquote. Now, again, given the great diversions that we have just on this committee, much less in the House, about what the right policies are in this country as far as monetary growth is concerned.

Can you talk for a minute about how we ensure that as we formulate policies they are not simply done from one perspective?

And I will give you two examples that trouble some people.

The Board of Directors of the Millennium Challenge Account, as I understand it, is to be made up exclusively of cabinet officers chaired by the Secretary of State. It would seem to me that there might be some utility in certainly, including some economic experts who are not part of the Administration.

Second of all, it is very clear that Congress has not been involved, and I am sure there is an intent to really involve Congress in sifting through these criteria, getting them from the very general categories to the more specific.

So, how do you address the general concern about the right policies in effect when rewarded from a very particular perspective and the more specific concerns about the lack of outside input?

Secretary SNOW. Well, the right policies, I think, are laid out pretty clearly as are the eligibility criteria.

Mr. DAVIS. What are they beyond those three categories though?

Secretary SNOW. Well, there are things like having an effective education system, there are things like having an effective program to deal with corruption, having an effective system of law and order; things like, on the financial side, the country's debt levels versus its GDP, its monetary policies. Does it have a monetary policy, which is well calculated to avoid excessive inflation?

Good governance is a part of this and the criteria there are taken from an external group.

Mr. DAVIS. I do not want——

Secretary SNOW. Freedom House and I were just trying to think what it was, a group called Freedom House that has laid out some criteria for governance. So there are, I think, fairly well established and hardly exceptionable criteria for performance.

Mr. DAVIS. I do not want to interrupt you now, but one thing that is conspicuous, but missing from that list, there are no real reference to the persistence of poverty in a particular country or the level of income disparity in the country in that criteria. Those seem to me to be pretty important criteria that ought to be weighed.

Secretary SNOW. Well, there are poverty criteria. This is only for poor countries. But, it is an effort to focus on poor countries, who are doing the right things and reward doing the right things.

Leaving the countries who do not meet this criteria really to USAID for support, assistance and so on. But, there is merit, I think, in this idea of rewarding the right behaviors, rewarding countries that deal for countries that are reforming themselves and dealing with the pressing issues of corruption and law and order and fiscal deficits and——

Mr. DAVIS. Well, let me try to comment a little bit, since the time is so limited.

Again, given the diversions that I think a lot of us would have or what it means to follow the right policies, why not include some people who are not President Bush's appointees on the Board of Directors of the organization?

Secretary SNOW. Well, this is an executive branch initiative. And the members of the board are the Secretary of State——

Mr. DAVIS. Would there be some utility in including outsiders from your perspective?

Secretary SNOW. I think the Administration has put forward the proposal that they think makes the most sense.

Mr. DAVIS. What about congressional input?

Secretary SNOW. We can certainly—it would certainly be a matter for discussions as we move through the legislative process. But, I do hope this will get a lot of attention in the legislative process because it is, I think, one of the most, and I mean this sincerely, innovative and potentially powerful additions to the whole enterprise of trying to lift poor countries up and doing it the right way.

The CHAIRMAN. The gentleman's time has expired.

The gentlelady from Florida, Ms. Harris?

Ms. HARRIS. Thank you, Mr. Chairman.

Welcome, Secretary. I wanted to just follow up with the gentleman from Alabama's comments on the Millennium Challenge grants. I think they are going to be an exciting program that the President has put forward, in terms of expending bilateral aid.

But, I would like to go to the Millennium Challenge Corporation itself, as well. I think under the President's proposal, the MCA Board would not only include the secretary of State and the undersecretary of Treasury and the director of OMB, but there is some discussion at this point that would also include officers of USAID.

My concern is that the accountability that would be offered by this separate corporation, the kind of opportunity that we could uniquely fund these countries and the 15 indictors that will apply to those three exciting criteria that you set forward before that really are clearly stated and accountable, measurable, factors.

I guess my concern is do you think that it will weaken the MCA autonomy if, indeed, we do bring in USAID and we do not have that kind of separation and do you think that it weakens really what the President is trying to do with regard to the Millennium Challenge Account?

Secretary SNOW. Yes, I think there is a separate and distinct role for the MCA from USAID. And I think it would confuse those roles. They are both important roles, but they are different. And this is a results oriented economic assistance and development program focused on outcomes where countries really have the wherewithal and the ability to produce good outcomes.

And the whole point here is to reward those countries that are reforming themselves and making progress. There are a number of countries who are not. And those countries who are not still deserving of support and assistance, but that is more the USAID role. And I think it confuses roles and the strength of this idea to conflate them, to bring them together.

Ms. HARRIS. One of the comments I wanted to follow up from the gentleman from Texas in terms of the Millennium Challenge Account, do you think it will be a unique opportunity for Treasury, typically you work in a multilateral fashion, now you would have the chance to work bilaterally with the Millennium Challenge Accounts.

Would that strengthen your position?

I understand this question with regard to IMF and you are going to be strengthening some of these countries with the debt level, but do you think that would be an important new role for Treasury?

Secretary SNOW. Yes, I think it would. I think it would. The Millennium Challenge Account really puts into practice for the poorer countries the very ideas that the Treasury Department has been advancing as the fundamentals for economic growth.

I think we know an awful lot more today about economic development then we knew 40 years ago when I took my first course in economic development.

We have got a track record of what works and what does not work. And, the Millennium Challenge Account will push those ideas, advance those ideas, help those countries that are using those right ideas. And I think it will hopefully accelerate the rate of their removal from poverty.

You know, the President's goal is to make great strides over the next decade in eradicating poverty. This is one of the key vehicles to do that.

Ms. HARRIS. Let me just say I think it is important because in talking with some of the heads of state that happen to come through, they are very excited about this opportunity and they are already challenging themselves, pushing to try to move those criteria. So, I think just by virtue of putting it out by way of doing that it is already achieving some good results.

Let me shift gears for just a second. With regard to Iraq, I think one of the most important issues is that the creation of a central bank and the leader is apparently on it in terms of one that prescribed international standards and it constitutes one of the main ingredients of a country's ability to achieve and maintain strong financial stability.

Would you comment on any developments regarding the creation of a strong and independent central bank in Iraq that can be capable of preserving strong currency regimes, and what role do you think the Treasury Department will play and how can Congress assist in that aspect?

Secretary SNOW. Well, I agree with you, it is absolutely essential to have a central bank and to have a well functioning central bank that controls the monetary aggregates and interest rates and so on.

Iraq has not had one for an awful, long time. The precise request to the IMF was to go in and do an assessment of the central bank practices and the requirements to put in place a well functioning central bank.

But, we also need to put in place a well functioning ministry of finance, which does not exist. We need to put in place a well functioning set of national accounts that does not exist. We need to put in place a well functioning payment system that does not exist.

So, there is a far-reaching set of things that needs to be done. But, I would agree with you that at the very center of that is having a good monetary authority.

The CHAIRMAN. The gentlelady's time has expired.

Secretary SNOW. Controlling the money supply is essential to the economic performance of any economy.

The CHAIRMAN. The gentlelady from New York, Ms. McCarthy?

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman.

Secretary, I need some—listening to all the comments from my colleagues—I just need some clarification. When you talked about it, and I think it is great that we are going to be giving 100 percent grants to the poorest countries on those that are dealing with HIV and AIDS, but I think one of the reasons that we see so many of our undeveloped countries not making it is because no one is talking about all the other diseases that are in our poorest countries.

The diseases, by the way, that are very, very easily curable. And I am hoping that we are going to be finding money through the MCA or the IDA or the World Bank because on two businesses really correlate together diseases and the poorest of the countries' poverty, those are all diseases we are losing thousands and thousands of children a year. And they lose their eyesight, they lose their hearing or they are crippled and $35 can probably cure most of them.

So, will some of the money or is the money only going—and I do not want to take any money from HIV because, obviously, that is something we have to eradicate, but we are still dealing with diseases that this country has not seen in 20 years.

Secretary SNOW. Yes, I am not an expert on those issues that you raise, but the global fund will, I understand, focus primarily on AIDS, HIV/AIDS——

Mrs. MCCARTHY OF NEW YORK. But, do you——

Secretary SNOW. But, I think TB and malaria are also noted or earmarked as diseases to be addressed.

Mrs. MCCARTHY OF NEW YORK. I think my point is that if you are going to continue to give these monies to this undeveloped countries, until you really look at it holistically you can pour all the money you want, but until you reach to the young people that survive them, they are not going to be able to be educated.

So, you are going to be dealing with poverty. In homes we have that cycle, we got to break the cycle, that is what I am saying. We are going to do it with AIDS. And I think that is terrific.

But, we actually had been dealing with these other diseases even long before AIDS was actually discovered and I think that is why the comments that were made earlier on giving money to some of these undeveloped countries for 25 to 30 years is because we have never put the two together.

A country is not going to develop unless they are healthy. And if they are not healthy they are going to stay in poverty. And if they stay in poverty, we can dump all the money we want, we have to break that chain.

So, basically, with your influence, and certainly with the Administration's influence, we would look at this together. There is a reason why some of the policies have failed. It is mainly because the people are not healthy.

Secretary SNOW. Well, I will educate myself on that subject better. My understanding today, though, is that this global fund is, as I said earlier, about equally divided among TB, malaria and AIDS.

Mrs. MCCARTHY OF NEW YORK. I think if you educate yourself, if you really look at it, any diseases and those affects. And, by the way, it is a very small cost to prevent a lot of these diseases. But, with the credits, and hopefully these countries then can put their monies into the health care system that they really need.

That is the only way we are going to see these countries develop and end this. We have done it in this country. Those countries that have developed have eradicated these diseases. And I really hope you get involved in it because it will make your job a lot easier.

Secretary SNOW. Thank you very much.

Mrs. MCCARTHY OF NEW YORK. You are welcome.

The CHAIRMAN. Mr. Feeney?

Mr. FEENEY. Thank you, Mr. Chairman.

And I wanted to first follow up on a question from the Ranking Member that he has asked before. And I actually disagree with his conclusion and I think that he has hit a key premise that I probably agree with and maybe I would describe it as a paradox of liquidity because from the borrowers perspective if you are an emerging country, an industry or a financial institution it would be nice to able to lock in a capital investment for a period of time.

The suggestion is that by driving up the risk that there will be restrictions on the outflow of capital that ultimately allowing for those restrictions is going to make the risks higher for those lenders either through fixed investments or through equitable investments in the long run, because of that higher risk is essentially regular or what I would refer to as the paradox of liquidity that you are not doing any long-term saving to the borrowing nation's institutions and enhance the risk because you made the price of capital higher and the long-term growth and prosperity lower.

Secretary SNOW. Well, I think that was my basic response with Congressman Frank that I think there is an IMF study that concludes as much. That if you make capital flows more difficult, you raise the cost of capital. And if you raise the cost of anything you have less of it.

And, if you raise the cost of capital you have to put a risk premium on it, you are going to have capital flowing in and out. And it could make it difficult to take capital out of the country, you are going to get less capital coming in. And I think it is for that reason that the IMF came down in that study arguing against those sorts of controls.

Mr. FEENEY. And, on another matter, you mentioned Lord Keynes earlier and you suggested that some people thought he was the greatest economist of the last century.

He clearly was the most important for seven or eight decades, depending on your philosophy, maybe not the greatest; but, as I understand it, what Lord Keynes suggested is that full employment in a free market economy was actually the exception or an anomaly and not the rule.

And that in times of less than full employment that it was incumbent on an aggressive government to get involved in fiscal policy such as tax cuts, or he actually preferred government spending because of the multiplier effect as he described it.

And, while that theory sort of dominated economic thought for some time, in the last 15 or 20 years, as I understand it, there has been a shift in significant economic response to that for a couple of reasons.

Number one, the multiplier effect is not as certain today in economic theory as it was. As a matter of fact, some people would argue that the multiplier effect is closer to one-to-one than six-or seven-to-one, because of the crowding out of borrowing and investment in the private sector.

And, secondly, it seems to me that increasingly free market thinkers are coming to the attitude that if you have the right set of circumstances in a market—low marginal tax rates, the rule of law, respect for property, et cetera—that solid monetary growth is probably more important than anything that you are doing on the fiscal side in an otherwise healthy free market.

And, so could we conclude that increasingly we have got economists who are basically finding that the visible hand of government does more harm than the invisible hand of the private marketplace does good?

Secretary SNOW. Well, I would have to go back and brush up on Lord Keynes, but you are absolutely right, he was concerned about something he called the liquidity trap. And the liquidity trap is this notion that whereas markets normally adjust pretty well and you get into a down-turn in the economy and prices will go down.

Interest rates might not fall low enough to secure appropriate levels of demand for capital, to assure that you had a full employment system or that you would then—he really thought you could get stuck. I think that the revolution of modern economics is to suggest that the adjustment processes really do work awfully well.

Mr. FEENEY. Well, he also——

Secretary SNOW. And concerned about getting stuck is misplaced.

Mr. FEENEY. Well, yes, because he also implied there was a paradox of thrift, the money you saved under certain circumstances, the worse it was for long-term investment and growth. And he actually implied that there was a difference long-term in the economy between savings and investment. But, as I understand it, most economists today think there is very little difference, if any, between savings and investment.

Secretary SNOW. Savings and investment equilibriate.

Mr. FEENEY. Well, I——

Secretary SNOW. And they do so through the interest rate mechanism and I think the core idea of Keynes is not widely accepted today, that economies get stuck and that the problem is excess savings. I think, because interest rates will be—will induce more investment to pick up the extra savings is sort of the standard view today, I think.

Mr. FEENEY. Well, I have one question more, but I am out of time.

The CHAIRMAN. Thank you for those thoughts.

Mr. Watt?

Mr. WATT. Thank you, Mr. Chairman.

Mr. Secretary, at the bottom of page one of your prepared statement you make a comment that I profoundly agree with when you say our first international economic priority should be getting economic policies right at home by strengthening economic growth in the United States we provide a natural impetus for global growth.

And then at the top of page-two of that same statement, you start me to worry because then you say that that is why President Bush's job and growth package is so critical, not just for the U.S. economy but for the global economy as well. And, obviously, I agree that a jobs and growth package of some kind is critical.

I would have to tell you, though, that I have not been a big, strong supporter of the concept of trickle down economics, giving substantial tax breaks to the wealthiest people. And, I am especially looking at what happened in terms of employment after the Economic Recovery Tax Act was passed July 29, 1981, the 12-month period following the passage of that we had over 2 million jobs lost.

And, then again, March 8, 2001, that was 20 years later, we passed another Economic Growth and Tax Relief Act, which followed the same kind of trickle down economic theory and since then we have had a net job loss in non-farm jobs of over 1.7 million jobs.

So, the track record that following President Bush's jobs and growth package in the United States has not been all that stellar, I would have to say. And, so I am troubled by that on the domestic front.

I am also troubled when I try to apply it to the situation in Iraq, because as I understand the reconstruction package what we are talking about in Iraq is something that we have been aspiring to in our communities right here in this country for years and years and years; that is, universal health care, universal education and quality education for all our children, the whole range of things that I have been advocating for here in this country.

And it strikes me that those things cost money and it either has to be paid for out of U.S. government tax money, or it has to be paid for out of Iraqi tax money. So, the notion that we are following the same prescription for Iraq that we are following on the domestic front is not very encouraging to me.

So, I did not mean to just give a speech, I want you to maybe help set me at ease that you cannot be saying that the policies that we have followed here have been successful, or even are being successful. And I do not see how you think they are going to be successful in Iraq. So, I have got more time, so I will give you the rest of it.

Secretary SNOW. Thank you.

The CHAIRMAN. Excuse me, the gentleman has four additional seconds.

Secretary SNOW. I will respond briefly. I am not sure I will convince you, but I will respond.

Mr. WATT. I doubt you will convince me, too, but go ahead.

Secretary SNOW. The tax relief plan or reduction plan that the Congress enacted in 2001, I think, was precisely what was called for then. I think if you had not done that, if Congress had not responded as you did, we would have found ourselves in a much deeper, much longer and much harsher recession.

Mr. WATT. More than 1.7 million jobs lost.

Secretary SNOW. I think, Congressman, in all deference, if you had not acted as you did then it would have been much, much, much worse. And I will never forget my old life as a business person, getting the numbers from the subsidiaries of the company that I worked with coming into Richmond, Virginia, and I looked at these numbers and it was a transportation company with operations in the barge line business and the trucking business and logistics and railroads and ocean shipping and ports and terminals, and it was as if our numbers and our business had fallen off a cliff.

And I called the people from the—who were responsible for these various subsidiaries and I said these numbers cannot be right. This cannot be right. Well, they were right. And they got worse.

And by the time the new Administration took office, a very significant decline was already underway and I remember going to meet with then President-elect Bush in Austin, Texas, in January and with a group of other business people and economists and academics and so on, and being asked the question: “Well, what is the state of the economy?”

And, I said, Mr. President, “You are inheriting the recession. There is no mistake about it. You are inheriting a recession.”

And, of course, the National Bureau of Economic Research, as I think dated the beginning of that recession back to that first quarter of 2001. So, think the Congress did exactly the right thing then. And I do not go back far enough to—1981 was it? That, I would have to dig out my—the facts on that one. But, I think for 2001, you did precisely what was called for. It was the right remedies, the right medicine for the time. So, I take my hat off to you.

The CHAIRMAN. The time of the gentleman has expired.

The chair will recognize himself.

Mr. Secretary, for a couple of decades in international affairs has been conjecturing around the concept of nation state bankruptcy as an analogue to individual corporate or individual bankruptcy.

And in the last half a dozen years that conjecture has—or thinking has reached a somewhat greater maturity. As we look at the circumstance in Iraq, it would seem that you had a country that was both a political and morally bankrupt regime.

But, it is also economically left the Iraqi people with a staggering amount of debt, most of which was invested in armaments or the good life of the leadership. And, so, one of the great questions as we proceed is, what is the status of the debt of the country of Iraq?

And how should it be treated?

And does the Administration want to consider looking at the possibility of nation state bankruptcy or does it only want to look at the notion of reordering or reconstituting debt? And then, what processes and procedures does the Administration have in mind?

And, frankly, from an American taxpayer point of view, if this is a very large issue, because to the degree that all Iraq assets might have to be on the table for debt repayment, that implies that the U.S. taxpayer might be supporting a transfer of wealth from our society to the Russians, the Germans or French, who hold so much of this debt. And that seems not a very credible thing from an American perspective.

There are obvious moral hazard issues, as well, but how are you thinking about this, because this is your department's principle bailiwick and it is a really critical thing to be done right.

Secretary SNOW. I agree with you, Mr. Chairman, that it is. It is an issue that I intend to put on the table with my G-7 brethren here this weekend, when we meet in France for this round of G-7 meetings.

I think it is pretty clear that the debt, while it, the debt levels of Iraq, are so high that they are not sustainable. They have not made any interest payments on that debt or principle payments for 12 or 13 years, I am told.

We are not sure just what the debt levels are, but they are going to be large. I have seen estimates of $80 billion, $90 billion to $125 billion or $130 billion. So that is a great multiple of the GDP of the country. A lot of that is arrears, is interest that has accumulated. And I think we should engage in a process to begin setting in motion, anyway, a framework for dealing with that debt.

At the last G-7 meeting, I asked that the Paris Club process be invoked to begin doing the assessments, so that the Paris Club would have a better fix on just what these debt levels are. I think my suggestion, the last G-7 meeting got well received.

And I am hopeful that we will continue those discussions. There was an agreement last time that the Paris Club framework would be assessments through the Paris Club framework would begin. I hope to see where we stand on that.

And I certainly agree with your general observation that we do not want to put the American taxpayers at risk vis-a-vis other countries, who are unwilling to be entertaining debt reductions or debt forgiveness, or postpone payments, or the rest of the options that are available to us.

The CHAIRMAN. Well, I appreciate that. I am not convinced that, policy-wise, we are as far along as we might be. But, I just want to stress that I think, from the perspective of many of us, a dramatic change in the framework of thinking about this kind of issue might well be in order at the Department of the Treasury.

Let me note that there are, I believe, two members that have not asked questions yet.

Is that right?

And I will call on them next. Congressman Frank has asked for a second set of observations, and then I would like to call—and did you want to ask anything further, Mr. Feeney?

Mr. FEENEY. Mr. Chairman, I would be pleased either way. I would love to ask questions, but not at the cost of my colleague's time. So, whatever your pleasure.

The CHAIRMAN. Okay. Fair enough, Mr. Feeney.

Let me first turn to the two members that have not asked questions.

Mrs. Waters, you are recognized.

Ms. WATERS. Well, thank you very much.

Thank you for being here, Mr. Secretary. What I am about to say I do not wish you to take it personally. I know that you have been here for a limited period of time and you may not have even had the opportunity to focus on Haiti.

I know that my colleague, our Ranking Member, has indicated that they will be submitting to you questions that were raised by Congresswoman Barbara Lee, but I want you to know I join in with Congresswoman Lee and others about deep concerns about Haiti, and I wish to use my time to focus you on Haiti as you sit here today.

I know many of my colleagues that are disgusted by the Administration's indifference to the needs of the people of Haiti and by its ongoing efforts to prevent the Inter-American Development Bank, from disbursing $145.9 million in loans previously approved for Haiti.

Haiti's a deeply impoverished country and an island just off our shores. It is the fourth poorest country in the world. Half of the population in the country earns no more than $60 a year. Haiti has an unemployment rate of about 60 percent and a literacy rate of only 45 percent.

Only 40 percent of all Haitians have access to potable water. Tuberculosis cases in Haiti are 10 times as high as those in other Latin American countries and 90 percent of all the HIV infections in the Caribbean are in Haiti.

Our own State Department has acknowledged that because "Haiti is the hemisphere's poorest country, there is a continued need for assistance to programs that increase access to education, combat environmental derogation, fight the spread of HIV/AIDS and foster the creation of legitimate business and employment opportunities. These programs can create an atmosphere conducive to building democracy and reducing illegal migration."

Yet, at somebody's urging in this Administration, the Intra-American Development Bank is denying Haiti any access to loans for the developmental assistance.

Haiti has already had $145.9 million in development loans approved by the IDB. These loans include $50 million for rural development, $22.5 million for reorganization of the health sector, $54 million for potable water and sanitation and $19.4 million for basic education programs.

Haiti also could qualify for an additional $317 million in new loans for development projects, as well as a $50 million investment sector loan. However, IDB is refusing to consider Haiti for any additional loans and has not even dispersed the loans that have been approved.

The reasons provided by the IDB and the U.S. government concerning the suspension of lending and assistance to Haiti shift from day to day. None of the purported explanations provide any justification for withholding this vitally needed aid. While the IDB and the Administration sit back and offer a new excuse each week why these loans cannot be dispersed, the people of Haiti suffer and continue to live in extreme poverty.

On March 5, 2003, I introduced H.R. 1108, the Access to Capital for Haiti's Development Act. This bill does require the United States to use its voice, vote and influence to urge the Inter-American Development Bank to immediately resume lending to Haiti, disperse all previously approved loans and assist Haiti with the payment of its existing debt and consider providing Haiti debt relief.

The Access to Capital for Haiti's Development Act would allow Haiti to build roads and infrastructure and provide basic education and health care services to the Haitian people. This bill currently has 26 co-sponsors.

The United States is now spending billions of dollars to rebuild Iraq. Earlier this month, the Congress passed a supplemental appropriation act that contained $1.7 billion to rebuild Iraq's infrastructure. That bill included funds for health care services for 13 million Iraqis and on and on and on.

It included money for Columbia, Afghanistan, Israel, Jordan, Turkey and the Eastern European countries of Poland, Hungary, the Czech Republic, Slovakia, Estonia, Latvia, Lithuania, Romania, Slovenia and Bulgaria.

How, in good conscious, can this Administration provide loans and assistance to countries all over the world while ignoring the needs of suffering Haitians so close to our border by denying Haiti loans that are so desperately needed?

What can you do?

What are you willing to do, Mr. Secretary, to ensure that the IDB will immediately resume lending to Haiti and disburse all previously approved loans?

I need your help. What can you do?

Secretary SNOW. Well, I think there is a little good news, Congressman Waters, that I just learned about recently on this score that I think is encouraging. The government of Haiti does not, at this point, have an IMF program because of these arrearages. But, an IMF team has been, I think is currently in Haiti trying to work with the government on discussions for one of these staff monitored programs, which is a prelude to getting the arrearages worked off.

I am told, and we need to confirm this, but I am told that there is now, among the staff anyway, an agreement to proceed with a staff monitored program and that will be recommended soon to Mr. Kohler, the President of the IMF.

And, that would be an important first step in trying to get these efforts advanced to help Haiti clear its arrears with the IDB, an important step. And if those arrears are cleared, of course, then they will be able to reactivate their IDB funding program, the United States intends to be helpful in this process.

And, of course, once this IDB arrears are worked off, then we can—the IDB will be in a position to begin disbursements with respect to those four pending approved IDB project loans that would be so helpful for the country. So, I think this is an encouraging note.

The CHAIRMAN. The time of the gentlelady is expired.

Ms. WATERS. Mr. Chairman, 30 seconds, please. I would like to indulge you for just 30 seconds.

The CHAIRMAN. The gentlelady has asked unanimous consent for an additional 30 seconds. Without objection.

Ms. WATERS. It is not as encouraging as you would think. This has been going on for far too long. We believe that there should be debt forgiveness and we believe that the same kind of strong program that has been put together for Iraq to assist should be done in Haiti.

And you also need to know that the Caricom countries have offered to even pay off the debt and that has not even been dealt with. So, I would like to follow up with you personally and to arrange for a meeting with me and about 15 other members of Congress who have been going back and forth to Haiti for far too long, watching this poverty and this debt so that you can help us move this process forward.

Secretary SNOW. I would be pleased to meet with you. I am told that there is bilateral donor support here for helping deal with this arrearage problem. Of course, the United States, on another score, it makes available some 50—I think it is $50 million a year through USAID.

And I think Haiti is one of only a handful, maybe 12 to 13, 14 countries eligible for assistance under the President's emergency HIV/AIDS initiative. So, but I would be very pleased to meet with you and your colleagues to discuss aid.

The CHAIRMAN. Mr. Inslee?

Ms. WATERS. Thank you.

Mr. INSLEE. Thank you, Mr. Secretary, I got here late, but I read your testimony and there was a theme running through it, I think, that I understood in talking about our international aid programs that basically events the philosophy of the Administration to encourage countries to have sound economic social policies, political policies and to try to provide carrots for those that do and I think that is probably a wise policy.

But, one of the things you mentioned is that you wanted to be on the lookout for countries that had, I think you said, had deficits and that you wanted to be somewhat judicious in that regard.

And that our current government on policies that the Administration is advocating will have a willfully inflicted deficit of hundreds of billions of dollars, depending on what day it is because they keep going up, of course.

And, not only for this year, and not only for the next year and not only for the year following that, but for decades, perhaps our lifetime.

And, to me, it is a little bit difficult it seems to me for us to be providing these incentives and this encouragement when we have a fiscal policy that is making us look at little bit like a Banana Republic at home, fiscally.

Where we are raiding the Social Security trust account occasionally, a forethought of billions of dollars, not accidentally, not out of unforeseen recessions, but willfully raiding the Social Security trust fund in order to finance the tax cuts the new Administration has added to it.

Now, the question I have is, you know, to me that is a little bit difficult to go preaching the gospel on sound fiscal policies and sound democratic traditions around the world, when we are sort of like the virtuous—almost like the virtuous, you know, the preacher of virtue gets found out that he is a big time gambler.

It is almost that bad, almost. And, it is a serious question how you are expected to go around the world instead of bringing the gospel for this sound fiscal policies home, when the current Administration is leading us into these enormous structural deficits, which I understand. At one time, I spoke the gospel we are not sound economic policy.

And, so, my question to you is how do you expect to succeed in being the saint and spreading this gospel around the world, when right here at home we are creating these structural deficits in the trillions of dollars of debt to increase the debt tax on our taxpayers at home?

Secretary SNOW. Well, Congressman, thank you for that good question.

There is a real fundamental difference here between the debt levels of the United States, which we can clearly afford, where our interest rates are the lowest in what 40 years, 45 years, compared with these developing countries, who have debt levels that are very large relative to their GDPs, and which are unable to get access to financing at low interest rates. They are paying huge country premiums to get access to capital. The U.S. deficit is never welcomed.

But it occurs at a time when the United States is dealing with a number of priorities, the war on terror, the homeland security and the need to get the economy moving again, create jobs. And we are under performing.

It is one thing to have a deficit at a time when the economy is under performing where there is no risk of crowding out capital and where there is no risk of having an adverse affect on interest rates and that is the case here today, and having deficits as we did in the 1990s, when I was quite outspoken about the deficits because then we had a growing economy. We had full employment. We had high GDP growth rates.

Mr. INSLEE. Could I ask you to——

Secretary SNOW. That environment is—now, sure I will answer it again, but it is the main environment that you have to worry about deficits, because those deficits were rising over time, and I was concerned they would distort financial markets and drive interest rates up and crowd out capital. That just cannot happen under the current circumstances.

Mr. INSLEE. I kind of want to make sure I understand your answer, because my understanding of the Administration proposals are not that we are going to have a deficit this year or during the time of war and recession or maybe next year when we have the cloud of the recession and war, but we are going to be crowding capital investment for public activities and you are going to be increasing the debt tax, which is the interest paid by American taxpayers on the federal indebtedness, not for the next year or two.

Your policies, under your numbers, create deficits for the next decade of trillions of dollars. Now, did I understand this correct that your Administration policies create deficits for years and years and years, not just during these little integral times of recession and war, but permanent deficits as long as we can see. Isn't that your proposal?

Secretary SNOW. Congressman, the deficits that we foreseen under the President's budget plan that were sent to the Congress has the deficit coming down to well below 1 percent. And I think it was Alan Greenspan testified up here not too long ago and said to you the deficits that matter are those years, those deficits in the out years that had to do with Social Security and with Medicare and those programs.

And that the United States, nothing troubling about a deficit at 2 percent of GDP. That could go on, I think he said, indefinitely and not rile up our financial markets.

So, no, I think you have misconstrued the budget plan. The budget plan has the deficit coming down nicely to well under 1 percent and that is even before you do dynamic scoring. And, of course, there is some feedback from more jobs and more capital market transactions and higher corporate profitability to the revenue stream in the United States. So, I think a realistic assessment is that in those out years, not only will this deficit be modest, but it will converge with zero.

Mr. INSLEE. Well, I appreciate it.

The CHAIRMAN. The time of the gentleman has expired.

Mr. Frank is recognized.

Mr. FRANK. Thank you. I know it is hard to keep things straight, but I have to tell you that you have mis-cited both the IMF and Alan Greenspan. In his most recent testimony, Mr. Greenspan, first of all, has consistently said that he is not in favor of net tax cuts right now adding to the deficit.

I did note that in 1995 in your article to the Richmond Times in favor of balanced budgets, which did not differentiate any of the nuances that we now have over here. They were not good deficits and bad deficits and indifferent deficits, they were all bad ones.

And you did say this is not speculation, it is the consensus of a wide range of respected economists and financial market analysts, including Federal Reserve Chairman Alan Greenspan. And I wanted to ask you when you and he had split on the issue and what point remembered.

But, you seem now to have cognitive dissidence, if you are thinking he agreed with you. When he most recently testified here he said that a recent fed study in his view made even more robust, his word, the evidence that deficits raise long-term interest rates and he, in fact, did not say that it is not a problem until we get to the Social Security situation.

In fact, I cited to him the budget charts that show under the President's budget plan the debt, the debt now, not the deficit, as a percentage of GDP would have doubled over this period. And he agreed, according to this study of the fed that would add significantly to long-term interest rates. So, I think you misunderstand Mr. Greenspan's testimony.

Secretary SNOW. Well, I do not think I do, frankly, Congressman. I think what he is talking about is deficits.

Mr. FRANK. No, excuse me, Mr. Snow, I am sorry, but you are simply wrong. I asked him a specific question about the debt, not the deficit, and particularly the OMB study did say that there was a relationship, four basis points, et cetera for one percentage of the difference in the ratio between the debt and the GDP.

And I asked him specifically about that and he said he thought that the study was right and it would have added about more than half a percentage point to long-term rates. So, it is simply wrong to say that he was not talking about debt.

Secretary SNOW. Well, I may be referencing some other testimony.

Mr. FRANK. Yes, different testimony.

Secretary SNOW. The testimony that I recall.

Mr. FRANK. No, I am not asking you about that——

Secretary SNOW. ——is testimony that——

Mr. FRANK. ——Mr. Snow, I only have five minutes.

Secretary SNOW. Okay.

Mr. FRANK. And, I advise you to read his most recent testimony because he made it very clear that he is not in favor of a tax cut that would be a net reduction in revenues at this point. He also said with regard to scoring, he would never catch up. And he did say that he thought that that relationship was quite robust.

As to the IMF, and I saw, but I gather your maximum concrete the general principles do not decide concrete cases of Holmes got overruled while I was gone, because apparently you, in later questions, told some of my colleagues that you did hold to the fact that there should never be an allowance for any kind of capital free flows.

Secretary SNOW. No I did not. I cited general principles.

Mr. FRANK. Well, let me ask you——

Secretary SNOW. It is the general principle that capital——

Mr. FRANK. ——a question then.

Secretary SNOW. ——controls are a bad idea.

Mr. FRANK. Does that mean in every case they are a bad idea, Mr. Secretary. Does that mean that—let me ask you specifically, dealing with Central America—by the way the IMF opposed the notion of capital controls as we embodied in the last two treaties.

Mr. Rogoff, the chief economist, was critical and I asked Ann Kreeger in a conversation and she said yes, the IMF did not support that—the inclusion there, probably because of the nature of—well, let me ask you this specifically for a concrete case.

Central American countries, we are not talking now about controls over capital outflows, you could write a treaty that said no controls over capital outflows. But, are you, in every case, for the United States insisting that countries do not adopt any proposals that seek to restrict very short-term capital flows of say, less than a year?

Is that our general—is that not our general position, is that the position that we will be taking?

Secretary SNOW. I am not here to utter procrustean views.

Mr. FRANK. I asking your views, forget procrustean. That is not what I am saying.

Secretary SNOW. Well, but procrustean views are views that fit——

Mr. FRANK. ——that we——

Secretary SNOW. But, I am not——

Mr. FRANK. You are not going to answer——

Secretary SNOW. ——going to articulate those sorts of views, but I think you will be—one view that fits every circumstance.

Mr. FRANK. I am asking you, not about every circumstance. I do not understand what the problem is and why you are being so evasive. I am asking you about the proposal to deal with the Central American countries, that is not every view. Is it the intention of the Administration to say to the Central American countries that they should not ever try to restrict inflows of short-term capital? That is pretty concrete.

Secretary SNOW. Yes, and I would say in response that the general principle should be not to have——

Mr. FRANK. Mr. Secretary, I am not asking you for your general principle. What game are you playing here?

You, first of all, say, "well, look, it is two general—I do not want to be procrustean."

I am asking you specifically, forget the insistence on all general principles. In this particular case, the Central American countries, which I think not well developed in every case financial situations, inflows of capital. It is a very specific question.

Secretary SNOW. And, you know, what are these bilateral negotiations all about?

They are about advancing the interests of the U.S. and the U.S. investors. And I do not think it is wise for somebody who is involved in those negotiations to answer in advance questions like the one you are advancing to me because——

Mr. FRANK. American policies, and if you——

Secretary SNOW. Well, the policy comes in the context of time which when the individual negotiations.

Mr. FRANK. I am really disappointed in your evasiveness and your refusal to give me honest answers. This is really a disappointment.

The CHAIRMAN. Mr. Feeney?

Mr. FEENEY. Thank you again for being here, Mr. Secretary. I hope that at least, at a very minimum you will look at this as great practice for some talk show host, in your new position.

Secretary SNOW. It is better than that by far.

Mr. FEENEY. Your new position will come in handy. Mr. Secretary, I am new in the federal level of policy making and it seems to me that I have been deeply disappointed over the 30 or 40-year track record of what is generally known as foreign aid.

And, I would include in that private trainable work, certainly foreign aid directly authorized by our Congress. I would include the IMF, the World Bank and other international institutions, because it occurs to me that the continued commitment to do a large amounts of foreign aid through these programs, whether it is grants or gifts or charitable work or whatever, it basically amounts to the type of hope over experience because I think we have gotten very little good long-term for our money with the exception of maybe some American contractors, you know, I cannot see any long-term benefit from our history there.

I am encouraged and at least open to the President's proposal to have incentives and what has been referred to today as carrots for companies that adopt certain fiscal and monetary policies that may, in the long run, make some good use out of the future of aid in general.

But, it occurs to me that these lessons are pretty hard and they are not very complicated.

And, as complicated as monetary and fiscal policy and economics and currency exchange rates are, the bottom line is that when a nation with absolutely no valuable resources, I can think of that is basically one huge rock that has soon poured over 99 percent of its food that has gotten them in democracy, because they are a colony of Britain that has their key trade progress for the last 40 years, thousands of miles away, is one of the first and most prosperous countries on the face of the Earth.

And, of course, I am referring to Hong Kong, that there is a lesson for Iraq and Africa and emerging nations all over the world that has not been taught and it certainly has not been learned by American and international foreign aid policies.

And I would like you to describe for me how you are going to hold accountable, not just through the new program that has been suggested by the State Department and the President, but through all foreign aid, as our Treasury Secretary, to make certain that countries, if they are going to participate, that they are very committed to the long-term of free trade, property rights, both intellectual and literal, low marginal tax rates on investment, the rule of law, transparency, with respect to dealing with government and low government expenditures as a percentage of gross domestic product.

And I would be, I guess, enthused if and only if I can be convinced that the Administration is committed to doing things that heretofore have not been part of a very thorough and very expensive set of programs.

Secretary SNOW. Congressman, it seems to me from that comment that you are really in economics, which includes an open figment as well as Lord Keynes. And maybe Mr. Metzler as well.

Mr. FEENEY. But, if I could do, all you need to do is get out the real almanac and the second highest per capita income are people that on an overpopulated rock that cannot grow any food. It is pretty dramatic stuff.

Secretary SNOW. Let me say that I am not an apologist for the performance of the institutions that have made aid available, development assistance available. I think they need to be reformed. And the Metzler Commission pointed the road. Undersecretary Taylor has added to that and the Treasury Department has been in the forefront of a really far-reaching, results-oriented, reorientation of the behaviors of the IMF and the other IFIs.

It is a results-based orientation. It is an orientation that says that large grants should not be readily made available. We should limit official finance. We should make sure we are not making the entry to moral hazard situations.

We should focus countries' behaviors, on the fundamentals of their economies you are suggesting. Do they have in place anti-corruption systems?

Do they have in place respect for private property? Do they have in place the ability for loader markets to work right?

Do they have in place policies and monetary and fiscal policies that create financial soundness?

We are very insistent, very insistent that these are the right policies and that funding should only be made available where these policies are being advanced.

And the funding should be short-term. And the objective, I will go back to what I said earlier, the objective should not perpetuate emerging countries, but to see emerging countries emerge.

Success will be when the countries do not need to go to the IMF window, but have access to the private capital markets, to get them access to the private capital markets they have to do these things that you and I discussed.

But, once they do them, then private capital will be available, and once private capital is available then the need for access to these subventions through the IFIs will be greatly reduced. That is where we ought to be pointing. I agree with you.

The CHAIRMAN. Thank you, Mr. Feeney.

This has been a very long day, Mr. Secretary, and you have put up with a lot and we are very appreciative of your stamina, as well as the difficulty of some of the philosophical issues.

I would like to end with one observation that will not require an answer. But, one of the obvious dilemmas of the Millennium Challenge Account, as thoughtful as it is, is what happens when you have a situation which one country receives benefits and another, because it does not meet any of these standards does not, but the people are in a difficult position and one can say, "Well, we will do that through AID, but AID's money is surprisingly locked up."

And anyone that thinks that AID has a lot of discretion, that is not the case. The discretionary budget will be in the Millennium Challenge Account and my only minor suggestion to you, sir, is to keep a little bit of an open mind to an imperfect country, not to give anything through the government, but through an NGO or a faith-based organization in the event of a true, true humanitarian dilemma, which could well arise in parts of the world with governments that are absolutely intolerable by any of the decent standards that this Administration or any outside group would arise.

And I only suggest that that little bit of discretion be kept in mind, not moving through governmental channels in the event that that circumstance comes to the floor.

And I do not want an answer. I just want to suggest that you think that through.

Secretary SNOW. I will and I take your point on that. It is worth pondering, I agree.

The CHAIRMAN. In any regard, we are very appreciative of your testimony today and much more importantly for the public service that you have offered this President.

Thank you very much.

Secretary SNOW. Thank you, Mr. Chairman.

[Whereupon, at 6:36 p.m., the committee was adjourned.]

A P P E N D I X

May 13, 2003

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

The Honorable John Snow
Secretary, United States Treasury Department
Annual Testimony, International Financial System and International Monetary Fund

May 13, 2003

I want to welcome my good friend John W. Snow, the Secretary of the Treasury, to the Financial Services Committee in his first appearance before our panel. This hearing is mandated by the 1999 foreign operations appropriations bill which provided an $18 billion funding increase to the IMF. We had planned on holding this hearing in early March; however the events in Iraq demanded the Secretary's attention and oversight.

The IMF plays an important role in ensuring economic stability around the world. As the largest contributor to the IMF, the United States provides this institution with over 17.5 percent of the total resources. As a result, it is critical for Congress to ensure that the taxpayer dollars spent on IMF programs are spent wisely and in accordance with the goals and objectives of the U.S. government. Today's hearing will give Members of the Committee an opportunity to learn more about the activities of the IMF and the reforms sought for this institution. Additionally, I look forward to a dialogue on the state of the international financial system in general and the Treasury Department's activities.

Mr. Secretary, we have seen the success of our military in toppling a corrupt regime that oppressed its people and threatened the security of its neighbors. Now that military activities have slowed, I am interested in learning more from you about the rebuilding of Iraq. Last month, Subcommittee Chairman King and I sent a letter to the President of the World Bank strongly urging him to commit staff and resources to the rebuilding of Iraq. I am deeply concerned that any delay in the commencement of activities in this country for purposes of gaining U.N. support could result in a missed opportunity for the people of Iraq. The World Bank and the other aid institutions must act quickly to help bring stability to this country and restore freedom and prosperity to the people of Iraq.

I understand that the Treasury has sent many technical advisors and contractors into Iraq to help restart the economy. I am very interested in learning about the status of these efforts and to what extent the IMF will participate in the development of monetary policy for the newly liberated Iraqi people.

Debt relief is an issue that we have been examining here on the Hill for many years. There are a number of proposals that have varying costs and varying amounts of empirical data on their effectiveness. The Administration has requested $75 million in additional funding for the HIPC Trust Fund. I believe that we must live up to our commitments in the HIPC program, but there seems to be a growing consensus that more debt relief will be needed in the future. Can you share with the Committee your thoughts on the HIPC

Oxley, page two

program and what additional debt relief measures you think are needed or appropriate? The Committee looks forward to working closing with you in developing an effective and workable debt relief strategy.

I would like to address the recently proposed Millennium Challenge Account. This account will direct bilateral assistance to countries that are committed to ruling justly, investing in people, and promoting economic freedom. As proposed by the President, the Secretary of the Treasury would sit as a member of the board of directors overseeing the account and would play a key role in setting the performance standards for the distribution of aid. If this board becomes the primary body in which U.S. bilateral aid policy is developed, I would be interested in hearing what role it would be expected to play in development of U.S. multilateral aid policy. It makes sense to me that U.S. bilateral and multilateral policy should be as consistent as possible.

Finally Mr. Secretary, I would like to address the development bank authorizations before this Committee. Congress appropriated $ 959 million for U.S. participation in the International Development Association, the Asian Development Fund, and the African Development Fund; however, the expenditure of those funds has not yet been authorized. In the 107th Congress, this Committee and the International Monetary Policy and Trade Subcommittee held eight hearings related to the authorization of those institutions. I want to thank you for working closely with the Committee on a bipartisan basis to formulate an authorization package for these institutions, and I look forward to finalizing a proposal soon.

Secretary Snow, welcome. I look forward to your testimony.

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May 13, 2003
Statement of the Honorable Rahm Emanuel
U.S. House of Representatives
Committee on Financial Services
Re: Testimony of the Secretary of the Treasury

Mr. Chairman, I would like to thank you for holding this important hearing on the Administration's international economic agenda and priorities. I also appreciate that our distinguished guest, Treasury Secretary John Snow, has taken the time to share his views with us on these topics.

While I am concerned about many of the topics Secretary Snow plans to discuss today, including our rebuilding efforts in Afghanistan and Iraq and our free trade efforts, I wanted to take this opportunity to focus on a critical issue I see here at home. The Internal Revenue Service recently announced plans to implement a "pre-certification" program for working Americans filing for the Earned Income Tax Credit. To date, the IRS has not consulted with the Congress or sought public comment on this proposal. Like many other Members of the House of Representatives, I hope the IRS will do so expeditiously.

As I stated in my May 6, 2003 letter to Secretary Snow, the EITC is the only benefit that makes a meaningful difference in the lives of tax filers with the lowest incomes. By any measure, the EITC has been one of the key factors in lifting millions of poor Americans out of poverty. With corporations using the tax code to distort the free market to the tune of billions of dollars a year, I am mystified as to why the Administration has focused its enforcement efforts on those who file for the EITC. Further, the estimated $100 million cost of implementing these changes could be spent far more effectively if it were directed toward reducing corporate tax abuses, such as those resulting from U.S. corporations incorporating with a mailbox in offshore tax havens, while keeping their employees and major operations here. Or these funds could be dedicated to addressing the health care crisis in America, as the Administration continues rewarding lucrative contracts for rebuilding Iraq.

The EITC stimulates local economies as it helps families. In Chicago alone, tax filers received $462.7 million in tax year 2000 through the EITC. Those dollars translate into payments for homes, cars, and education. These tax filers represent some of the hardest working members of our society. Before targeting these individuals, we should address the egregious corporate welfare provisions that riddle the tax code and bestow tax breaks and subsidies on profitable companies who need them the least.

Mr. Chairman, any EITC overpayments can be rectified in a manner that assists deserving tax filers. One solution is the Simplified Family Tax Credit, which I have proposed and is being discussed among my colleagues. I look forward to working with my colleagues in Congress and with the Administration to make the tax code more progressive, simple and family-friendly.

May 13, 2003

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Full Committee Hearing to Receive the Annual Testimony of the Secretary of the Treasury on the State of the International Financial System, IMF Reform, and Compliance with IMF Agreements

Thank you, Mr. Chairman, for holding this important hearing and Mr. Secretary, for joining us here this afternoon.

As a fellow Ohioan, allow me to take this opportunity to congratulate you on assuming the position of 73rd Secretary of the Treasury and claim you as a distinguished constituent of the Fifth District of Ohio which includes a portion of your hometown of Toledo, Ohio. I would also like to thank you for the work you are doing to promote the President's Jobs and Growth package that will provide an essential boost to our economy through much needed tax relief.

Today, I am interested to hear your prognosis on the health of the international financial system and learn more regarding the policies currently being pursued to deal with the economic ramifications of a variety of recent challenges faced by the global community. I understand the Treasury Department is playing an important role in the rebuilding of both Iraq and Afghanistan and look forward to your summary of those efforts.

I am also very interested to learn more regarding the Treasury Department's ambitious agenda to promote growth in developing countries. Many of my constituents in the Fifth District have expressed their strong support for the Administration's Millennium Challenge Account (MCA) proposal. I would appreciate any elaboration you can provide on the Treasury Department's current efforts in this regard and how you envision the MCA working within, and complementing, the current structure providing development aid.

Again, thank you Mr. Chairman for holding this hearing and I look forward to an informative session.

OPENING REMARKS OF THE HONORABLE RUBÉN HINOJOSA
HOUSE FINANCIAL SERVICES COMMITTEE
HEARING ON THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM
IMF REFORM, AND
COMPLIANCE WITH IMF AGREEMENTS
MAY 13, 2003

Chairman Oxley and Ranking Member Frank,

Thank you for calling this annual hearing to receive the testimony of Treasury Secretary John Snow on the state of the international financial system, IMF reform and compliance with IMF agreements. I look forward to his testimony and to his responses to my questions.

The Bush Administration entered office criticizing IMF loan packages for countries facing debt crises. Since then, the Administration has supported large loans for Turkey, Brazil, Uruguay, and Argentina. Former Treasury Secretary O'Neill never established a coherent policy for addressing financial crises through the IMF, and Secretary Snow has made only a few statements on the issue, emphasizing improved surveillance and transparency in crisis prevention efforts. I look forward to hearing his position on loan packages for countries facing debt crises.

I commend the Bush Administration for creating a new government entity called the Millennium Challenge Corporation (MCA), which is intended to:

- reward pro-growth policies;
- establish a true partnership in which the developing country, with full participation of its citizens, proposes its own priorities and plans; and,
- place a clear focus on results in which funds will only go to well designed programs that have clear objectives, measure baseline data, and set benchmarks for both intermediate outputs and final outcome goals.

However, this government entity and its goals remain somewhat vague. I would appreciate Secretary Snow providing more details on this program.

I have additional issues to address, but I will reserve those for the question and answer period.

Hearing on International Financial Institutions
Committee on Financial Services
Rep. Maxine Waters
Statement for the Record
May 13, 2003

I would like to thank Chairman Michael Oxley for organizing this hearing on the state of the international financial system and international financial institutions. I am also grateful to the Honorable John Snow, the Secretary of the Treasury, for his willingness to testify before the Financial Services Committee today.

Access to Credit for Haiti

I am particularly concerned about Haiti and its inability to access international credit. Haiti is the fourth poorest country in the world. Half of the population of the country earns no more than $60 per year. Haiti has an unemployment rate of about 60% and a literacy rate of only 45%. Only 40% of all Haitians have access to potable water. Tuberculosis cases in Haiti are ten times as high as those in other Latin American countries, and 90% of all HIV infections in the Caribbean are in Haiti.

The Inter-American Development Bank (IDB) is denying Haiti any access to loans for development assistance. Haiti has already had $145.9 million in development loans approved by the IDB. These loans include $50 million for rural road development, $22.5 million for reorganization of the health sector, $54 million for potable water and sanitation and $19.4 million for basic education programs. Haiti could also qualify for an additional $317 million in new loans for development projects, as well as a $50 million investment sector loan. However, the IDB is refusing to consider Haiti for any additional loans and has not even disbursed the loans that have been approved.

The reasons provided by the IDB and the U.S. government concerning the suspension of lending and assistance to Haiti shift from day to day. None of the purported explanations provide any justification for withholding this vitally needed aid. While the IDB and the Administration dither, the people of Haiti suffer and continue to live in poverty.

On March 5, 2003, I introduced **H.R. 1108, the Access to Capital for Haiti's Development Act**. This bill would require the United States to use its voice, vote and influence to urge the Inter-American Development Bank to immediately resume lending to Haiti, disperse all previously approved loans, assist Haiti with the payment of its existing debts and consider providing Haiti debt relief. The Access to Capital for Haiti's Development Act would allow Haiti to build roads and infrastructure and provide basic education and health care services to the Haitian people. This bill currently has 26 cosponsors.

I hope that the Financial Services Committee will consider H.R. 1108 or other legislation addressing the financial needs of the Haitian people, and I also hope that the Treasury Department will urge the Inter-American Development Bank to immediately resume lending to Haiti.

Deeper Debt Relief for Countries

I am also concerned about the continuing burden of international debts on many other poor countries. The Enhanced Heavily Indebted Poor Countries (HIPC) Initiative was developed in 1999 to free impoverished countries from the burden of debts and allow them to invest their resources in HIV/AIDS treatment and prevention, health care, education and poverty reduction programs.

Unfortunately, the HIPC Initiative failed to provide a lasting solution to the problem of poor country debts, because the International Monetary Fund (IMF) and the World Bank refused to provide their fair share of debt relief. While the United States agreed to cancel virtually all of the bilateral debts owed by poor countries, the IMF and the World Bank are reducing these countries' debts by less than half. At least 18 of the 26 countries that have received debt relief are still spending more money on debt payments than they are on health care.

Zambia provides an excellent illustration of why deeper debt relief is necessary. Zambia is a deeply impoverished country with a per capita income of only $330 per year. Almost 20 percent of the adult population is infected with the AIDS virus, and 650,000 children have been orphaned by AIDS. The HIV/AIDS epidemic has also ravaged the educational system by causing a shortage of trained teachers. Yet the IMF actually required Zambia to increase its annual debt service payments after its total debt stock was reduced. Moreover, Zambia still spends more than twice as much money on debt payments as it does on health care.

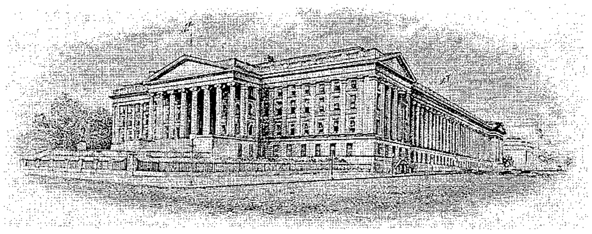
On February 5, 2003, I introduced **H.R. 643, The Debt Cancellation for the New Millennium Act**. This bill would urge the President to negotiate with the IMF and the World Bank to completely cancel 100% of the debts the world's most impoverished countries owe these institutions and give these countries a fresh start in the new millennium. This bill currently has 29 cosponsors.

I hope that the Financial Services Committee will consider legislation this year to expand the HIPC Initiative and provide complete debt cancellation to impoverished countries. It is time for the IMF and the World Bank to cancel these countries' debts once and for all.

Conclusion

I look forward to hearing the testimony of Secretary O'Neill at today's hearing, and I hope he will share his views regarding access to credit for Haiti and deeper debt relief for poor countries.

I thank the Chairman for the time.



DEPARTMENT OF THE TREASURY

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TESTIMONY OF TREASURY SECRETARY JOHN W. SNOW
BEFORE THE COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

Chairman Oxley, Representative Frank and Members of the Committee, thank you for inviting me here today to discuss the Administration's international economic agenda. I welcome the opportunity to describe where we are today on advancing that agenda and our priorities for the future.

These are challenging times for our country and for the world. Yet we must remain focused on fundamental tasks. The Administration is working to strengthen our economic recovery, expand growth, create jobs, and raise living standards for Americans. So too are we dedicated to promoting stronger global growth and improving the lives of people throughout the world. There are no easy answers to the dilemmas posed by the poverty and financial instability that persist around the globe. Nonetheless, the Administration is determined to persevere and to work with the international community to accomplish our shared goals.

Rebuilding Iraq and Afghanistan is clearly a key priority for the United States and the international community, and I want to bring you up to date on Treasury's role in the Administration's efforts in this area. I also want to focus today on vital long-standing policy objectives – promoting global growth, fostering growth and stability in emerging markets and increasing growth in developing countries. And I want to underscore the importance that the Administration attaches to the authorization requests related to the Multilateral Development Banks (MDBs) that are pending with this Committee.

Promoting Global Growth

Our first international economic priority should be getting economic policies right at home. By strengthening economic growth in the United States, we provide a natural impetus for global growth. As the world's largest economy, when we grow faster we provide a boost to the world as a whole. That is why President Bush's jobs and growth package is so critical, not just for the U.S. economy, but for the global economy as well.

I have emphasized in meetings with my colleagues from the Group of Seven (G-7) countries how President Bush's economic growth proposals will build on the proven strengths of the U.S. economy – generating jobs, encouraging savings and investment, and promoting entrepreneurship.

The United States is doing its part in contributing to a healthy global economy. But a healthy global economy needs multiple engines of growth. I have underscored that our G-7 partners must immediately take their own steps, appropriate to their own circumstances, to spur growth and contribute to global prosperity. When Finance Ministers convene this weekend in advance of the G-8 Summit, I will continue to emphasize this point.

Trade liberalization is one of the most fundamental steps that countries around the world can take together to achieve growth and reduce poverty. Spreading the benefits of free trade is a key priority for the Administration. We are pursuing this objective at a global level in the World Trade Organization, regionally through the Free Trade Area of the Americas that is being negotiated, and bilaterally through the recently signed agreement with Singapore, the recently concluded agreement with Chile, and negotiations with the Southern Africa Customs Union, Morocco, Australia and several Central American nations. Treasury is working as a key member of the inter-agency team to advance this agenda, focusing on financial sector liberalization, investment, customs issues, trade-related capacity building, and the revenue implications of tariff reduction.

Rebuilding Iraq and Afghanistan

The urgent reconstruction efforts in Iraq and Afghanistan are a primary focus of the Administration's international economic policy. To provide intensive attention to this priority, the Treasury Department has formed a task force to help address key financial and economic aspects of Iraq's reconstruction. This task force includes broad representation from US Government Agencies, including representatives of the Federal Reserve, OCC, USAID, and the State Department. In conjunction with State, the Department of Defense, and others, Treasury will be working closely with Peter McPherson, who will be the lead advisor on financial matters on the ground in Iraq. Treasury's Office of Technical Assistance already has deployed 14 advisors to the Office of Reconstruction and Humanitarian Assistance (ORHA), and additional personnel may be deployed as necessary to help staff ORHA, which is expanding in conjunction with its move to Baghdad.

Working in concert with USAID, State, and the emerging leadership of a free Iraq, Treasury will assist in the formulation and execution of financial and economic policies in post-war Iraq. We start from the premise that our role is to help the Iraqi people rather than to impose changes upon them. It will be a priority to restore essential operations of the Finance Ministry, the Central Bank, commercial banks and the stock market. Where elements of the existing system are corrupt, ineffective, or inconsistent with a market-oriented economy, Treasury will work with the Iraqi people to begin essential reform and restructuring efforts. A crucial near-term challenge will be paying civil servants, teachers, and pensioners in a fair, orderly and prompt manner – and transitioning to a wage/pension payment process under Interim Iraqi Authority control. Near-term goals include assisting the Iraqi people in the development of a fair and transparent federal budget, creation of a responsible system of regulation and supervision for financial institutions, reform of the tax and customs regimes, design of a strategy for the management of domestic and external debt, and implementation of financial fraud, anti-money laundering and anti-terrorist financing measures.

Development of a system of commercial law, founded on a base of private property rights, is an essential element of developing a market-based economy in Iraq. For this reason, we believe there are several areas in which the Iraqi people will need to focus, ranging from dealing with real estate and personal property to intellectual property rights. These will also include establishing the legal framework for corporations, the banking system, and capital markets. Given the reach of commercial law, more than just Treasury will be involved in assisting this effort; it will also include the Departments of State, Justice, Commerce, and USAID. However, each of us recognizes the importance of creating a free market economy in the country, and development of a sound framework of commercial law is key to this goal.

We also expect the international financial institutions to play an important role in supporting Iraq's reconstruction. The World Bank is already forming a team of experts to conduct a needs assessment in Iraq, which will help focus attention on assistance priorities and lay the groundwork for economic recovery and growth. The World Bank has the authority to determine when the time is appropriate to send a mission to Iraq for a field-based needs assessment. The IMF has provided general advice on the currency and monetary policy, and has also signaled that it is prepared to undertake a needs assessment at the appropriate time.

Shortly after the creation of the Interim Authority in Afghanistan in December 2001, Treasury's Office of Technical Assistance (OTA) sent an advisor to Kabul to conduct early assessments of budgetary, financial and economic conditions. OTA Budget Advisor Larry Seale has since been in Kabul for over a year working closely with Finance Minister Ashraf Ghani in establishing modern budget mechanisms in the country. Treasury consulted with the World Bank, the Asian Development Bank and the UN Development Program during their development of the Needs Assessment for Afghanistan, which was presented at the Tokyo donors' conference in January 2002. Treasury provided advice and assistance on the creation of a new, unified currency, which completely replaced the old afghani in January of this year. Under Secretary Taylor has also played a key role in marshaling international financial support for the Afghan government's day to day expenses through the World Bank-administered Afghanistan Reconstruction Trust Fund

The MDBs are providing critical support for economic reform in Afghanistan. The World Bank and the Asian Development Bank (AsDB), together with UN agencies and international donors, are working closely with the Afghan government to respond to the country's urgent reconstruction needs. Last year, the World Bank extended grants totaling \$100 million to support public administration, infrastructure, education, and public works and provided a

$108 million concessional loan in March this year to rebuild Kabul airport and a section of the "ring" road. Last year, the AsDB moved quickly to offer grants assistance on roads, energy, and capacity building and to date has provided about $40 million in grant assistance. Additionally, Afghanistan has received an Asian Development Fund post-conflict concessional loan of $150 million that is supporting urgent road building and another $150 million in concessional resources are expected to be approved for post-conflict reconstruction next month.

Fostering Growth and Stability in Emerging Markets

Financial crises in recent years have threatened the progress made by many emerging markets in improving living standards for their people. Successive crises have constrained global capital flows and helped leave growth well below its potential, hurting both emerging markets and the global economy.

The Administration's fundamental goal is to increase economic growth and stability in emerging market economies. Above all, this means providing strong support for policy reforms. The choice to reform must be made by countries themselves; ownership is vital to successful implementation.

It also means reducing the frequency of crises and improving the access of emerging market economies to private capital flows. To achieve these goals, the Administration is pursuing several key steps. First, we aim to prevent crises before they erupt -- by better understanding potential vulnerabilities and taking early action to encourage countries to correct policies. Second, we aim to reduce the spread of crises from one country to others. Third, we are working to make clear that official sector finance is limited – and not available in large sums to encourage excessive risk taking by investors or to provide an escape for policy-makers from making difficult choices. And finally, we are seeking to create a more orderly and predictable process for debt restructuring through introduction of collective action clauses in sovereign bonds.

The International Monetary Fund (IMF) plays a central role in these areas, and over the last year, we have sought to ensure that the IMF is improving its focus on each of the four objectives that I laid out above. In sum, the IMF is more transparent, more focused on its core macroeconomic mission, and more intent on anticipating events that could lead to crisis. (Greater detail on reforms is provided in Treasury's Report to Congress on Implementation of Legislative Provisions Relating to the IMF, October 2002.)

To enhance crisis prevention and limit contagion, we have worked with the IMF to continue to strengthen its surveillance of economic conditions and performance in member economies. In this context it is gratifying to see private markets increasingly discriminating on the basis of the credit quality of individual emerging markets. We strongly support ongoing work at the IMF to enhance its analyses of member economies, by focusing on core issues that are vital to macroeconomic performance and by ensuring that its analysis and advice are of high quality, objective and useful. This includes: paying closer attention to key areas of potential vulnerability; more effectively assessing debt sustainability; and zeroing in on potential weaknesses in regulatory frameworks and steps needed to strengthen national financial systems and financial sector performance.

Providing better information to the public is key to crisis prevention. The IMF cannot contribute in this respect if the results of its analyses are not widely available. IMF analyses are already much more widely available to the public, helping countries differentiate themselves to the community of investors and thus helping protect against unwarranted contagion. The Administration continues to press for more routine publication of IMF analyses, and we strongly support ongoing IMF work with countries to improve compliance with standards and codes and publish the results, which will enhance the information available to foreign and domestic investors.

To further strengthen incentives for strong policies and prudent risk-taking, the United States has sought to make clear the limits on official finance, both through our actions in tackling recent crises and through introduction of new constraints on the financial support that can be provided in future cases. The Administration has emphasized and will continue to insist that the IMF must be the key source of emergency support in the face of financial crises. Where exceptional, large scale financing is needed from the IMF, it should be provided on shorter terms and at higher interest rates than normal IMF lending. Within the IMF, we have worked to strengthen the requirements for access to exceptional amounts of financing, so that IMF support in all but the most extreme cases falls below specific, pre-set levels. The Administration gained the support of other members for this approach in February, when the IMF approved procedural changes that, among other things, will require the IMF to prepare a separate report with detailed justification for any exceptional access request.

Creating a more orderly and predictable process for debt restructuring has been a particular priority in recent months. More broadly, there has been a wide ranging debate in the international community about the potential for a centralized sovereign debt restructuring mechanism analogous to a bankruptcy court. Given the reactions of markets and emerging market countries, however, it is the United States' strong view that collective action clauses offer a more practical vehicle. There can at times be "collective action" problems that prevent a prompt, orderly resolution of a sovereign debt crisis. The source of these problems lies in the relationships and agreements of debtors and their creditors. It is these parties, not an international organization, who must assume responsibility for the solution.

The United States continues to work in the IMF to strengthen the crisis resolution framework through broad voluntary approaches. We have seen excellent progress made in developing and incorporating collective action clauses in external sovereign bond contracts. Mexico has shown strong leadership in issuing several bonds that include such clauses and committing to include such clauses in all new external bond issues. Brazil and South Africa have also had success with a global bond issue including such clauses. We urge other market borrowers to follow this example. We have been working with the IMF on how best to promote more widespread inclusion of collective action clauses and enhanced transparency and disclosure. Emerging markets countries that regularly access international financial markets need to assume rightful ownership of these issues and help assure a more stable and orderly international financial system.

Increasing Growth in Developing Countries

The persistence of poverty is one of the most difficult challenges the world faces. Yet we are committed to tackling it. The Administration's strategy in developing countries centers on increasing productivity growth, thereby raising living standards and reducing poverty. Creating economic opportunities is vital not only to the daily lives of individuals and the economic development of their countries but also to stability for all of the world's citizens.

The President's commitment to tackling poverty is exemplified by his proposed Millennium Challenge Account (MCA), which represents a tremendous innovation in the delivery of development assistance. The MCA brings together the lessons we have learned about development over the past 50 years: 1) Aid is more likely to result in successful sustainable economic development in countries that are pursuing sound political, economic and social policies. 2) Development plans formulated by a broad range of stakeholders engender country ownership and are more likely to succeed. 3) Integrating monitoring and evaluation into the design of activities ensures that aid is going where it's most effective.

President Bush's vision of the MCA recognizes the importance of each of these lessons. First, it rewards pro-growth policies. President Bush categorizes these policies as ruling justly, investing in people and encouraging economic freedom. These policies benefit developing countries by increasing growth, creating an environment conducive to foreign and domestic investment, and making development assistance more effective. The MCA provides a strong incentive for countries to adopt these good policies. Second, the MCA establishes a true partnership in which the developing country, with full participation of its citizens, proposes its own priorities and plans. Finally, the MCA will place a clear focus on results. Funds will only go to well designed programs that have clear objectives, measure baseline data, and set benchmarks for both intermediate outputs and final outcome goals.

The MCA's targeted mission reaffirms our development objectives and contributes to an integrated strategy for achieving them. The MCA will focus on spurring growth in the subset of developing countries that have policies in place to use such assistance most effectively to achieve lasting results. USAID, State, and other agencies will continue to deliver humanitarian and regional assistance, to address complex emergencies, and to work with failed and failing states, all issues critical to U.S. national interests. USAID will also work with countries that are MCA "near misses" to encourage them to achieve the development-readiness essential for receiving assistance under the MCA.

Over the past few years, the international community has worked at creating a set of development goals. These goals include such ambitious targets as halving by the year 2015 the proportion of people whose income is less than one dollar a day. Last year, President Bush added another ambitious goal – "we ought to double the size of the world's poorest economies within a decade." Such goals will require developing countries to take vital policy steps to increase economic growth rates. They will also require a serious commitment by the donor community and the multilateral development institutions. If these ambitious goals are met, we can add another target that we should all want to achieve, and that is for the development institutions – bilateral and multilateral -- to start working themselves out of business. While it may seem like a strange measure of success – think about it – such an achievement would mean that countries are relying on investment, private capital, and entrepreneurship instead of pledges, concessions, and debt relief. It would mean that the people of developing countries will have governments that deliver basic services and provide for the rule of law; it will mean that they will have a chance to better their lives and see their children educated; and it will mean that they will know freedom and human dignity.

This is a very ambitious and forward-looking goal. But President Bush has already taken the initiative to begin working toward it. He set out a new economic growth agenda for the multilateral development banks that focuses these institutions on raising productivity growth and measurable results by channeling more funds to countries that follow pro-growth policies, and by structuring our contributions to create incentives for specific outcomes. He called on the development banks to increase the use of grants, rather than loans, to the poorest countries, and the banks are already responding to this call.

Raising productivity growth depends on developing the private sector in individual countries, including by expanding small businesses' access to credit. The MDBs can play a useful role in advancing this goal. In particular, the U.S. has proposed that the International Finance Corporation (IFC) – the private-sector arm of the World Bank Group – work with the International Development Association (IDA) to promote lending by financial sector institutions to small and medium-sized enterprises (SMEs) in Africa. This is intended to build on a number of successful programs already in place in some of the MDBs for SMEs, including those at the European Bank for Reconstruction and Development (EBRD) for Russia and Eastern Europe. The IFC and IDA are now developing this program for African SMEs.

Producing measurable results requires fundamental changes in operating style. As a first step, systems must be put in place to measure outcomes and facilitate accountability. To drive this change, the U.S. will make results-based contributions to the most recent replenishment of IDA, the flagship of development assistance institutions. The U.S. has proposed to provide an additional $300 million in contributions if IDA produces a results measurement system, expands essential diagnostics and achieves progress toward concrete health, education and private sector goals. A similar results-based mechanism was established for the Global Environment Facility (GEF), with the final $70 million of our contribution tied to the GEF's achieving specified, quantifiable program goals.

The U.S. has also persuaded the MDBs to begin increasing the use of grants, instead of loans, to fund priority development activities in the poorest and least creditworthy countries. Grants help poor countries make productive investments without saddling them with ever larger debt burdens. Recipients perceive grants to be more valuable than loans, permitting higher performance hurdles and thus enhancing development effectiveness and results. With strong U.S. urging, both the World Bank's concessional window – IDA – and the African

Development Fund have agreed to increase sharply the share of resources provided in the form of grants to the poorest countries, so that 18-21 percent of total assistance over the next three years will be provided in grant form. The poorest countries are eligible for 100% grant financing for efforts to counter HIV/AIDS. Donors likewise committed to increase grants in the International Fund for Agricultural Development to 10 percent of total assistance. This year we will seek to expand the use of grants at other MDBs, particularly the Asian Development Bank through its facility for the poorest countries, the Asian Development Fund.

I strongly believe that U.S. participation in the MDBs is vital to achieving the goals of increased growth and improved living standards in the developing world. I look forward to working with this Committee and the Congress, to help make the MDBs strong and effective institutions. In this context, I want to underscore the importance we attach to transparency in the operations of the MDBs. The United States has long been a leading force for increased openness in these institutions, and the Administration will continue to press strongly for greater openness. For example, we are working to ensure that all the MDBs put in place transparent systems for allocating resources to countries that can use them effectively.

Authorization Requests

As part of this year's budget, the Administration is seeking authorization for additional commitments to the HIPC Trust Fund. The HIPC authorization request supports the U.S. contribution for its share of additional HIPC financing agreed to by the President and other G-7 leaders. We appreciate recent passage by the House of Representatives of legislation (HR 254) to help implement the President's proposals to reform the North American Development Bank and Border Environment Cooperation Commission, and are working with the Senate to achieve enactment as soon as possible.

In addition, Treasury has resubmitted requests for Congressional authorization for U.S. contributions to most recent replenishments of IDA, the African Development Fund, and the Asian Development Fund. Each of these funds provides critical development assistance to the poorest and most vulnerable peoples of the world. In early 2001, President Bush requested the authorization for the seventh replenishment of the Asian Development Fund (ADF-8). In early 2002, he further requested the authorization for the thirteenth replenishments of IDA and the ninth replenishment of the African Development Fund (AfDF-9). Most recently, the FY 2003 Consolidated Appropriations Resolution appropriated related funds but did not include authorization legislation for U.S. participation in these replenishments. This situation is undermining United States reform-minded institutional leadership. If it continues, it also will threaten to slow the provision of critical assistance to the poorest countries and peoples in Africa, Asia and Latin America. Without the U.S. contribution to IDA-13, IDA will not have enough resources to make its normal lending and grant targets for its 2004 fiscal year, which begins on July 1, 2003.

As Treasury Secretary, I believe that it is critical that the Congress pass authorization legislation for U.S. participation in these replenishments as soon as possible. I look forward to working with you and other members of Congress in achieving this end.

Legislative Mandates and Reports

Finally, I would like to raise, as I did with your colleagues on the Appropriations Committee two weeks ago, the issue of legislative mandates. Currently, Treasury carries out an extremely large number of specific legislative mandates relating to U.S. participation in the international financial institutions that have built-up over time. Some mandates go back 50 years. Some provisions overlap, or are inconsistent. There are 37 directed vote mandates and over 100 policy mandates, plus numerous reporting, certification and modification mandates. The proliferation of these legislative mandates can be confusing and counterproductive to U.S. efforts to develop international economic policy and to implement it effectively in these institutions. The U.S. Government's ability to influence other shareholders and the institutions themselves could be enhanced by consolidation of these mandates. I would like to work with you to rationalize and focus our mandated reports and requirements, so that Treasury can work as effectively as possible in pursuit of U.S. policy goals.

Conclusion

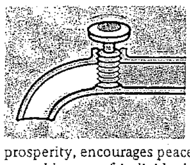
I appreciate this opportunity to review the Administration's international economic agenda – our recent achievements and our ambitions going forward. I look forward to continuing to work with this Committee and the rest of the Congress on the important goals of promoting growth and improving lives both in the United States and beyond.

Thank you. I welcome your questions.

Global finance

A place for capital controls

For many developing countries, unrestricted inflows of capital are an avoidable danger



IF ANY cause commands the unswerving support of *The Economist*, it is that of liberal trade. For as long as it has existed, this newspaper has championed freedom of commerce across borders. Liberal trade, we have always argued, advances prosperity, encourages peace among nations and is an indispensable part of individual liberty. It seems natural to suppose that what goes for trade in goods must go for trade in capital, in which case capital controls would offend us as violently as, say, an import quota on bananas. The issues have much in common, but they are not the same. Untidy as it may be, economic liberals should acknowledge that capital controls—of a certain restricted sort, and in certain cases—have a role.

Why is trade in capital different from trade in goods? For two main reasons. First, international markets in capital are prone to error, whereas international markets in goods are not. Second, the punishment for big financial mistakes can be draconian, and tends to hurt innocent bystanders as much as borrowers and lenders. Recent decades, and the 1990s most of all, drove these points home with terrible clarity. Great tides of foreign capital surged into East Asia and Latin America, and then abruptly reversed. At a moment's notice, hitherto-successful economies were plunged deep into recession.

These experiences served only to underline the lesson of previous financial debacles. Yet it is a lesson that governments remain decidedly reluctant to learn. Big inflows of foreign capital present developing countries with a nearly irresistible opportunity to accelerate their economic development. Where those flows are of foreign direct investment, they are all to the good. But in other cases, disaster beckons unless a series of demanding preconditions are met first (see our survey of global finance, after page 50). A flood of capital into an economy with immature and poorly regulated financial institutions can do more harm than good.

Unquestionably, developing countries should strive to improve their financial systems so that foreign capital can be successfully absorbed. Good government, sophisticated financial firms, and regulators who are honest and competent cannot eliminate the risk of financial calamity altogether, but they can reduce it to bearable proportions. At that point a liberal regime for international capital makes sense. The trouble is, many developing countries are nowhere near that point.

Rich-country governments and, until recently, the International Monetary Fund have often seemed reluctant to endorse this notion. One might say the same of *The Economist*. This reluctance is defensible. Often, indeed typically, governments have abused capital controls in ways that oppress their citizens and do grave economic harm. It seems safer to frown on any and all controls—and, in those cases where they have been used intelligently and successfully, to acknowledge any success very grudgingly. But this is dishonest. It is better to face up to the case for such rules in some circumstances, and think hard about how to use them sensibly, with restraint.

In from the cold

Experience suggests some rules. Refrain from blocking capital outflows (tempting as this might be at times of crisis). Such measures are usually oppressive, and deter future inflows of all kinds. Poor countries need all the foreign direct investment they can get: let inflows of FDI be unconfined. Other long-term inflows also pose little threat to stability. The chief danger lies with heavy inflows of short-term capital, bank lending above all. These can be difficult to stem, but many developing countries would do well to emulate the successful experience of Chile, which has imposed taxes on such inflows, with the rate of tax varying according to the holding period.

In negotiating new free-trade arrangements with Chile (and with Singapore), the United States has recently sought assurances of complete capital-account liberalisation. Bitter experience suggests that such demands are a mistake. It is past time to revise economic orthodoxy on this subject. ■

QFRs from Rep. Hinojosa

Treasury released the final Section 326 regulations of the USA PATRIOT Act, which is neutral on the issue of *matricula* cards. What is your opinion of these cards, and how do you view the attempt made in the International Relations Committee to ban them?

Response:

Treasury and other financial regulators require financial institutions to have policies and procedures in place to verify the identity of their customers. We do not prescribe any specific, one-size fits-all approach. Nor do we publish views on particular forms of identification. Rather, our approach has been to place the obligation for developing specific policies and procedures on the financial institutions themselves. The regulators then examine financial institutions to ensure that the policies and procedures are adequate to satisfy the institutions' obligation to verify the identity of their customers.

In keeping with this approach, Treasury and the other financial regulators have not opined on the merits or demerits of the *matricula* cards or on other forms of identification. Similarly, we have not opined on any other particular form of government issued photo identification, whether it be the driver's license of a particular state, the passport of a particular government, or other similar forms of identification.

With respect to the *matricula* cards, as with any other form of identification, financial institutions must assess the risks associated with accepting any particular form of identification and take appropriate steps to minimize those risks.

3. Although the hearing is not on the Fair Credit Reporting Act, Assistant Secretary Wayne Abernathy appeared before the Financial Institutions Subcommittee last week on the FCRA, talking about identity theft but not definitively embracing or rejecting the extension of the federal FCRA preemptions, which expire at the end of this year. In addition, earlier this year at a conference of America's Community Bankers you referred to extending FCRA and said that, "It's awfully important that we get this done and we have a national standard." Are you close to making that official Administration policy? When do you anticipate the Administration will make a decision on FCRA? Could you share with this Committee the other issues that you are considering in connection with the FCRA preemption?

Response:

As Assistant Secretary Abernathy testified, we believe that changes to the Fair Credit Reporting Act (FCRA) should, in a balanced way, promote consumers' interests in improving access to credit and other financial services and strengthening the security and accuracy of their personal financial information. The Administration is working on developing a unified position on what changes should be made to the FCRA to promote these interests. We expect that this work will be completed over the next several weeks. At that time, we would be pleased to share any specific proposals that are developed.

4. I would like to inquire about the competitiveness of the U.S. credit markets and the U.S. economy versus other countries as a result of the uniform national credit reporting system. Are consumers abroad paying higher rates for home loans? Will foreign economies be able to sustain consumer spending as did the U.S. during an economic downturn by affordable access to credit [and] mortgage refinancings without a national credit reporting system?

Response:

International differences in home loan rates and the sustainability of consumer spending during periods of slow or negative economic growth are attributable to many factors. There is evidence, however, that consumers in countries with national credit reporting systems that include both positive and negative data benefit in ways that consumers in countries with more restrictive credit reporting systems do not. For example, consumers in countries with national, comprehensive credit reporting systems appear to have broader access to credit at lower cost than do consumers in countries with more restrictive credit information systems. *See, e.g.,* Michael E. Staten and Fred H. Cate, "The Impact of National Credit Reporting Under the Fair Credit Reporting Act: The Risk of New Restrictions and State Regulation," (2003). Other things being equal, therefore, a national, comprehensive credit reporting system should help sustain consumer spending during times of slow or negative economic growth.

5. Given the fact that 60% of the small business and agricultural loans in this country are provided by community banks, and given the extremely high percentage of the U.S. export market that is generated by small businesses and the agricultural sector, has the Treasury any plans to assess the current health and status of community banks? Such an assessment was required as part of HR 1151 because of the concern that HR 1151 would have on community banking – and that assessment was never completed. Now the full impact of Gramm-Leach-Bliley on all segments of the financial services industry can be determined, would this not be an opportune time to assess the health and future of community banking?

Response:

Section 109 of the Gramm-Leach-Bliley Act (Act) directs the Secretary of the Treasury, in consultation with the Federal banking agencies, to study the extent to which credit is being provided to and for small businesses and farms, as a result of the Act and the amendments made by the Act, and to report to Congress by November 11, 2004 with such recommendations as the Secretary determines to be appropriate for legislative or administrative action. The Treasury Department plans to fulfill this requirement but has no other plans at this time to assess the health and future of community banking. Section 403 of the Credit Union Membership Access Act of 1998 (H.R. 1151) directed the Treasury Department to report to Congress on, among other matters, any recommendations the Secretary deemed appropriate to preserve growth and viability of small banks. In fulfillment of that requirement, the Treasury submitted a report on January 18, 2001, to the House Committee on Financial Services, Comparing Credit Unions with Other Depository Institutions, which highlighted some of the ways in which the previous Administration implemented policies promoting the growth and viability of small banks.

Response to Question from Congresswoman Barbara Lee

Under the leadership of President Bush and the Congress, I am pleased that the United States is leading the world in fighting HIV/AIDS abroad. The new Leadership Against HIV/AIDS, Tuberculosis, and Malaria Act of 2003 (Pub. Law No. 108-25) will provide $15 billion over five years to fight HIV/AIDS abroad.

The United States has been taking other steps to help in the fight against HIV/AIDS. Due to U.S. leadership in the International Development Association (IDA) 13th Replenishment Negotiations (IDA-13), the World Bank has now introduced grants as a substantial portion of IDA's assistance. As part of the implementation of this new grants initiative, HIV/AIDS projects in IDA-only countries (the poorest, most vulnerable countries) are now 100 percent grant-funded. In addition, IDA is now providing poor, highly debt-vulnerable IDA-only countries with about 30% of their overall IDA allocation in the form of grants – helping to avoid a recurrence of debt problems in the future.

To take care of the debt problems of the past, this Administration and the last one have implemented the enhanced HIPC debt relief initiative. Over the last three years, this initiative has provided debt reduction of more than $41 billion to 26 countries. Overall debt relief for these countries, including from traditional mechanisms and additional bilateral relief provided by the U.S. and some other creditors, will reduce their debt by about two-thirds in aggregate. Over the next five years, total debt service savings for these countries will average $1.3 billion, allowing increased expenditures for economic growth and poverty reduction, including the fight against HIV/AIDS. In addition to debt reduction and more grants, the HIPCs will need strong performance on economic policies, and prudent debt management policies, in order to have an opportunity at achieving achieve debt sustainability.

The HIPC initiative, however, is still not finished and has a financing shortfall. In addition to forgiving 100% of credits owed to the United States, we have contributed $600 million to the HIPC Trust Fund, which has helped leverage about $2 billion from other creditors. However, additional contributions of at least $650 million are still needed. Therefore, the Administration has pledged an additional contribution of $150 million to the HIPC Trust Fund, and is seeking appropriations for $75 million for this purpose in FY 2004. The Administration is also seeking $300 million in FY 2004 for the cost of bilateral debt cancellation for the Democratic Republic of the Congo, which is expected to be the 27th country to receive debt relief under HIPC.

Questions from Congressman Paul to Secretary Snow

Question 1: Are there any plans to use the Exchange Stabilization Funds to aid other countries in exchange for their cooperation with American foreign policy goals or as a source of funds to assist in the reconstruction of Iraq? Please provide my office with any estimates of the potential costs to the taxpayer of using the Exchange Stabilization Fund in this manner.

Answer:

The Administration has no plans to use the Exchange Stabilization Fund for this purpose.

Question 2: Would you support legislation requiring the federal government to obtain congressional permission before intervening in the gold market?

Answer:

The Secretary of the Treasury has authority under the Gold Reserve Act to intervene in the gold market. The United States has not operated in the gold bullion market since 1979, when there were some gold sales to help reduce the U.S. current account deficit. Treasury does not believe that new legislation is warranted.

Question 3 : Would you support efforts to modify Article 4, section 2b of the International Monetary Fund (IMF)'s Articles of Agreement, which prohibit IMF member nations from linking their currencies to gold?

Answer:

The official abandonment of gold's role in the international monetary system, as confirmed in the Second Amendment to the IMF's Articles of Agreement, reflected a growing consensus in the international community in favor of a mixed system with major currencies floating and some other currencies being pegged (other than to gold). This amendment was approved by an overwhelming majority of the Fund's membership, including by the United States in 1978. U.S. monetary authorities continue to hold the view that, on balance, a flexible system of exchange rates is more conducive to U.S. and global economic growth and price stability than is a system based upon a fixed price for gold. Consequently, I do not believe there is a compelling rationale to seek amendment of the IMF Articles to permit countries to link the value of their currencies to the value of gold.

Question 4: The shrimping industry, which is very important to the Gulf Coast region of my district, in a crisis caused by government regulation. I have introduced legislation, the Shrimp Financing Fairness Act (HR 155), which would reduce America's contributions to the IMF by the same percentage with which the IMF provides aid to the major foreign competitors of the domestic shrimping industry. The bill also forbids these countries from receiving Overseas Private Investment Cooperation (OPIC) funding. Do you have any comments on the efficiency and morality of forcing American businesses and workers in struggling industries to subsidize their competitors through taxpayer-funded institutions like OPIC and the IMF?

Answer:

The IMF provides financial support to countries experiencing balance of payments problems, conditioned on market-oriented reforms that among other things aim to promote free trade. The IMF does not provide direct assistance to any industry. The United States will continue to encourage Fund support for market-oriented reform. I do not believe it would be desirable for the U.S. to oppose IMF assistance to all countries with which we might compete. This would diminish the Fund's ability to respond to potential crises in other countries and to promote stability and growth in the global economy -- with negative repercussions for U.S. producers and consumers.

As for OPIC, the Administration believes that it makes an important contribution to promoting economic development and U.S. foreign policy goals by mobilizing private sector capital in developing countries - all at no net cost to the taxpayer. Restricting OPIC programs would be counter to U.S. foreign policy and economic interests. Furthermore, OPIC reports that it is very sensitive to the importance of not harming sensitive U.S. industries. I understand that OPIC conducts an economic analysis on each project proposal to determine that the project does not have a significant negative effect on U.S. employment. By statute OPIC cannot support a project that will significantly reduce U.S. employment. Since 1990, OPIC has supported only two shrimp projects, both of which are in Ecuador, a less developed country for which OPIC's statute prescribes preferential consideration. For the two projects in Ecuador, combined average annual sales account for only 0.06 percent of U.S. shrimp imports. Therefore, OPIC believes the projects have an even smaller percentage impact on U.S. demand. I understand that OPIC will not support any future shrimp project if the agency believes the project would have a negative impact on U.S. shrimp producers.

Question 5: My office has been informed that as part of the Treasury Department's anti-counterfeiting efforts, the Treasury is working with the manufacturers of printers to install technology that would automatically shut down printers when someone tries to download an image of United States Currency. Could you please provide my office with information regarding this proposal?

Answer:

The United States Government is working with industry to incorporate screening features in the currency that prevent it from being reproduced. For security reasons, we do not discuss the details of these features.

Question 6: Would you please provide my office with any detailed information regarding the proposal to establish a new currency, banking system, and financial system for Iraq? In particular, I am interested in any proposals to dollarize the Iraq monetary system.

Answer:

Regarding Iraq and currency issues, one of our most important objectives in the near-term is to promote the establishment of a stable, unified national currency. A unified currency system is essential for Iraq's long-run economic prospects. Several options exist for currency reform, including the introduction of a new currency or the replacement of Iraqi (or "Saddam") dinar with the Old Iraqi (or "Swiss") dinar. We stand ready to assist in the implementation of whichever option the people of Iraq choose through a representative, elected Iraqi government.

We have been making emergency and salary payments to government workers and pensioners in dollars on an interim basis. This was not an attempt to dollarize the economy. On the contrary, the plan called for the continued use of dinars as an acceptable means of payment. Using dollars on an interim basis would create stability immediately after the war, as the dollar is a stable medium of exchange and a good store of value. By making sure that the spending on salaries was matched by the revenues available, the dollar payment plan also was a way to prevent inflationary financing.

Regarding Iraq's banking system, we are still in the early stages of making an assessment. Security concerns and post-war looting destroyed many bank premises, making assessments challenging. We know, however, that Iraqi banks were oriented much more toward the fulfillment of Ba'athist political objectives than toward financial intermediation and other economic services that one normally associates with banks. Essentially, Iraqi banks were vehicles for storing and moving cash around the country, and in some cases outside the country.

Our overarching objective in this area is to help Iraq restore its banking sector and ensure that it begins to function in a commercially viable way. We want Iraq's banking sector to be a vehicle for sound economic growth, to meet the needs of the Iraqi people, and to reflect regional as well as international best practices. We are also working with the Iraqis to help them create a sound supervisory and regulatory regime, a critical step to establishing a sound financial system.

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