AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

MAY 17, 2006

Printed for the use of the Committee on Financial Services

Serial No. 109–92

U.S. GOVERNMENT PRINTING OFFICE

31–038 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

MICHAEL G. OXLEY, Ohio, *Chairman*

JAMES A. LEACH, Iowa
RICHARD H. BAKER, Louisiana
DEBORAH PRYCE, Ohio
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
ROBERT W. NEY, Ohio
SUE W. KELLY, New York, *Vice Chair*
RON PAUL, Texas
PAUL E. GILLMOR, Ohio
JIM RYUN, Kansas
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
JUDY BIGGERT, Illinois
CHRISTOPHER SHAYS, Connecticut
VITO FOSSELLA, New York
GARY G. MILLER, California
PATRICK J. TIBERI, Ohio
MARK R. KENNEDY, Minnesota
TOM FEENEY, Florida
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
GINNY BROWN-WAITE, Florida
J. GRESHAM BARRETT, South Carolina
KATHERINE HARRIS, Florida
RICK RENZI, Arizona
JIM GERLACH, Pennsylvania
STEVAN PEARCE, New Mexico
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
MICHAEL G. FITZPATRICK, Pennsylvania
GEOFF DAVIS, Kentucky
PATRICK T. MCHENRY, North Carolina
JOHN CAMPBELL, California

BARNEY FRANK, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
BARBARA LEE, California
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
HAROLD E. FORD, JR., Tennessee
RUBÉN HINOJOSA, Texas
JOSEPH CROWLEY, New York
WM. LACY CLAY, Missouri
STEVE ISRAEL, New York
CAROLYN MCCARTHY, New York
JOE BACA, California
JIM MATHESON, Utah
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
ARTUR DAVIS, Alabama
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
DEBBIE WASSERMAN SCHULTZ, Florida
GWEN MOORE, Wisconsin,

BERNARD SANDERS, Vermont

ROBERT U. FOSTER, III, *Staff Director*

CONTENTS

	Page
Hearing held on:	
May 17, 2006	1
Appendix:	
May 17, 2006	39

WITNESSES

WEDNESDAY, MAY 17, 2006

Snow, Hon. John W., Secretary, U.S. Department of the Treasury	7

APPENDIX

Prepared statements:	
Oxley, Hon. Michael G.	40
Baca, Hon. Joe	43
Waters, Hon. Maxine	44
Snow, Hon. John W.	47

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Hinojosa, Hon. Ruben:	
Letter from Timothy D. Adams, Under Secretary for International Affairs, U.S. Department of the Treasury	54
Moore, Hon. Dennis:	
A Message From the Secretary of the Treasury	55

THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM

Wednesday, May 17, 2006

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:09 a.m., in room 2128, Rayburn House Office Building, Hon. Michael G. Oxley [chairman of the committee] presiding.

Present: Representatives Oxley, Leach, Bachus, Castle, Royce, Ney, Kelly, Paul, Gillmor, Miller of California, Kennedy, Hensarling, Garrett, Pearce, Neugebauer, McHenry, Campbell, Frank, Waters, Maloney, Watt, Carson, Sherman, Lee, Moore of Kansas, Capuano, Hinojosa, Crowley, Clay, McCarthy, Baca, Lynch, Scott, Davis of Alabama, and Green.

The CHAIRMAN. The committee will come to order. Pursuant to rule 3(f)2 of the Rules of the Committee on Financial Services for the 109th Congress, the Chair announces that he will limit recognition for opening statements to the Chair and ranking minority member of the Full Committee and the chair and ranking minority member of the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology or their respective designees to a period not to exceed 16 minutes, evenly divided between the majority and the minority. The prepared statements of all members will be included in the record.

The Chair recognizes himself for an opening statement. Today the Financial Services Committee meets to hear the annual report of the Secretary of the Treasury on reform of the International Monetary Fund and the state of the international financial system. This hearing is mandated by the Fiscal Year 1999 Foreign Operations Appropriations Bill which sought to ensure that the IMF would effectively use the funds appropriated to it on behalf of the United States. Congress included that requirement at the request of Representative Mike Castle, the senior member of this committee.

I look forward to your testimony, Secretary Snow. I am pleased to see you here today back before the committee and I thank you for serving our country so well.

Certainly our strong and growing economy is in part a testament to the steady hand that you have had at the Treasury Department.

The traditional focus of the Secretary's testimony at this hearing is on reform of the international financial institutions. This has been a longstanding priority for the Bush Administration and the President's Fiscal Year 2007 budget request for Treasury inter-

national programs reflects a continued commitment to these reforms. Despite foreign policy challenges abroad, the President has maintained that he will remain committed to ensuring the multilateral development banks work toward relieving the burden of unsustainable debt for countries with sound pro-growth economic policies.

I have always believed that free trade and growth through exports are the fundamental building blocks for economic prosperity and democracy both here and abroad.

The Treasury Department supported the establishment of programs aimed at creating market-based economies that are open to trade. I am encouraged by the work of the World Bank president in eliminating corruption and promoting a level playing field to international lending institutions.

Level playing fields are vital to fair and free trade. With that in mind, I am particularly looking forward to Secretary Snow's comments on last week's report to Congress on international economic and exchange rate policies. After years of ignoring free market principles, the Chinese have evidently begun to relax the hold over their currency. In the past, this currency control has created unfair advantages for Chinese exporters, all too often at the expense of American business.

Since the middle of last year, however, China has instituted a 2.1 percent reevaluation of their currency against the dollar, and has introduced various regulatory measures to free up capital flows across its borders. The Treasury report noted that China needs to move quickly to introduce exchange rate flexibility at a far faster pace, a subject which is of great interest to this committee in light of continued engagement with China and maximization of this important trading relationship.

Though China is the country so often cited as driving the global economy, we must not lose sight of America's trade relationship with Europe, Japan, and our neighbors to the north and south.

U.S. corporations continue to make strides in productivity and a rising global economy has created myriad opportunities for U.S. multinational corporations and for investors looking for growth opportunities in foreign markets. Particularly in Latin America, remittences have generated real economic growth in emerging markets. Transactions such as these between established and emerging economies foster growth in both, and merit ongoing considerations. We look to reform the international financial system.

On another topic, this year our colleague Deborah Pryce, Chairwoman of the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, led the way in reauthorizing the Multilateral Investment Fund at the Inter-American Development Bank. This is a good time for Treasury to take all possible steps to start similar programs at the other development banks.

The MIF is an outgrowth of the Enterprise for the Americas initiated by the first President Bush. While this is obviously now a multilateral effort, the MIF is in many ways a perfect exporter of U.S. values, a forum where a good idea, hard work, and fair access to credit can provide a healthy way for any number of people.

The MIF is an incredible success story. Combining modest grants for small- and medium-sized businesses, this program has encour-

aged private sector development and leveraged the power of remittances through Central and South America. The result has been the growth of small businesses here and abroad. As we all know, small businesses are the engine of job growth.

We are all committed to the big projects spearheaded by development banks; water and sewer system construction, infrastructure development, and the building of hospitals. Given the "bang for the buck" we get out of the MIF at $25 million a year, however, we should seek to clone that program at the other development banks and try to do the same thing bilaterally through the Millenium Challenge Corporation and other international financial institutions. We must be on the lookout for programs such as this that exhibit the best practice of government here and abroad.

Secretary Snow, I commend your continued oversight over the reform of the international financial system and your ongoing commitment to opening markets for our financial services firms abroad. Welcome back again to the Financial Services Committee, and I now yield to the gentleman from Massachusetts for an opening statement.

Mr. FRANK. Thank you, Mr. Chairman.

Mr. Secretary, I appreciate the courteous way you have conducted your office, and you have always been very careful to try and stay in touch with us.

First, let me say, I want to agree with some of what the chairman just said. I do that with some trepidation because sometimes when I agree with the chairman, I get him in trouble in other quarters, so let me say, there remain vast areas of disagreement between the chairman and myself. And he sometimes gets it right, and I do have to acknowledge that.

This committee, and it actually goes back to the chairmanship of the gentleman from Iowa, has a record that I think hasn't been fully noted of cooperation on international economic matters and particularly with regard to the international financial institutions.

I believe that there has been significant improvement in the World Bank and the IMF and some of the other development banks. If you go back a few years, there was great controversy, the 50 years campaign. There was a major effort to curtail, wipe these institutions out, and many of us agreed that there were some severe failings in the way in which they had operated, but we didn't think termination was the proper approach.

Things like debt relief and pushing for transparency and making—setting up a review panel, there is a history of this committee in a bipartisan way; because we have done it in a bipartisan way, there hasn't been a lot of controversy, people haven't noticed it. But it goes back to the chairmanship of the gentleman from Iowa who has been a leader in the international financial area, been fully continued by the gentleman from Ohio. The chairs of the subcommittee and the ranking members of the subcommittee have cooperated; we have the gentleman from New York here.

Obviously, there is a lot left to be done, but I think we are now focused on specific ways to improve the functioning of the international financial institutions as opposed to the great controversies when we had these reports and efforts to abolish them. This com-

mittee has played a major role in defusing the controversy not by suppressing dissent but by helping to work for improvements.

We do have a ways to go and the issue that concerns me transcends what these international financial institutions can do, although they had, particularly IMF, been part of the problem.

I am a capitalist. I think it is very clear that a free market system is the way to produce wealth. I also believe, however, that there are those who mistakenly think that once you have a functioning capitalist system, there is no reason for public sector policies that deal with some quality of life issues and some equity issues.

I think the consequence is that we now have in much of this world an attack on free market principles based on inequitable results that in my judgment goes much too far, but I don't think we counteract it simply by saying, but you are wrong. I think we have got to do a better job of forging a new synthesis.

The old so-called Washington consensus would seem to me excessively to focus on the free market and assume that, in a particularly stupid metaphor, the rising tide would rift all boats, because if you don't have a boat and you were standing on tiptoe in the water, the rising tide is not good news. That, unfortunately, has turned some people against the whole notion of capitalism.

We see it now in Latin America—it is a rare election in which the presidential candidate, most antithetical to the free market system, doesn't start out way ahead. We see a distrust of this elsewhere. We see in my judgment, here in our own country, an excessive skepticism towards international cooperation in a number of areas.

Now I think there needs to be some tempering. I haven't voted for any of the trade bills because I think they need to be done better. Many have gone too far. We, I believe, have made progress in abandoning this Washington consensus which was really more in my judgment religion than economics. It was a fundamentalist belief in the free market to the exclusion of elsewhere.

Instead, however, we have not forged the new consensus, and I think it is important for us to be actively working, and I believe under Mr. Wolfowitz, the bank began to try to deal with this. With Mr. Wolfowitz, with whom I agree far more today than I did in his former life, and vice versa, I should point out fairly, I think we are on the road to that, but we haven't done it well enough.

I think it is in the interest of those who understand the value of capitalism to do a much better and more active job in addressing the equity issues. It is clear that much of the world has said that if all you are going to give us is the free market and let us then live with the distributional consequences, you can take your free market and peddle it elsewhere.

And so I think we, as the United States and the international financial institutions, have to continue the movement. We have moved away from an excessive and rigid insistence on the free market only, but we haven't moved far enough in the other direction, and if we continue this, if we continue to neglect—and I think, frankly—and I will take 30 more seconds—I think people who are strong supporters of the free market system underestimate its power, overestimate its fragility. I think it has a greater capacity

to provide equity, a greater capacity to take care of people who will not do well on their own in a free market system than people think. I do not think the capitalist system is going to be jeopardized by a greater concern for equity. And until and unless we begin to do this in a better way, we are going to see what I think is a continuation of an unfortunate trend away from what is the best system for people.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Ohio, Mr. Ney.

Mr. NEY. Thank you, Mr. Chairman.

Welcome, Secretary Snow. I just want to focus in my opening statement on the economy. In an area I represent in the State of Ohio and across the country, we are trying to recover, but too many factory jobs have been lost, doors have been closed, and jobs have been sent overseas. And even though we are trying, we have a continued unfair trade practice because of Communist China. And they continue to be a major impediment to our growth and our jobs in our Nation, I believe. For this reason, I have been an outspoken opponent against a range of unfair trade practices by Communist China.

The continued rise in the U.S.-China trade imbalance and complaints from U.S. manufacturing firms and workers of the competitive challenges posed by Chinese imports have led several members including myself to call for a more aggressive U.S. stance against Chinese trade policies that are absolutely unfair to American workers.

I think we are turning a blind eye to this. Among these is China's refusal to adopt a floating currency change rate system. While the Treasury Department did not go so far as to brand China a manipulator of its currency, I am very concerned they have made far too little progress in making the exchange rate more flexible.

Last July, China ended a decade-old peg to the dollar saying it would manage its currency against a basket of currencies, yet the Chinese currency has appreciated just 1.3 percent since then. So I think it is clear that the Communist regime has failed to fully implement its commitments to make its new exchange rate more flexible and refuses to increase the role of market forces that determine its current value. This has led to a significantly under-valued Chinese currency vis-a-vis the U.S. dollar.

And as far as the free trade agreements, in 1994, we were $30 billion in the hole, and now we are $202 billion in the hole. So I think that says what free trade has done for American workers. And because we might have a free trade agreement, which I don't believe in permanent status for China, with this currency situation we are not going to win on jobs. As a result, U.S. production and employment have been hurt in several key U.S. manufacturing sectors that are forced to compete domestically and internationally against artificially low-cost goods from China.

In Ohio, for example, this devalued currency is allowing Chinese metal producers to undercut business from American mills. There is no level playing field for American workers whatsoever. The Chinese government's actions towards its currency value are just an-

other example of its complete unwillingness to compete fairly in the global marketplace.

I will just sum it up by saying that Congressional concerns about our economic relationship with China will only intensify in the coming years unless the Communist party leadership takes concrete steps to moderate its export-led growth strategy, including implementing a market-based exchange rate. Without a proper response, American manufacturing jobs will continue to be in jeopardy, and I think we have to push for tougher action.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

The gentlelady from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you, Mr. Chairman, and welcome Secretary Snow to this hearing on the state of the international financial system. We have a great deal to talk about because, frankly, I am worried about the state of the international financial system and the contribution of our own policies to that troubling situation.

You are part of a record setting Administration, but they are the wrong records. We have seen the Federal budget deficit set a record in dollar terms on this President's watch. We have seen the national debt rise to a record level, over $8 trillion, and this Administration has raised the debt ceiling four times. The budget before us today includes yet another provision to raise the debt ceiling for the fifth time. And in my district, there is a clock that notes that each American owes $28,000 because of this debt. And most disturbing of all, we have seen our indebtedness to the rest of the world rise to yet again another record level.

In 2005, the U.S. current account trade deficit, our trade deficit was $805 billion, an amount equal to 6.4 percent of the GDP. That is how much Americans, including the Federal Government, had to borrow from the rest of the world just last year to cover the difference between our current income and our current spending. We have become the world's largest international debtor. The Federal Government is a big part of that problem. Since President Bush took office, foreign holding of U.S. Treasury securities have more than doubled, rising from $1 trillion in January of 2001 to $2.1 trillion in March 2006, the most recent month for which we have data.

The entire increase in the public debt over that period was not much larger than the $1.1 trillion increase in debt held by foreigners. Think about that. Almost all of the increase in publicly-held debt since President Bush took office is account for by purchases of U.S. Treasury securities by foreigners, including foreign governments and not by Americans.

It is one thing when we owe the debt to ourselves; it is quite another when we owe it to the rest of the world. Repaying that debt with interest will erode the standard of living of our children and our grandchildren. Foreign holdings of U.S. Treasury securities have increased by 106 percent since January of 2000. Japan is the Treasury's largest creditor, with holdings of $640 billion, an increase of 105 percent since 2001. China is in second place and has increased its holdings of Treasury securities by 423 percent. Much of that increase has resulted from purchases by China's central bank to keep its own currency from appreciating.

Mr. Secretary, you may not be willing to say that China is manipulating its currency, but you surely cannot be happy with China's role in creating the large payments, and the large trade imbalances that threaten the stability of the international financial system.

I hope you would be equally unhappy with our own role in creating those imbalances. Running large Federal deficits that drain our national savings and financing and an increasing portion of our national investment through foreign borrowing rather than our own national savings are the wrong direction and the wrong way to run fiscal policy. Creating conditions in which we are a large international debtor is bad for the international financial system, and it is also bad for our own future standards of living.

Mr. Secretary, I look forward to your testimony and to exploring with you the steps we can take to create an international financial system in which the United States and its trading partners in both the developed and developing world can prosper. I look forward to your testimony.

The CHAIRMAN. The gentlelady's time has expired.

We now turn to the distinguished Treasury Secretary.

Secretary Snow, it is good to have you back again, and we appreciate your participation in this important hearing on international issues, and the floor is yours.

STATEMENT OF THE HONORABLE JOHN W. SNOW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary SNOW. Thank you very much, Mr. Chairman.

I am delighted to be back here for this annual opportunity to meet with you on the state of the global economy, and I always look forward to this opportunity to respond to your questions and continue this important dialogue on what is clearly a critically important subject.

Overall, the state of the global economy is good. We have witnessed the best GDP growth that the globe has seen in decades; sustained growth, not inflationary growth, and it is touching all parts of the globe, including Sub-Saharan Africa, which has seen growth rates approaching 5 percent, which is important to lift people out of poverty in that part of the world. Clearly, India and China are growing at very fast rates, 7, 8, 9 percent and becoming larger and larger players in the global economy.

It is important that the institutions of the global economy better embrace the changing nature of the players and the flows that make up the global economy. One of the reforms that we are pushing, Mr. Chairman, at the IMF is better representation on the board at the IMF and through the quotas of the IMF of the changed nature of the participation in the global economy.

As for the U.S. economy, it continues to do well. It has done quite well for the last 3 years and is on a good course for sustained growth here. As you know, for the last 3 years, we have had growth rates at about just under 4 percent, which is well above the long-term sustainable trend line. As a result, we have drawn many new resources into the economy. Plant utilization has risen. Employment has risen. Aggregate hours worked have risen. We now have

5.2 million additional workers. We are beginning to see wages rising, which is what you would expect at this stage of a cycle.

Business investment has strengthened significantly. Equity markets have picked up. And while there has been some increase in headline inflation, core inflation remains well contained. And we have done this, Mr. Chairman, in the face of some serious, serious developments like $75 oil in Katrina and Rita, which clearly take a toll on our economy.

So, overall, I think the American economy, the global economy are on a good path, but we need to continue to focus on the things that you and I have talked about so often, the U.S. deficit, which I think will come down nicely over the course of the next few years with good spending control and with the very, very important surge in revenues we are seeing.

You may have seen, CBO is now indicating that the deficit will be much lower this year than had originally been forecasted. We will do our mid-session review soon. Given the surge in revenues, April was the second highest month we have ever seen. We are running well above estimates and well above last year.

It is pretty clear that the deficit is on a good path come down. We will meet the President's target, I think exceed it, and do so ahead of time.

The fundamental problem the global economy continues to face is slow growth rates in large parts of the world and Europe, Japan particularly, that are under performing. Their growth rates are well short of their potential. That is having real effects, material effects that show up in things like the global current account, our current account deficit in the global flows.

So we need to work on our savings rates in the United States. We need to deal with our deficit. Those industrialized parts of the world that are growing short of their potential need to take steps to grow faster, create more investment opportunities, absorb more of the world savings, and then the third part of this equation is that in those parts of the world where the adjustment process is frustrated by lack of currency flexibility, we ought to continue to encourage more currency flexibility.

Congressman Frank, I agree with what you said, I think this committee has played a very important role in focusing attention on the global economy and on the institutions of the global economy, the multilateral development banks, the IMF, the World Bank, and has encouraged a set of reforms that clearly have those institutions performing better now and on a path to perform even better in the future.

With that, Mr. Chairman, I thank you very much for your comments.

[The prepared statement of Secretary Snow can be found on page 47 of the appendix.]

The CHAIRMAN. Thank you, Secretary Snow, and we, again, appreciate your appearing here. I just recently returned from a trip with the Speaker in which we visited India and Vietnam, and I think neither the Speaker nor anybody on the delegation had been to either of these countries, and it was a fascinating opportunity to see some parts of the world we had not seen and to visit with leaders both in India and Vietnam, and you specifically had men-

tioned India is one of the largest, fastest-growing countries. In fact, the Speaker was clear that we represented the oldest democracy in the world, and they represent the largest democracy. Soon they are going to be the largest country in the world, and the issues that we dealt with including of course the peaceful use of nuclear energy was critically important and particularly India's desire to have closer relationships with the United States.

Then when we went to Vietnam, I don't think anybody knew really what to expect. I certainly didn't, and the fascinating part about that trip, and I appreciate your comments on this, we had a meeting with the prime minister there, and this is still a one-party country; they were getting ready for the party conference. And all of the banners were out there and the hammer and sickle and the like. It is still a Communist country. But I was struck by the fact that the prime minister acknowledged to our delegation that after the war, Vietnam adopted an Eastern European style economy with all of the obvious implications. He said that was a disaster. It was a failure.

And since that time, about 10 years later, they adopted a market-based economy that has led to significant growth rates, stability, and their major plea to us was to give them permanent normal trade relations as we did with China, for example, because they desperately want to join the WTO and become part of the world community.

I took that as an incredible step forward, given the history that we have with Vietnam, that a country which is still controlled by one party, the Communist party, has adopted a market-based economy and wants to be part of the World Trade Organization, and the acknowledgment that there was a failure of the past and an embracing really of American principles of their economy. I just wonder if you care to comment on that.

Secretary SNOW. Yes, Mr. Chairman. Thank you very much. I, too, have traveled to that part of the world. I recently came back from India, where I had a series of meetings with leaders, as you did, including the prime minister. In India, there is real progress being made, but I think more progress could be made there, and in Vietnam, with further openings.

One of the issues that India suffers from is lower rates of development of their financial institutions than otherwise would be available if they raised caps on insurance and on banking in terms of foreign direct investment and ownership. The same is true of retailing. I am sure that came up when you were there, the restrictions on putting in place investment in retailing to create a more modern retailing structure.

I think the government is committed to moving in those directions. I think they know that is the right path, but there are internal political issues that affect the pace of the path they are on. But the path they are on is a good one, and the current prime minister was the finance minister in 1990 or 1991 when this reform movement began when they said we are going to open up, we are going to go to more open trade, we are going to go to more open markets, we are going to move in the direction of a more market-based economy.

The economy is showing the benefits of that, I think. I think the case is pretty clear that when countries adopt good policies, market-based policies, they get better results. One of the problems I think we see in the global economy is that market economies don't work unless there is clearly an environment of anti-corruption. That is where the World Bank and IMF are playing an important role now. Unless there is respect for law and property rights, market economies can't work. These are the institutional frameworks within which market economies function, and they only function well if that investment is in place.

To that extent, I would agree with other Members of Congress who have spoken to that, and other members of the committee who have spoken to that. So we are encouraging a market approach. We are also encouraging the environment in which markets can work, including, as you said, micro finance, which has a much, much larger role to play in creating opportunities for small- and medium-sized enterprises.

The CHAIRMAN. Thank you. My time has expired.

The gentleman from Massachusetts.

Mr. FRANK. Mr. Secretary, I agree with much of your statement, but I confess to some trouble with your citation of the rise in hourly wages. What is the CPI increase over the past 12 months; do you know?

Secretary SNOW. It came out recently, as you know.

Mr. FRANK. 12 months.

Secretary SNOW. 5, 5.1.

Mr. FRANK. You have got 3.8, and I believe that is nominal. That is not adjusted for inflation. My understanding is, even in the past 12 months, which are your best 12 months, hourly wages have barely kept up with inflation, and I think frankly you are cherry picking to take 12 months.

But you would acknowledge that 3.8 percent increase in wages is nominal, not adjusted for inflation, correct?

Secretary SNOW. I have to go back and check these numbers.

Mr. FRANK. That is not a tricky question. Is 3.8 nominal or real? Adjusted for inflation or not?

Secretary SNOW. For the 12 months, it is nominal. For the first quarter, that is the real number.

Mr. FRANK. For 12 months is what you have in your statement. So, frankly, I think it is misleading to talk about 3.8 over 12 months when that doesn't take into account inflation, which was very close to that. Also, I ask you to submit what has it been over 24 months, 36, 48, because real wages have dropped; correct, compared to inflation and the nominal increase?

Secretary SNOW. Wages have not, as you would expect, caught up with where they will be.

Mr. FRANK. As you expected; my expectations are a little lower.

Secretary SNOW. It is just that we have gone through a recession.

Mr. FRANK. You are comparing it to previous ones. I think it is a mistake to talk about only the past 12 months and in nominal terms.

Let me ask you then, secondly, we have an enormous balance of payment deficits, and you talk about your hopes to get the budget deficit down. What is the long-term 10-year prospect. Ten years

from now, are we going to continue to have this kind of trade deficit or is our debt that we owe the rest of the world going to grow, is there an exit strategy or a downward tide path. How do you see this going forward?

Secretary SNOW. I think we are putting in place, the finance ministers, central bank governors, leaders of the institutions of the global economy are putting in place a pretty good adjustment framework which, over time—over time will see the imbalances—

Mr. FRANK. What is your projection for the United States 5 years from now, trade deficit? Are we going to owe the rest of the world more?

Secretary SNOW. If we continue to do the things that I talked about and the rest of the world does the things that I talked about, higher growth rates, flexible exchange rates, I can't give you a number, but we are going to see that trend line reversing and begin to come down.

Mr. FRANK. Begin to come down; 5 years from now, will it be down noticeably?

Secretary SNOW. I don't have a good prediction on that. I do think we will see an orderly and effective adjustment process that will put us on a course to reduce the imbalances. I am confident of that. But it does take these other things to happen.

Mr. FRANK. Yes. The poet laureate Rudyard Kipling; "If" being the poem.

Mr. Secretary, I am going to ask a question I would rather not have to ask, to be honest, and it is not a pleasant thing to ask and I respect you and I appreciate how you have dealt with this. I don't mean to impute any fault to you, but we are talking about serious national and international policy, and I think we have to confront this.

I am troubled by the constant report that your status is uncertain, that the Administration has failed to give you the kind of confidence it has given other people. There has clearly been a contrast between the President's conversations about your tenure and that of Secretary Rumsfeld.

You are a lead person in negotiating a lot of these things. You just in your answer correctly pointed out progress in this area depends on negotiations with other central bankers and other finance ministers with the World Bank, with the IMF. I mean, credibility is, I perceive, very important here.

I assume that you don't think your ability has been undercut, but why do we have this? It just seems to me unfortunate, and of the major Cabinet officers, you are the only one about whom we read this. Have you addressed this with the Administration? I apologize for addressing the elephant in the room. I wish this elephant wasn't in the room. I wish other elephants weren't in the room. Maybe we will change that. But that is a separate issue.

I do think we have to address this. You are a very important man holding a very important job in this country. You have a major agenda that requires a lot of negotiations and acceptance of your word, and it is troubling to have your position undercut as it has certainly been in the media, and it does not seem to me the Administration at the highest levels has done what they should to

give you the kind of strength that you ought to have to carry us forward.

Secretary SNOW. Well, thank you, Mr. Frank, and I never comment on rumors, of course. There is no serious purpose to be served by commenting on rumors and speculation. A great leader of the Labour Party, Aneurin Bevan, once observed in response to rumors and speculation that he was an avid—had an avid interest in fiction, and as a result, he read the daily newspapers.

I think we have seen a lot of fiction here, and it doesn't do any good for me to comment on rumors and speculation. But let me say, I do appreciate that word of support from you, and the rumors and speculation have not undermined my ability to be effective.

We just had a very good IMF World Bank meeting, G–7 meeting, where the objectives of the United States, I think, were well advanced. The movement of the IMF into surveillance is something that was really our agenda item. The HIPC debt deal was one, as you know, we pushed awful hard. I think the anti-corruption agenda at the World Bank is grown right out of the U.S. book.

I appreciate your comments and the sentiments behind them but I do think that we continue to be able to work effectively in the institutions of the global economy.

Mr. FRANK. I just hope that your position isn't further undercut as it has been by the fact that you are clearly the most conservative Secretary of the Treasury ever, quoting Aneurin Bevan, the most left wing of British Labour leaders.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Iowa, Mr. Leach.

Mr. LEACH. Thank you, and welcome, Mr. Secretary.

It seems that in all countries, literally all people seem to have a growing angst about globalization, and everyone seems to think that the system is stacked against them, and yet literally the impact of your testimony this morning is that reality rather than fiction as you just referenced is world GNP is growing, and U.S. GNP is leading the industrial world, and that is very impressive.

And yet when you look at movements in countries, it appears that irrationality is growing. Lots of Latin countries want to move away from free markets. There is Latin leadership now against joining American free trade arrangements.

In this country, it appears to many that this Administration is a little too unilateral in political policy, but it appears that the alternative political party is a little more unilateral in economic policy, and by that I mean leans a little bit more towards protectionism than the Republicans.

Since your field is economics, I would like you to comment on what the alternatives policy-wise are to your policies in this sense; basically speaking, the anchor of your Department of the Treasury is free markets and restrained spending and restrained taxes. Whether we disagree or agree with all the elements of it, that is basically the marker.

If one were to run it on an alternative policy, it would seem to be one of greater protectionism and maybe less restraint in spending and taxes. If that were the case, what are your projections on whether that would be good for the economy or bad for the economy, and what would that do to our position in the world?

Secretary SNOW. Congressman Leach, the policies that we are following, I genuinely believe, are the right policies to advance not only the United States, but global prosperity, and lift people out of poverty around the globe. I am concerned that we are not making more progress on Doha because the Doha round offered more promise for people in the developing world than any other single thing on the economic policy agenda of the world today. Something like two-thirds, three-quarters of the benefits of that will go to developing countries. I think the record is just unmistakable here that embracing trade is beneficial to the poorest countries of the world.

In terms of taxes, I think the low tax rates that the President has advanced make sense. They remove distortions from the code. They encourage work and effort and risk-taking, and they encourage investment. You always get less of everything you tax, so if you tax those things less, you get more of them.

But they can only be sustained, and I have tried to be clear on this, you can only sustain a low-tax environment if you are sustaining a discipline on spending because ultimately the consensus breaks down on low tax rates if you have large deficits. So we as advocates of this set of policies have to be equally forceful on spending restraint as we are on low taxes or else we won't be able to sustain low taxes.

Now I think the other side of that, higher taxes is not as well calculated to give us high long-term growth rates, which is what we want. You get high long-term growth rates when you encourage savings and investment. Today's savings and investment creates tomorrow's higher GDP, tomorrow's higher real standard of living. Lower tax rates encourage that, but we won't get the benefits of those encouraging more savings and investing today for higher growth in the future if we are ransoming the future by having to borrow to fund large deficits. That will just drive up interest rates and defeat the whole beneficial cycle that I just described.

So I think if you want low tax rates as I do, we have to also press hard for spending constraints.

The CHAIRMAN. The gentleman's time has expired.

The gentlelady from California, Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman, for this meeting, and I would like to thank Secretary Snow for being here today, and for his cooperation. Whenever I have had the opportunity or the need to seek information from him, he has always been very responsive, and I am very thankful for that.

I have a lot of questions that I would like to ask you, but I would like to focus on Haiti, Liberia, and Sudan. As you know, Haiti was not included in the multilateral debt relief initiative. I understand that the World Bank and IMF have recently agreed to include Haiti in the heavily indebted poor countries initiative. However, they may not receive complete debt cancellation from IMF and the World Bank under the MDRI until 2009.

Now, Mr. Preval, the newly-elected president, has been invited to the White House. The Secretary of State and the President have all signaled their desire to be of assistance to Haiti. They were responsible for removing the past democratically elected president from Haiti.

Now what are you doing, and what should we be doing to make sure that Haiti can be successful? They can't wait until 2009. What is going on?

In addition to that, Liberia is in a very similar situation. We had a great ceremony here for President Johnson. She was invited to the White House. We have talked about how wonderful it is that she is now the President of Liberia. We had a codel that is there, and they are in very difficult straits there, and there is no way that she can be successful without having access to the HIPC debt relief.

There is a sunset clause, as I understand it, that is currently scheduled to become effective as of the end of 2006, and that five of the countries—well, Liberia is included, and those countries who may not be able to apply for the debt relief.

And then, of course, I see that Sudan is one of those countries, but I am not pushing for any help for Sudan. I want to know if you are involved in support for any sanctions for Sudan for the genocide.

Those are the three areas; Haiti, Liberia, and Sudan. What do you know, and what are you doing?

Secretary SNOW. Thank you very much, Congresswoman Waters. You and I have had good discussions on these subjects in the past, and we worked cooperatively to advance some important initiatives.

On Haiti, as you know, the United States is the largest bilateral donor to the country, and we—I think it was $194 million last year, and we are requesting a like sum for this year in the 2007 budget. Our aid there, we know it is critical; it is used for humanitarian needs and strengthening the government and improving security and fostering broadbased economic recovery.

On the question of the international institutions, the World Bank, IDB, and IMF all have initiatives underway where we are working with them. The World Bank has a 2-year strategy to make available something on the order of $140 million, including the same sort of things that we have talked about, transportation, electricity generation, community development, and education.

At the IDB, they are actually very heavily engaged in Haiti, with, I think, it is 9 or 10 projects totaling $350 to $400 million, covering again the same subjects; economic recovery, basic services, agriculture, roads, and those things.

Finally, the IMF has extended this emergency post-conflict assistance program to Haiti in consultation with us. We did that last year. That was $25, $30 million, some number like that.

Ms. WATERS. Mr. Secretary, I don't want to interrupt you but let me stop you because I think that you are struggling a bit there, and I think the reason is because there is not a lot happening in Haiti at this point. We know that there were some attempts to do some humanitarian assistance. No money has gone to this new government. No money has been invested in the infrastructure. They practically have no water system in Haiti. And all of the efforts that you are alluding to are just not happening.

What I would really like, Mr. Treasury Secretary, I would like you to go to Haiti. I would like you to get with the heads of each of these agencies in Haiti in a summit that is called by you along

with the Members of Congress who will be happy to go down there with you so that we can get a handle on what is real and what is not real.

The CHAIRMAN. The gentlelady's time has expired.

Ms. WATERS. I ask unanimous consent for 1 more minute.

The CHAIRMAN. The gentlelady is recognized.

Ms. WATERS. Thank you.

This is very important. Otherwise you won't have the information that you really need to understand. We can either advance Haiti, or it can continue to deteriorate, and this new president won't have a chance.

What about Liberia, quickly?

Secretary SNOW. Similarly, we are working with the government. As you said, leadership of the country was invited to the White House. We had meetings with them, pledged support, and are continuing to work directly and through the international institutions.

Ms. WATERS. They are desperate, Mr. Secretary. Nothing is happening quickly enough. I would suggest that you use your leverage and your power with IMF and the World Bank to try to speed up some assistance to Liberia or they will be not successful.

Thank you, and I yield back the balance of the time.

The CHAIRMAN. I yield back to the gentleman from Alabama, Mr. Bachus.

Mr. BACHUS. Thank you.

Mr. Secretary, I might account for some of the rumors about the job you are doing at the Treasury. I think you have done—been such a success that maybe the rumors are people are trying to hire you away from the government because you—the economy is very strong, it is stable, consumer confidence is at record highs, and I can't imagine any basis for those rumors other than maybe there is some competition for your services.

Secretary SNOW. Thank you very much.

Mr. BACHUS. Thank you.

Let me pursue what Ms. Waters was talking about. She mentioned Sudan. Do you have concerns that the Chinese are coming into Sudan as we are—they are eligible for debt relief. We are encouraging countries to get out from under debt relief, and yet, at the same time, Mozambique and Sudan; the Chinese are loaning them money and seem to be to be worsening the situation.

Secretary SNOW. Well, China is—there is certainly evidence that China is extending its influence around the globe, as you are suggesting, and we continue to monitor and see signs of that, absolutely.

Mr. BACHUS. Okay. Thank you.

Eighteen countries have been approved for debt cancellation by the IMF, the World Bank, and the African Development Bank. But my question is, is the Inter-American Development Bank and the Asian Development Bank, they have not gone forward as these other institutions have. Can you give me—do you know if they have future plans to fully engage?

Secretary SNOW. Congressman Bachus, we are meeting with those institutions and making it clear that we think that a HIPC-like program there would be desirable, and we will continue to press that case. In fact, I have had that very discussion with the

presidents of—Mr. Moreno, Ambassador Moreno, former ambassador, president of the institution of the Inter-American Development Bank on that subject. He knows that the United States wants to see progress on that, and through our ED's at those institutions we are continuing to try and build broad-based support for it. It has to get the support of the board of those banks, but we are doing our best to build support for them.

Mr. BACHUS. I just think the members of this committee ought to realize that there have been some laggards in this effort. I use that term—

What about the prospects for opening up debt cancellation beyond the 42 countries? I think it is 42 countries now. I know some in Britain think that maybe 67 countries—

Secretary SNOW. Well, my own view is we can continue to look at that, but the focus ought to be on getting the first wave accomplished. We are still a long way off from getting the full contingent of countries through that process, 18 or 19.

Mr. BACHUS. Yes, and I agree. Earlier on, there was a thought to that. Now the debt relief, we are getting such wonderful reports back from these countries about the education levels, and, you know, we are seeing health standards, we are seeing vaccinations. We now know that it does work if it is properly instituted, and I think that ought to give us some urgency to extend it to those other countries.

Secretary SNOW. I think it does work. Congressman, you are absolutely right. And of all the things I have worked on in the last 3-and-a-half years, there is none I think I am prouder have having had a handle on, as well as many others, in getting the G–7 to move forward on that and then getting it approved through the IMF and the World Bank, which was something of a struggle, as you know.

Mr. BACHUS. And let me say this, the Administration—you have done an excellent job. You have helped stabilize and strengthen several of these countries so they are not a problem for the United States from a security, national defense case, and I guess—because it is good news. And, you know, you would think that hundreds of thousands of children attending school for the first time, little girls attending school for the first time in their lives in some of these countries, that it would be headline news, but I guess that doesn't sell newspapers. But I think the Administration and Treasury would be commended because you have pushed these other institutions and I think we have made tremendous progress.

Secretary SNOW. I think it is fair to say that, unless the United States has been in the forefront of pushing these HIPC initiatives, they would not have occurred.

Mr. BACHUS. All right. I want to just ask one final question. I have some concern about this. Some of the economic policy reforms includes—one of the conditions is mandating privatization of electric and water systems, and I would like to revisit that. Because, for instance, in my area we have the TVA. Now a lot of us have said we would like to look at privatizing a lot of these operations. They would be more effective. It is more of an economic argument. I am not sure that we ought to tell these countries that they ought

to privatize their water systems, and their electrical systems. I just ask you to take another look at that.

And my other and final concern, and I won't ask any question, just any suggestions you could give me in writing for ways to speed or add progress to moving these countries from the decision point to completion point would be helpful. You know, in certain cases, it looks like it is going to be 6 to 8 years.

Secretary SNOW. I will do that and look forward to a chance to talk to you about that, because it is a concern of ours as well.

Mr. BACHUS. Thank you.

The CHAIRMAN. The gentleman's time has expired.

The gentlelady from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you.

Mr. Secretary, would you comment and elaborate further on China's growing influence over our economy? According to Treasury statistics, China's ownership of U.S. debt has increased 5-fold since January of 2001, from about $60 billion to now over $300 billion; and their overall reserves have grown even more. So if China's not buying dollars to keep their exchange rate from appreciating, what are they doing?

Secretary SNOW. China and the United States play a critical role in each other's economy and in the global economy. The Chinese, of course, are running a large current account surplus with the United States and a sizable surplus with the world as a whole. As a result, they are—in effect, their savings exceed their investments; and the savings that they have, the excess savings they have find a way into the rest of the world, some of it into the United States—not all, but some of it into the U.S. markets. And that reflects the numbers you just cited, which are the right numbers.

They have been increasing their holdings of long-term U.S. securities. But, despite this increase in holdings, there is still a relatively small part of the U.S. Treasury securities, about, oh, 7, 7-and-a-half percent, something like that, and of course even smaller part of the total U.S. capital market.

One of the great strengths of the United States is that we have, as you have heard me say many times, the deepest, most liquid, and most resilient capital markets in the world; and foreign ownership of U.S. securities should be viewed as a vote of confidence in U.S. markets.

As I think Chairman Bernanke said when a question like this came to him sometime recently, foreigners aren't buying our securities because they want to be nice to us. They are investing in the United States because they like the returns, the best risk-adjusted returns which they can get for the quantity of investments they want to make.

So the important thing here is, we have the best financial markets and they are investing in our markets. Foreign investment in our markets is really a vote of confidence in us.

But this policy has kept their exchange rate from appreciating, and I would like to know concretely, what are we as a government doing, what steps are we taking to encourage China to look to its own domestic demand as a source of growth, rather than relying on exchange rate management to promote its exports?

Many of us are very concerned with the indebtedness of our country to China, and to Japan. It is the largest ever in the history of our country, and what would happen if they decided not to buy our Treasury notes? Would the value of the dollar fall? And what are we concretely doing to get them to stop using this policy to basically keep their own exchange rate from appreciating and helping with their exports?

Secretary SNOW. Well, Congresswoman Maloney, you are absolutely right to focus on that central issue of their domestic savings rates, their very high domestic savings rates and the failure to develop domestic consumption.

Now when President Hu was with us several weeks back he made a commitment to strengthen domestic consumption, in other words, to reduce focus on exports and to drive more of the economic activity of China into domestic consumption. That is something that we have suggested—we, the U.S. Treasury, have been suggesting for 3 years now. They are now committing to reducing their surplus with us and the world, to developing their domestic consumption market, reducing focus on exports, and it is in their own self-interest to do it. In the end, the best thing we can do is to appeal to their own enlightened self-interest.

Mrs. MALONEY. Is there any enforcement for this commitment?

And I would like to request that Mr. Hinojosa's opening statement be placed in the record and a letter from Treasury stating that the North American Development Bank will not be closed. If unanimous consent from Mr. Hinojosa—

The CHAIRMAN. Without objection. The gentlelady's time has expired.

The gentleman from Texas.

Mr. PAUL. Thank you.

Good morning, Mr. Secretary.

I have three questions for you. I would like to ask all three, though, before you answer the first.

The first one deals with inflation. If we look at the April statistics, we find the PPI was up at an annualized rate of over 10 percent and CPI was up at a rate of over 7 percent. I think that this relates to the comments made by the gentleman from Massachusetts that, when prices go up, it is as if taxes were placed on these goods, and it is a detriment to the wage earner, since, of course, real wages do go down. But most economists recognize that prices go up because of a monetary phenomenon, when we increase the supply of money, credit prices subsequently go up; and many of us believe that M3 has been the best measurement of this inflation and what is happening. Yet that number is no longer given to us.

The first question is, do you have any strong objection to a Congressional request for that number to be once again reported?

The second question I have deals with China. There has been a lot of pressure on you and the Administration to demand that the Chinese revalue their currency to strengthen the yuan against the dollar. And they give the so-called benefits from this, and sometimes they are true and sometimes they are not and sometimes they are fleeting. But I would like to know from you, what are the disadvantages? Is it a zero-sum game? Do some people receive some disadvantages from a weaker dollar and a stronger yuan? I

think we too often look at the so-called benefits, which aren't always forthcoming.

The third question deals with currency flexibility, which you have talked about already, but I am interested in currency flexibility here within the United States, and this deals with—and I would like to talk about that in relationship to gasoline prices. Most people think Iraq and immigration are the two top issues, and they are very high in the poll numbers that are being taken, but gasoline prices are very high on the agenda as well.

But because of my concern about the appreciation of the dollar, I have followed the constitutional mandate that only gold and silver be legal tender, and yet legal tender laws force us to accept paper money. But because I have been old fashioned enough to deal with a gold dollar, the price I pay for gasoline is about 9 cents. Five years ago, I was paying 27 cents, so the price of my gasoline is going down. The more our government and our Congress depreciates the money, the cheaper my gasoline gets.

Yet, although I can do that, it is difficult, and there are a few things in the way of this. That is the legal tender laws which dictate and mandate that depreciating paper money is the only currency of the realm, and yet the Constitution is very clear that only gold and silver should be legal tender.

My question is, is there room to start talking about fluctuating rates here domestically? We know that trillions of dollars are traded internationally, and it serves as a market mechanism to adjust these currencies that are created by the various central banks at different rates. The market performs an amazing service, and I see no reason why that couldn't be done domestically, but it would require really two things. One would be to repeal the legal tender laws and the other would be to adjust our tax codes so that gold would be recognized as money and not as a strictly a commodity that has to be taxed as a commodity.

Since this is such a benefit to people who would prefer to be on a sound currency where prices go down rather than up, I would like to know if there is a time and place for discussion of this sort.

Secretary SNOW. Congressman Paul, I think there certainly is on all these subjects room for a good discussion. You take me back to discussions I have had in the past with my good friend, the former Member, Jack Kemp, who has advanced some of these ideas in the national debate.

It is interesting, when you think about the United States and the issue of flexible exchange rates, we have a fixed exchange rate system really, don't we? A dollar is worth what a dollar is worth in Utah, Indiana, Ohio, New Mexico, or Michigan. Everywhere we have the dollar, it is worth a dollar.

The reason that system of fixed exchange rates works is because it really is a fixed exchange rate across all 51 jurisdictions; we have the free flow of capital and the free flow of labor. So it is the market processes that allow the adjustments to occur, and nobody ever says, is Massachusetts in surplus or deficit with Wyoming? Nobody knows the answer to that, and it is not relevant to anything.

On the subject of—so, yes, I think you are raising subjects of far-reaching intellectual interest, and sometime I would be delighted

to sit down and try and understand where you are coming from and how I might be able to respond better.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from California, Mr. Sherman.

Mr. SHERMAN. First, Mr. Chairman, the meteorological comment. The rumormongers told us that, come spring, Snow would be gone, but here we are in May, and Snow is still here. And I want to say that the persistence of Snow does not disprove the theory of global warming.

One thing we, as politicians, understand is regimes and individual politicians survive when they bring home the bacon. That applies in Iran. Even though bacon is not halal, they understand the concept, too.

The World Bank, both under the prior Administration and this Administration in your tender, Mr. Snow—Secretary Snow, has approved loans to Iran on a concessionary basis. This is important to the Iranian regime not only because it provides capital at low rates but, perhaps more importantly, what stamp of approval could one have from the world economic community that would be more solid than concessionary loans from the World Bank?

Now I have talked to your predecessors on this before, and they have all responded, we have done enough, we voted "no". Well, you voted "no" because statute requires that the Treasury Department cast a U.S. vote "no" on sending World Bank loans to terrorist—terror states. But what the Treasury Department has not done up until now is do anything other than vote "no". You vote "no", you lose. The loans are approved, and you go have tea and crumpets with the people who outvoted us. The United States has never publicly indicated that our continued involvement in the World Bank could be diminished if the World Bank is sending, in effect, U.S. tax dollars to Tehran.

Couple of questions, how would you come to my district and defend Brad Sherman, who has been in support of foreign aid, when some of that foreign aid is going to Iran? And what steps is the Treasury Department going to take to make sure that these loans, which have been approved, are not actually dispersed?

I would point out that, thanks to this loanness of bureaucracy, three-fourths of the money has not actually reached Tehran. Any chance that we have a friend perhaps running the World Bank who could make sure that it takes another decade or so before these funds are dispersed?

Secretary SNOW. Well, thank you very much, Congressman Sherman.

The U.S. position on this, as you know, is clear. We oppose that sort of funding. We work with the other ED's to try to persuade them to accept our view. We haven't yet been as successful as I would like to be.

Mr. SHERMAN. Mr. Secretary, because I have such limited time, perhaps I can sharpen the question and say, have we told anyone our enthusiastic monetary involvement in the World Bank would be impaired in any way if they just say, shut up, we are sending the money to World Bank whether you like it or not, and we are sending the money to Iran whether you like it or not?

Secretary SNOW. We have made it clear that we are totally opposed to the policy.

Mr. SHERMAN. And the loans have gone through anyway, whether we have done anything about it.

Secretary SNOW. We have expressed our serious opposition.

Mr. SHERMAN. Effectually and continually, loan after loan after loan is approved. We keep doing the same thing even though it doesn't work. Imagine coming to a town hall in any of our districts if the people there knew that we voted for foreign aid and some of that foreign aid was going to Iran, sir. Thank God—you know, you can be lucky that you have the job you have and not one that involves explaining why American foreign aid is going to Iran.

But I want to shift to another topic. We have had a failed trade policy that has failed working Americans. That is not just this Administration; it is the prior Administration. We have the largest trade deficit in history by far. Do you think it is prudent for us to develop a plan to deal with what is a real possibility, and that is the sudden decline in the value of the U.S. dollar versus other currencies? And when I say sudden, I mean 20 percent in 1 week, 50 percent in a month. Do you think prudence requires that we have such a plan, perhaps involving circuit breakers, or do you think we should just dismiss that as a possibility and not have a plan to deal with it?

Secretary SNOW. Congressman, as I am sure you are aware, prudence requires we take steps to see that the global economy functions well, and part of the way the global economy functions well is to have an adjustment process so that sharp breaks of the sort you suggest don't occur. And I—

Mr. SHERMAN. So, Mr. Secretary, are you saying it is impossible—it is so unlikely for this to occur that it is not worth developing a plan because you are so confident in the smooth realignment of currencies that there is no reason to have a plan for a sudden and catastrophic decline in the value of the dollar?

Secretary SNOW. No, I think that prospect is remote. I think the most important priority we have is—

Mr. SHERMAN. Mr. Snow, do we have such a plan?

Secretary SNOW. We continue to monitor contingencies.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Well, Mr. Secretary, you have heard a number of members of this panel show a great amount of concern about the Federal deficit and obviously try to tag the Administration with that deficit number. If I read the Treasury reports correctly though, since we passed the President's economic growth package in 2003, frankly, we are awash in new tax revenues. I think—and correct me if I am wrong—we have now had tax revenues increase, I believe, for 3 years, and last year we had tax revenues increase by approximately 15 percent. Is that correct, Mr. Secretary?

Secretary SNOW. That is absolutely right, Congressman.

Mr. HENSARLING. And do we appear to be on track to do the same thing for this fiscal year? Or is it in the 10 to 15 percent growth for range for tax revenues?

Secretary SNOW. I think we came in at about 11-and-a-half percent, just under 12 percent, for April.

Mr. HENSARLING. So if we are awash in tax revenues and we continue to have a deficit, that might suggest that part of our challenge is on the spending side. I have noticed that there tends to be a correlation between those who tend to cry deficit the loudest tend to vote for great amounts of spending.

As concerned as I am about the Federal deficit, I am even more concerned about our unfunded liabilities for our social entitlement programs; Medicare, Medicaid, and Social Security. I guess it was about a week ago, less than a week ago, that we received the latest report from the Medicare and Social Security trustees saying, if I recall correctly, that in their estimation Social Security will go broke a year earlier than originally thought, and I believe Medicare will go broke 2 years earlier than originally thought, and the unfunded obligations increased by some astronomical figure that no one in America can comprehend because it begins with a "T", as in trillions of dollars. And yet there are those in the body who fight every single effort to do something to reform those programs. What are the long-term economic implication if we do not address the growth rates in these entitlement programs?

Secretary SNOW. Congressman Hensarling, the long-term consequences, as we have tried to point out in the trustees' reports, are devastating for the country. They are really just not sustainable. Those programs, unless reformed, put on a sound financial basis, will absorb virtually all of the revenues of the United States, meaning there is nothing left for any other programs.

Now, that clearly can't be allowed to occur. It would take roughly a doubling of taxes to cover the—more than a doubling, because you never—if you double, you don't get double. You have to do more than double to get double because of the way people react to higher tax rates. No, we would put the American economy in serious jeopardy if we allow these unfunded obligations to continue to be on automatic.

Mr. HENSARLING. So is it a fair assessment to say that those who refuse to reform these programs have de facto advocated doubling taxes on the American people?

Secretary SNOW. Or huge borrowing in the future to fund it.

Mr. HENSARLING. Let me change subjects to the Chinese currency issue and perhaps give you a perspective that you haven't heard here today. In your testimony, you have spoken about a need for China to show greater exchange rate flexibility, and certainly, if I was a citizen of China, I would want that to happen. But every time the prices change, there is going to be somebody who wins and somebody who loses.

I believe in the marketplace, and I wish the Chinese would let their currency flow. But, at the same time, when we have bills, I believe, like S. 295, that are threatening retaliatory sanctions and tariffs on China if they don't allow their currency to flow, ultimately, all this is about making their exports more expensive and making their imports less expensive.

I got into the fatherhood business 4 years ago, so I know a lot about toys, and my 4-year-old daughter—I am fairly certain I have this right—her swing, her favorite teddy bear, her Dora the Dancing Cowgirl doll, and her Wiggles lunchbox were all made in China.

And I assume they are made in China because American consumers can buy them at a cheaper rate.

Now my family has the benefit of living off of a Congressional salary that many Americans can only dream of. So if we are going to engage in a policy of de facto trying to get China to raise the cost of their exports, aren't you essentially trying to take toys away from America's children to benefit manufacturers and labor union workers?

Secretary SNOW. I wouldn't put it quite that way, Congressman.

Mr. HENSARLING. You wouldn't?

Secretary SNOW. No. What we are trying to do is to get the global economy to function the way it needs to function. And if it is to function right, one of the fundamental rules of the game is trade, free trade, free capital flows and not pursuing begger thy neighbor policies with your currency.

The CHAIRMAN. The gentleman's time has expired.

The gentlelady from California, Ms. Lee.

Ms. LEE. Good to see you again.

Secretary SNOW. Thank you.

Ms. LEE. Let me ask you a couple of questions.

Let me first mention a meeting that you probably are aware of that Representatives Blake, McGovern, Waters, and I held. This was in March, and it was with the Office of Foreign Assets Control and the State Department. We held this meeting to discuss religious travel to Cuba, and we wanted to develop constructive solutions to allow religious exchanges to continue.

Not only have we not received an answer to that meeting, but it has come to our attention that decisions to further restrict contact between the United States churches and religious organizations and Cuban churches and religious organizations are moving forward. And, once again, I understand that this is in the absence of any consultation with American religious organizations and churches and faith groups that might be affected by these limitations, restrictions and prohibitions which have placed their ability to meet with their counterpart—their religious counterparts in Cuba for spiritual and religious fellowship and support.

We talked about this at length in the meeting, and, of course, we understand that if there are those bad actors who have violated the law or regulations then you address them individually as such. But what in the world is going on and why are these restrictions moving forward on religious travel?

Secretary SNOW. Congresswoman Lee, I am aware of your meetings and your long interest in this issue. In fact, I think you have had some effect on this. OFAC and the Department of State, the State Department, have actually been having meetings on the question you have raised because you have raised it the way you have raised it.

I don't want to say for sure what is going to come out of it, but it is—it looks like we might have an expectation of some new regulations that will come out from the Cuba Commission here at some point.

Ms. LEE. Right. That is coming out fairly soon, I understand.

Secretary SNOW. Fairly soon. I want you to know we have communicated your concerns to both, you know, OFAC, NSC, the Na-

tional Security Council, and the State Department; and we are going to stay engaged and maintain the dialogue with you and the Commission.

Ms. LEE. Well, Mr. Secretary, we would like an answer to some of the questions that were raised in the meeting. This was, quite frankly, raised in March, and if these regulations are coming up, we would at least like to see a draft of them and know what is going to be in them and weigh in on them.

Secretary SNOW. I will see what I can do to follow up.

Ms. LEE. Following up on Congresswoman Waters' question with regard to the Sudan, as you know, numerous divestment campaigns like State pension plans, universities, and State public employment retirement systems are moving forward as a result of the horrific genocide that is taking place in Darfur.

I would like to find out how this committee could receive a list of United States companies that have investments in multinational companies which are doing business in Sudan and also just your general thoughts about divestment and sanctions as a means of force and an end to these horrible atrocities that are taking place.

Secretary SNOW. Right. Well, as you know, Congresswoman Lee, the State Department has the lead on that. Deputy Secretary Zoellick is just back from a visit there and I think has focused a lot of his time and effort on that. Let me talk to him and then try to get back to you.

Ms. LEE. Sure. Because we need this list. It has been very difficult to find a list of companies that—and some groups want to sell these lists. You know, I think they should be made available to the public. So we would really like to have that.

Finally, let me just ask you, with regard to the progress on the G–8 agreements on the 100 percent debt cancellation, you talked a little bit about that earlier, but I wanted to find out if the President intends to request any additional funding to pay for debt cancellation in his remaining years in office, and is he willing to put the necessary pressure on Congress to ensure that this funding is provided?

Secretary SNOW. Well, the approach we laid out to the debt forgiveness contemplated either replenishments being helpful in funding that process, so, yes.

Ms. LEE. So you do intend to—well, hopefully you intend to put more money in.

Okay. Thank you very much, Mr. Chairman; and I will yield the balance of my time.

Mr. MILLER OF CALIFORNIA. [presiding] The gentleman from New Jersey, Mr. Garrett, is recognized for 5 minutes.

Mr. GARRETT. Thank you, Mr. Chairman. And as I begin, let me just say that I am heartened by the fact that the Secretary does not intend to take the Wiggles dolls away from the kids across America. If nothing else that we leave with today, we leave with that.

But, on a serious note, along those lines—and I just have two questions for the chairman. It was a comment from both gentlemen from Texas, Mr. Hensarling and Mr. Paul, and perhaps when I am done, you can—you were not able to address all of Mr. Paul's questions, but both these gentlemen raised sort of the same question

with regard to the China issue and the currency trading issues. That is, in the capital aversion, is it a zero-sum game if we achieve what many advocate that we achieve? That is the first question.

And the second question goes along the line or at least down the road of what Mr. Royce was raising. What happens if we take an alternative approach, a different approach? Some of the suggestions you were making here in your testimony, you have indicated that, at the end of the day, your ultimate goal is to go to that proverbial level playing field. As far as trade is concerned, in order to have capital growth you have to have free capital flow and free trade.

But one of the areas that we have heard from and prior testimony in another committee just down a different road is, with regard to restrictions that we are placing on ourselves here at home, with regard to equity interests and equity investments in this country, one of the facts and figures that came out was an estimated 90 percent of international small companies have chosen to list abroad on other exchanges rather back here at home.

So my question on the second line is, what impact will that have on our ability to have free trade and free flow and long-term—if we don't become on the same level playing field as other countries in this area as far as the exchanges are concerned, will that have a negative consequence to the U.S. economy?

Secretary SNOW. Right. Thank you, Congressman, thanks.

On the first question, it is not a zero-sum game at all. It is very much a positive-sum game. Because by getting the price signals right—and that is what exchange rates are; they are the price signals for the global economy—we are encouraging the better, more efficient use of resources.

One of the problems with suppressing exchange rates is that the price signals get confused and producers are led to believe they really are efficient at producing something when they aren't as efficient as somebody in some other part of the world, which means that resources are being misallocated, that the production ought to occur somewhere else rather than the way it is occurring. Canada found that out very much when it moved for the fluctuating exchange rates, that there was a freeing up of resources from less efficient uses to more productive uses.

I think China, as it moves to a market-based system of exchange rates, will find a rebalancing within its own economy, that some of the export activities that are attracting capital and resources won't attract as many and more domestic activities will attract more. That would make the resources of the world more effectively utilized, which means the size of the total output of the world would be greater. And what I just gave you is a definition of a positive-sum game.

On that second question, I think it is an important issue. We have got to make sure that, whether it is through our regulatory policies or through any changes in the CFIUS process or whatever, we don't discourage investment in the United States. Investment in the United States is one of our great strengths. It has created 5-and-a-half million jobs and jobs that pay well above the median.

So I share your concern. Absolutely. We have to be on guard against actions that would send a signal to the world that America isn't open for investment.

Mr. GARRETT. Thank you.

Mr. MILLER OF CALIFORNIA. The gentleman's time has expired.

The gentleman from Kansas, Mr. Moore, is recognized for 5 minutes.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman, and Mr. Secretary, thank you very much for being here. I want to join Chairman Oxley's and Ranking Member Frank's comments to you about the courtesy and civility and respect you have always expended to members of this committee as well as to Members in general, and I think you have set a very positive example for all of Congress.

I do appreciate your comments about the sustained economic growth of our economy, but I want to ask you some questions, too, about the other side of that. I guess to start off with the debt—and I want you to correct me if my numbers are not correct. But the debt that I read, in 2001, was about $5.8 trillion for our Nation, the national debt; and it now stands at about $8.35 trillion, which is an increase of just about $2-and-a-half trillion. Is that correct, sir?

Secretary SNOW. The total public debt, yes, sir.

Mr. MOORE OF KANSAS. And the deficit—and I am going to read these numbers, which I believe are correct, but please correct me if I am not correct—was, in 2002, was about $158 billion as reported; in 2003, $378 billion; in 2004, $413 billion; and in 2005, $319 billion. And the projected debt deficit for 2006 is $371 billion, although you said you hope that is much lower than that. Is that correct?

Secretary SNOW. That is correct, Congressman Moore, for all the years 2002 through 2005. I think the evidence now is pretty clear we are going to come in considerably below the $371 billion.

Mr. MOORE OF KANSAS. I hope you are right. I hope you are right.

You, as Secretary of the Treasury, are required to issue a financial report of the United States, and you did issue such a report in December of 2005, is that correct, sir?

Secretary SNOW. Yes, sir.

Mr. MOORE OF KANSAS. And, in fact, one of the first pages in the report was a message from the Secretary of the Treasury, signed by John W. Snow, correct?

Secretary SNOW. Yes.

Mr. MOORE OF KANSAS. And you indicated in there that the projected deficit—or the deficit for 2005 was about $319 billion but that the—on the accrual-based net operating cost, it would be $760 billion for 2005, is that correct, sir?

Secretary SNOW. Yes, it is.

Mr. MOORE OF KANSAS. And, in fact, the first method of calculating is using the cash basis and the second, the $760 billion figure, was based on the accrual method of accounting, is that correct, sir?

Secretary SNOW. Yes.

Mr. MOORE OF KANSAS. What do most major corporations in this country use? Do they cash-based accounting or accrual-based accounting?

Secretary SNOW. Normally accrual-based.

Mr. MOORE OF KANSAS. In fact, when I talked to corporate executives about the numbers $319 billion and $760 billion, they kind of smiled at the $319 billion because they are required to use accrual and not cash-basis accounting, correct?

Secretary SNOW. That is the standard general accounting practice.

Mr. MOORE OF KANSAS. Mr. Chairman, I would ask that this statement be received as an exhibit in the record, please.

Mr. MILLER OF CALIFORNIA. Without objection.

Mr. MOORE OF KANSAS. I am concerned, Mr. Secretary—and this is not to be partisan at all, because I tell people back home that 85 percent of what we deal with up here shouldn't be about Democrats or Republicans. It ought to be about taking care of our people and our country. I truly believe that, and I believe that you act that way as well.

I am very concerned that we are mortgaging the future of our children. Even though the sustained economic growth may be up and at a good rate right now, I am very concerned about what we are doing. I have children and grandchildren, and I think that we are putting them in a hole so deep they may never be able to climb out if we don't change the way we are doing business, and if Republicans and Democrats don't come together and change the way our country is doing business.

I guess I hear so much talk up here about values and from the President, from Members of Congress, and I don't think it is a family value to pass on massive debt to our kids and grandkids. I am just hopeful all the good people in our government—and I think 90 percent of them are good people—on both sides can come together and change the way we are doing business here.

And it is not just new spending, but I think we have tax cuts sometimes—and I voted for the President's first round of tax cuts back in the first year when we had a projected surplus of $5.6 trillion, but that turned around dramatically 2 or 3 years when the President asked for the second round, and I voted against it. I am just hopeful we all come together and do what is right for our country.

Thank you, Mr. Secretary.

Mr. MILLER OF CALIFORNIA. The gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Secretary. Good to have you back.

I want to go back to what I thought was the subject of this, and that is talking about our global economy and how it is doing. One of the things that I noticed with interest here this week is kind of the news that has been coming out that our trade deficit is actually for, I think, for the second time—quarter in a row or second month in a row, is less, even with high energy prices—that we look across the globe and economies in Europe, in Asia are growing at fairly rapid rates, and the economy in the United States is extremely good right now.

One of the things that I wanted to get your perspective on is, we look at this trade deficit. That is good news. Is that related to the fact that these other economies are growing at a better rate now, and does the falling dollar also kind of contribute to that?

Secretary SNOW. You know, one of the great mysteries of the global economy is to look at a month or 2 months—and what we have now is 2 months—and to say, uh-huh, we really understand what is going on. So I am—I have too much respect for economic data to take 2 months and say we have a real clear sense of what is happening there.

But Europe and Japan have both reported better growth rates, and that is important because if they have higher growth rates they create more disposable income. More of that disposable income will—if they have more disposable income, some part of it will come our way and help our exports.

And you did see in those two reports that exports were going the right way.

The counter side of that is that, when the United States grows much faster than our trading partners, as we have been, we are creating more disposable income here. We have a high propensity to consume and a high propensity to import. So that drives our imports up.

We don't want to see the current account deficit solved by the United States having slow growth rates. We want it to have high growth rates. But if we are going to sustain high growth rates and not—and see that our exports continue to rise, we need stronger growth than the rest of the world. I agree with you.

Mr. MILLER OF CALIFORNIA. Thank you.

The gentleman from Georgia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you very much, Mr. Chairman, and Secretary Snow, let me just say that I think you have handled your job in a first-class manner.

Secretary SNOW. Thank you.

Mr. SCOTT. Certainly with all the rumors swirling about your future, I think you have handled that situation with class and dignity and I want to commend you for that. It is not an easy task, I know.

But now let me talk about the debt, because I think that is the most pressing issue facing not just the country but the future of this country. You know great civilizations have all gone down because of a number of issues—global over-reach, dwindling resources at home, like we have with our oil, failure to take care of our borders—but, most importantly, huge debt in the hands of foreign governments. That spells disaster for our way of life and our civilization.

Let us look at the facts. The facts are these:

Number one, you and this Administration in the last 5 years have borrowed more money from foreign governments than all of the previous 42 Presidents and Administrations combined. That is extraordinary. To say that in the last 5 years this country, under this President and this Administration, with the sanction of this Congress, has borrowed more money than in the history of the country from 1789 until 2001, that is disastrous.

In the last 211 years leading up from 1789 to 2001, this country borrowed $1.0.1 trillion from foreign governments in foreign banks. In the last 5 years under this Administration and this Congress, we have borrowed $1.0.5 trillion dollars from national—from gov-

ernments and foreign governments and banks; and that is putting us in a very precarious position.

You talk about the current accounts balance. We have now in the last—in 2005, just this past year, we have borrowed from foreign governments $800 billion—our government, our businesses, our folks. This spells rank disaster; and I am wondering, when is this Administration going to come clean with the American people and say we need to put some controls on this?

When we also add to that fact that we are putting this burden on our young people, on our children and our grandchildren, which saddens me, that fact even makes it even more dramatic.

But here is the other point, the tax cuts that we are borrowing—and I want to talk about the tax cuts for a minute because I, too, voted for the first round of tax cuts because I thought it was a prudent thing to do to stimulate the economy; and I must say it did. But now to wage this war in Iraq on tax cuts, to make a tax cut at the time the country sacrificing as it is, is terribly wrong.

The other point that I would like for you to address is, given this go-along cowboy mentality of this President in dealing with foreign nations has placed us even in a more precarious state—situation.

Many of our allies have been defeated in elections: Spain, defeated; Italy, defeated; and poor Tony Blair is just hanging on by his fingernails. And even if we go to some of the oil petroleum countries like in Venezuela, Chavez and others.

So I want you to respond honestly, as we look to the future of this country, and we have to, what are the plans in the last 2 years of this Administration to address this debt, admit to what we are doing, and put some pay-as-you-go principles in place so that we can bring down this debt and cut not only this addiction to oil for foreign nations that we have but this addiction to their money. Because there is great worriation from financial markets all around this world that the dollar—our dollar could crash. Then what?

Secretary SNOW. Well, again, Congressman, thanks for those nice sentiments. I appreciate your comments. Let me try and address your question.

The debt levels have risen, as your numbers suggest, but, compared to most of the rest of the countries of the world, our debt levels are quite low; and even if you go back in history, our debt levels are quite low today, relative to the levels that they have been in the past. So I don't think that we should be alarmed.

And I do think we should address it. There is no doubt about the fact we need to continue to address the debt level and bring it down in absolute terms and as a fraction of GDP. But it is comforting to know that, when you look at the rest of the world, we are at the low end of debt; and when you look at most of American history, we are still at the low end of debt as a percentage.

One reason that public debt number has gone up so much is that we have a number of trust funds, like Social Security, that are currently in surplus; and under laws of the Congress, of the country, under the laws of the land, those surpluses can only be invested in debt instruments of the U.S. Treasury. So when the Social Security system wants to make an investment, they have to make an investment in U.S. Treasuries, and we issue a Treasury note.

Mr. MILLER OF CALIFORNIA. The gentleman's time has expired; 2 minutes over, sir.

Mr. SCOTT. One second, please.

Mr. MILLER OF CALIFORNIA. No, the gentleman's time has expired.

Mr. SCOTT. Will the dollar crash?

Secretary SNOW. I don't comment on the exchange rate values of currencies, but I think the set of policies that we have put in place are the right policies to ensure stability in the global economy.

Mr. MILLER OF CALIFORNIA. Thank you.

Mr. Snow, one of my top priorities since I have been in Congress is the concept that anybody who wants to own a home in this country should be able to. We have had numerous hearings with Secretary Jackson. I talked to him privately on numerous occasions about the most difficult impediment we have to deal with is down payment. Most people—just a lot of people don't have the down payment to be able to get in a home.

There are many organizations that are nonprofits that are organized for the purpose of just helping people with down—buyers' down payments assistance programs. HUD is permitted to use these programs in conjunction with FHA. So, basically, I would assume that was an approved program. But, recently, the IRS issued a ruling that virtually put most of these good groups, I thought, out of business. Can you please explain that to us?

Secretary SNOW. Chairman Miller, I think what the IRS did was to enforce the charitable laws of the country in a way they thought were consistent with the intent of Congress. And I did not participate in that decision. That is an IRS enforcement decision. But, following up with information on what they did, it was a desire on their part to see that the tax laws weren't being evaded.

Mr. MILLER OF CALIFORNIA. The problem I think most have with this, is that Congress has been encouraging this. We have had hearing after hearing encouraging it. In fact, the Government is talking about trying to help with down payment assistance. We have encouraged these nonprofits. We have had hearings where the Secretary has basically applauded them for the good work they have done and all the people they have put in homes.

The problem I have with it, and many people that I have talked to that are members have said we are going back now on people and these organizations for actions in the past rather than issuing a ruling that would take place on any transaction in the future. How do we justify doing that?

Secretary SNOW. Well, only because the conduct as observed and reviewed and analyzed by the IRS wasn't consistent with the tax laws of the countries. That was their finding, Congressman.

Mr. MILLER OF CALIFORNIA. Why did it take so long then?

Secretary SNOW. I suppose because of the inherent complexities in the matter. But, as I say, it was an enforcement action by the IRS; and, under the rules, Treasury Secretaries are supposed to stay out of those enforcement actions.

Mr. MILLER OF CALIFORNIA. I think it something we need to look into, because this is going to have devastating consequences in the future on the possibility of those with low income getting into homes.

The other one is something I have been working on since I have been in Congress, and it is the Spanish-American War tax on phones. It was considered a luxury in 1898. In fact, I actually got the bill to President Clinton one time in a much larger tax bill, and he happened to veto that bill or we would have struck it from the law.

You have long distance services still being taxed. The third U.S. Circuit Court of Appeals became the fifth appellate court to rule against the Treasury Department, saying that this is not a legal tax to collect, and the IRS seems to ignore what the courts say, and they are continuing to tax us.

You think about all the young people who are away at college and calling mom or grandma at home or dad, and they are being taxed for making that phone call. Or grandma is wanting to call the grandchildren, and she is being taxed for that phone call. A lot of these taxes are impacting people with very low income levels. What do you plan on doing in the future?

Secretary SNOW. Well, we haven't had a very good batting average, as you know. The handwriting seems to be on the wall with respect to, I guess, the Fourth or Fifth Circuit Court that came down that way. We have to review that, meet with the Justice Department people, and come to a final determination.

Mr. MILLER OF CALIFORNIA. Are you going to take into consideration the entire phone tax or just on long distance calls?

Secretary SNOW. That would be one of the issues we would have to think about. I think they have ruled that local is still permissible; the long distance isn't. So I think we would have to take a look at the whole subject.

Mr. MILLER OF CALIFORNIA. I hope you take into consideration the entire phone tax, and I would strongly encourage you to, if you have an opportunity, to look into the nonprofit Down Payment Assistance Program. When HUD has worked with them in conjunction of making an FHA-insured loan, we send a message somehow that this is acceptable. So we have one section of the Government, HUD, working with these nonprofits, saying obviously it is okay, because we are working together. Then we have, after the fact, the IRS coming in and ruling, no, it is not a legal transaction; it is taxable. That sends a conflicting message, and I would like, hopefully, to get that resolved.

Secretary SNOW. At a policy level, I will try and take a look at that. I can't get into the enforcement, though.

Mr. MILLER OF CALIFORNIA. Mr. Green, you are recognized for 5 minutes.

Mr. GREEN. Mr. Chairman, I will yield to Mr. Davis, if permitted to do so.

Mr. MILLER OF CALIFORNIA. It is your time, sir.

Mr. GREEN. Mr. Chairman, will I be able to be held after Mr. Davis?

Mr. MILLER OF CALIFORNIA. You have 5 minutes.

Mr. DAVIS OF ALABAMA. I would be happy to yield back.

Mr. GREEN. I will use my time.

I thank you, Mr. Secretary for appearing today.

Mr. Secretary, I would like to talk for a moment about currency manipulation.

Mr. MILLER OF CALIFORNIA. If you want to allow him to take your time now and you have 5 minutes later, that is acceptable.

Mr. GREEN. That is what our intention was.

Mr. MILLER OF CALIFORNIA. The gentleman is recognized for 5 minutes.

Mr. DAVIS OF ALABAMA. We will trade the 5 minutes if the Chair will allow it.

Mr. Snow, let me get your attention back, since we settled that. Let me make a general observation and get you to respond to it in two contexts.

One of the most consistent criticisms we have had on our side of the aisle—but, frankly, on the other side of the aisle sometimes has to deal with whether or not your Administration is always susceptible to the power of evidence and whether or not your Administration is willing to rethink positions based on empiricism; something is working well and something is not working as well.

Some of us, again, on both sides of the aisle, have occasionally had the impression that you and some of your colleagues at 1600 Pennsylvania Avenue tend to dig into a position regardless of what the facts appear to be. So I want to test that proposition in two areas. One of them has to deal with the extension of the tax cuts.

As you know, both Houses last week narrowly voted to extend the cuts on dividends and the cuts on capital gains. You and others have argued for extending the personal income tax cuts, and I think you have—others have argued making permanent the repeal of the estate tax, and the consistent point that you and others have made is we can do all of this irrespective of the deficit.

Let me ask you hypothetically, Mr. Secretary, is there a point that this deficit could reach that could cause you to rethink your support for extending these tax cuts?

Secretary SNOW. Congressman, look, I came to Washington as a budget hawk and I will leave it as a budget hawk. Budget deficits aren't a good thing, but, as we have discussed earlier, the deficit is now coming down.

Mr. DAVIS OF ALABAMA. I understand that. Because time is limited, I do want to press this point with you.

Is there a point—let's say the numbers turn around. You know very well they fluctuated the last several years, revenues fluctuated the last several years, and you know this is not just a contemporary question, it is a question the next few Congresses will face. At what point does this deficit have to reach or what number would the deficit have to reach to make you rethink your support for extending all the tax cuts?

Secretary SNOW. Well, I am going to say what I have said over and over again.

Mr. DAVIS OF ALABAMA. That was my concern.

Secretary SNOW. We are not going to get there. We are bound and determined not to get to that point.

Mr. DAVIS OF ALABAMA. Let's say that we got there. What about a $450 billion deficit? Would that cause you to rethink?

Secretary SNOW. Again, we are on a path to bring this way below that number.

Mr. DAVIS OF ALABAMA. Let's say that we got to $450 billion. Is there any number—I am not trying to play a game.

Secretary SNOW. Sure, there is some number. It doesn't serve a useful purpose to speculate on it when we have before us the chance to avoid that.

Mr. DAVIS OF ALABAMA. Let me make my point. I think you get my point. I am not trying to play a game with you, but hypothetical numbers—I am trying to make the point that there ought to be some correlation between our deficits and our tax policy. We can't distance the two. I am simply trying to make the observation that there could come a point at which we have to rethink, which is, frankly, more than your Administration has conceded.

The second point relates to trade. The Administration has essentially locked into the policy that we will do trade agreements with willing partners as long as they agree to enforce their own labor laws. All of the agreements contain that provision. The countries enforce their own labor laws.

Are there countries in the world, Mr. Secretary, who might be willing trading partners of the United States whose trade policies and whose labor laws are so poor or so weak we would refuse to enter into an agreement with them?

Secretary SNOW. That is a good question for your former colleague, Mr. Portman, and his successor. Treasury doesn't negotiate those trade agreements—

Mr. DAVIS OF ALABAMA. I understand that.

Secretary SNOW. —so I don't want to tread on the jurisdiction of others in the Cabinet.

Mr. DAVIS OF ALABAMA. You do routinely give us your policy perspective, and you have done that all day.

Secretary SNOW. Oh, yeah, the policy of open markets, free capital flows, flexible exchange rates is the right policy. But the details of negotiating trade agreements I better leave to people who do that for a living.

Mr. DAVIS OF ALABAMA. Let me close on this point, because my time is about to run out.

I know, Mr. Secretary, that you may or may not be moving on to something else in the next few months. I would make this observation with you. If you have occasion to reenter the private sector in the next several months before the Bush term is complete, frankly, I would like to invite you to come back to the committee. Because I would love to hear your perspective on these issues without the constraint of the "Mr. Secretary" title.

Secretary SNOW. Thank you.

Mr. MILLER OF CALIFORNIA. The gentlelady from New York, Mrs. Kelly, is recognized for 5 minutes.

Mrs. KELLY. Thank you.

Secretary Snow, I appreciate your being here and putting up with such a long period of questioning.

I questioned Under Secretary Kimmet about the financing of the Dubai Ports World deal through Islamic finance. I did it in writing, and I received a written follow-up response from the Treasury several weeks later saying, and I am quoting: "The Department of the Treasury cannot comment competently on Dubai law."

That wasn't exactly what I was expecting, and I appreciate their candor, but it wasn't what I really wanted to hear, Mr. Secretary. You and I both know that Dubai has long been an open financial

channel for terror networks and nuclear proliferators. You and I both see the signs indicating that Iran is financing its acquisition of nuclear weapons through Dubai. You and I both know that Islamic financing is one of the fastest growing sectors of the global economy. I think we need to better understand the vulnerabilities, especially in the UAE, so we can address them more effectively.

I am circulating to all of my colleagues in the House a letter to the UAE about the gaps in their financial defenses which have implications for our national security. And my concern with this whole idea of CIFIUS is that they are not looking behind a deal to finance—to look at what the financing is.

So what I hope is that you can give me some guidance about what steps are being taken by Treasury to develop expertise in the financial laws of Dubai and the UAE for both Western and Islamic financing. Are there other resources that we can give to you from Congress. What do you need?

Secretary SNOW. Thank you very much. Interesting you would raise that question. Because we have had with us at Treasury, understanding the importance of knowing more about Islamic finance, a leading student of Islamic finance and how they carry on financial activities in light of their religious rules on interest rates. I think we are getting a better understanding of that.

I will be in Egypt this weekend meeting with the finance ministers from that region; and one of the subjects that we will be putting on the table both in the general meeting and in the bilaterals, where I hope to meet with the UAE as well, is just this subject of managing our way through the whole set of finance issues in the world of Islamic finance, which does take some special attention, I agree with you.

Mrs. KELLY. I would like your thoughts about some comments that were made by the UAE's central bank governor in the aftermath of the Dubai Ports deal. He essentially threatened the failure of the deal would damage financial and trade relations between the U.S. and UAE. You may remember that. He talked about selling dollars to boost their Euro holdings. Have you seen anything so far that might be construed as a sponsor retaliation from the UAE for the failure of the Dubai Ports World deal?

Secretary SNOW. No, we have not.

Mrs. KELLY. I would hope that we would be able to establish something with CIFIUS in their background checks, as I repeat, in their background checks on any deal that is being constructed by—from an outside-of-the-United-States company coming here. I think the depth of their research on where the finances came from was not enough.

I think the response that came from Secretary Kimmet was honest, but I think that it is very important that we follow through with what you said. I hope you will follow through with what you intend to do, and that is take a look at both the UAE law and the other Arab countries that we are dealing with.

You and I both know that there are essentially two constructs of financial constructs there in Dubai. You and I also know that anyone can register with their local tribal authority and evade the laws in Dubai. That needs to be looked at. I hope you will address that.

Secretary SNOW. We are, and we will, and I will keep you fully advised.

Mrs. KELLY. Thank you. I would appreciate that.

I yield back.

Mr. MILLER OF CALIFORNIA. The gentleman from Texas, Mr. Green, is once again recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. It is a rare occasion when I have the opportunity to speak twice.

I thank you again, Secretary Snow, for being here today.

As indicated earlier, I would like to talk for a brief moment about currency manipulation, what I would call initial invidious currency manipulation. As you know, the exchange rate with the yen broke the psychological 8 yen per dollar level on Monday. I believe it is at 7.9982 for the first time. At this level, we are finding that the manufacturing sector, they have certain criticisms, analysts have Criticisms. The analysts are saying that by allowing this to happen and not formally accuse China of currency manipulation we are going to allow the yen to rise further. Our manufacturers contend that the yen is undervalued by as much as 40 percent, giving China exporters an unfair price advantage overseas.

Now with these circumstances in place, assuming that there is some degree of credibility in what is being said, are we reaching points where we have to officially designate China as a currency manipulator? First question.

Secretary SNOW. Well, we looked hard at that question, whether China should be designated, and concluded, based on all of our analysis that is laid out in that report in some detail, that the statutory criteria wasn't met. But we also made it very clear we are not happy with where China is today.

China needs to do more, and they are being too cautious. They should move faster. I am pleased to see it is moving some, but I think there is a lot of room for it to move more, and we are going to continue to make that case.

Mr. GREEN. When we accuse China of manipulating, how does that technically—once we do that, how does that benefit us to do so?

Secretary SNOW. Well, if we make that designation, then under the statute we would be required to enter into formal discussions, formal negotiations really, under the statute with the Chinese; and we are already having effectively those sorts of conversations with them.

The designation would, in my view, play out in ways that might not be helpful. If we find that their behavior meets the statutory test, we would certainly make the designation. But when I say it might not play out as favorable, I cite a number of commentators who in recent commentaries on our report have said that because Treasury has now taken away the threat of the negotiation, China is in a better position to move their currency in the direction that Treasury and the United States would like to see it move.

Mr. GREEN. One final question, if I may, Mr. Chairman. If so designated formally and officially, are we required to take certain action, and, if so, what actions are we required to take?

Secretary SNOW. Congressman, the only action we are required to take is have these formal discussions and negotiations.

Mr. GREEN. Thank you, Mr. Chairman. I yield back.

Mr. MILLER OF CALIFORNIA. The gentleman from New Mexico, Mr. Pearce, is recognized for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

Thank you, Mr. Secretary. Following Mr. Sherman's lead, I would comment that we have had no snow in New Mexico for several years, no spring runoff. You could help me answer when the drought is going to end there, so I would invite you out at any time.

I would encourage you to think the opposite direction as my colleague Mr. Davis on the tax rates. Looking at the Irish America, when they set up the 10 percent foreign tax rate and the Europeans said, you have to rethink your tax rates, they did; and they came back down from 36 percent to 12 percent, for the domestic corporations, too. It created such a strong economy that they came in and built a $200 million plant right outside the Second District in New Mexico.

So I would encourage you, if we get the $450 billion deficit, we consider cutting our tax rates and getting more foreign investment in here.

The idea of exchange rates is awfully important. In the Second District in New Mexico is the last manufacturer of Christmas ornaments, glass balls. It is just now down to China and the United States.

When China let their exchange rate vary just a little bit, the guy called me—we are not in weekly conversation but in constant conversations—and called and said, they blinked today on their exchange rate. I got a 2-and-a-half percent increase. I will be able to stay in business this last year.

This stuff is really huge for jobs here, and I would encourage you to continue doing the things you are talking about in your report.

Another item that he points out is that the state corporations there don't have to repay the loans to the state banks. That at some point we must deal with. It is bad enough this is the last guy in the world that has kept up with the Chinese. He has done it through productivity, through cost control, but there is nowhere left to squeeze. The last two competitors went out this year that were in the United States, so we really do need to take a look at the way the Chinese are manipulating the market.

When Mr. Bernanke was here, he made a comment that is directly opposed to your comment that you say we need to encourage greater savings rates. He mentioned there is not a problem with saving in United States; there is a problem in other countries of under-consumption, meaning too much saving. That to me was kind of a different take than I had heard. Can you help me understand the difference between your position and his position?

Secretary SNOW. I don't think there is any real difference, Congressman. The current account deficit is simply the difference between a countries savings rates and its investment rates. The United States has low savings relative to our investment opportunities. China has very high savings, India has high savings relative to their investment opportunities. As a result, a country like China, with high savings rates, net savings rates, over-investment, is generating savings that are used by the rest of the world. So what I

think the chairman had in mind is what I said earlier, that we want to encourage China to move to stronger domestic consumption markets to absorb those savings.

We were pleased—I was pleased that President Hu, who said as much when he was here, pledging to reduce emphasis on exports and strengthen emphasis on domestic consumption.

Mr. PEARCE. I agree with you. It would be a strong possibility.

You had mentioned the idea of private property rights being essential for the reformation of the world economy. Do you take an internal look at the United States? There are certain slippages. I look at it like a transmission pulling uphill. There is slippage.

If I look at Los Alamos, New Mexico, I find a town that is completely encased in Federal land, and the Los Alamos lab is a Federal Government entity. I have said repeatedly, they have issued their 5-year forecast. They were going to release some land and allow some expansion, but they never quite get to it. Along interstate highways, States are increasingly saying that same thing.

This is such a captive market. If we go into the gasoline business, then we can really do well. Because people really won't go 20 miles for gas. They will stop at the state-owned thing, even if it is not as good.

Then, finally, with regard to the aviation industry, hangers of the FAA is encouraging local airports to put fixed leases. At the end of 15 years, your hangar belongs to us. What we are doing is incrementally—no one—

Mr. MILLER OF CALIFORNIA. The gentleman's time has expired.

Mr. PEARCE. —incrementally depressing our economy.

If you would like to make a comment on the U.S. policy.

Secretary SNOW. On the Celtic miracle, I think you are absolutely right. At the heart of the Celtic miracle, it took the poor man of Europe, about the most prosperous economy in Europe, was lower tax rates and less regulation, to your last point.

We are trying to encourage China to have less support for those SOE's, those state-run enterprises, which means they have to stop these loans that are never repaid, which are really a form of indirect subsidy or direct subsidy.

On the role of the private sector, obviously, Government can encroach on the private sector in ways that the private sector can't, do what the private sector does best, create jobs, invest and grow the community. So I am in sympathy with you.

Mr. MILLER OF CALIFORNIA. The gentleman from Missouri, Mr. Clay, is recognized for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for your appearance today.

My questions are more along the lines of the domestic side of the issues. One, the IRS revenue ruling 2006–27 would take away the 501C3 status of down payment assistance housing organizations that help low- and moderate-income folks become homeowners. Have you answered this question already?

Secretary SNOW. Well, the chairman gave me his views on it, and I told him that I would follow up and try and take a policy look at the question and answered the rationale for the action the IRS took as best I could, explaining, of course, as he knows, that we at the Treasury are not engaged in the enforcement side of the IRS.

Mr. MILLER OF CALIFORNIA. If the gentleman would allow, he can talk to Mr. Frank.

Secretary SNOW. It has been brought to my attention, Congressman.

Mr. CLAY. I look forward to the response, also.

Let me ask you then, how much money from the war on terrorism has been seized in the last 6 months and what is Treasury currently doing in this area?

Secretary SNOW. Treasury, of course, is on the front line of the financial war on terror, and we continue to track terrorist moneys and to try and intercept them, break up their networks and follow the flows. When people use the financial system—if a terrorist used a financial system, he creates an audit trail; and we are trying to follow that audit trail. So we are very open about the fact that Treasury is going to use every lead we can get, every terrorist lead we can get and follow it through and use the leads to deter and detect and break up terrorist financing and terrorist networks.

Mr. CLAY. Mr. Secretary, apparently, you must look at some of the habits that terrorists have as far as what kind of tools they use and where they bank and all of that; and so it must be pretty apparent that these systems can be easily stopped. Is that your impression?

Secretary SNOW. As a broad observation, terrorists can only carry on their evil activities with money. They have to get airplane tickets and find a way to live and travel and pay people for services. When they use the financial system, we want to be in a position to follow any trail that is left.

They also, though, knowing that we are using the financial system to track them and follow them and detect them, use couriers and these money changing operations that are below the radar screen, which is why we need to continue to enforce the laws on things like amounts of currency that can be carried and things like that.

Mr. CLAY. I thank you very much for your responses. That is all I have, Mr. Chairman; and you have a good day.

Mr. MILLER OF CALIFORNIA. Secretary Snow, thank you very much for your testimony today. You were extremely candid responding to the questions. I know you are saddened that there weren't more questions, so we are going to allow 30 days to submit questions in writing for the record. Welcome, sir. It is good to have you here.

This meeting is adjourned.

Secretary SNOW. Mr. Chairman, thank you very much.

[Whereupon, at 12:25 p.m., the committee was adjourned.]

A P P E N D I X

May 17, 2006

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Testimony of Secretary of the Treasury, John Snow
On the State of the International Financial System
May 17, 2006

Today the Financial Services Committee meets to hear the annual report of the Secretary of the Treasury on reform of the International Monetary Fund (IMF) and the state of the international financial system. This hearing is mandated by the Fiscal Year 1999 foreign operations appropriations bill, which sought to ensure that the IMF would effectively use the funds appropriated to it on behalf of the United States. Congress included that requirement at the request of Representative Mike Castle, a senior Member of this Committee.

I look forward to your testimony, and I am pleased to see my good friend John Snow, who is serving this Administration so well. Certainly, our strong and growing economy is, in part, a testament to the steady hand of John Snow at the Treasury Department.

The traditional focus of the Secretary's testimony at this hearing is on reform of the international financial institutions. This has been a longstanding priority for the Bush Administration, and the President's Fiscal Year 2007 budget request for Treasury International Programs reflects a continued commitment to these reforms. Despite foreign policy challenges abroad, President Bush has remained committed to ensuring that the multilateral development banks work towards relieving the burden of unsustainable debt for countries with sound, pro-growth economic policies.

I have always believed that free trade and growth through exports are the fundamental building blocks for economic prosperity and democracy, both at home and abroad. The Treasury Department has supported the establishment of programs aimed at creating market-based economies that are open to trade. I am encouraged by the work of World Bank President Paul Wolfowitz in eliminating corruption and promoting a level playing field at the international lending institutions.

Level playing fields are vital to fair and free trade, and with that in mind I am particularly looking forward to Secretary Snow's comments on last week's report to Congress on international economic and exchange rate policies. After years of ignoring free market principles, the Chinese have finally begun to relax the hold over their currency. In the past this currency control has created unfair advantages for Chinese exporters, all too often at the expense of American businesses.

Since the middle of last year, however, China has instituted a 2.1 percent revaluation of their currency against the dollar and has introduced various regulatory measures to free up capital flows across its borders. The Treasury report noted that China needs to move quickly to introduce exchange-rate flexibility at a far faster pace, a subject which is of great interest to this Committee in light of continued engagement with China and maximization of this important trading relationship.

Though China is the country so often cited as driving the global economy, we must not lose sight of America's trade relationships with Europe, Japan and our neighbors to the north and south. U.S. corporations continue to make strides in productivity, and a rising global economy has created myriad opportunities for U.S. multinational corporations and for investors looking for growth opportunities in foreign markets.

Particularly in Latin America, remittances have generated real economic growth in emerging markets. Transactions such as these between established and emerging economies foster growth in both and merit ongoing consideration as we look to reform the international financial system.

On another topic, this year my friend and colleague Deborah Pryce, Chairman of the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, led the way in reauthorizing the Multilateral Investment Fund – the MIF -- at the Inter-American Development Bank. This is a good time for Treasury to take all possible steps to start similar programs at the other development banks. The MIF is an outgrowth of the Enterprise for the Americas, initiated by the first President Bush. While this is obviously now a multilateral effort, the MIF is in many ways the perfect exporter of U.S. values – a forum where a good idea, hard work and fair access to credit can provide a healthy wage for any number of people.

The MIF is an incredible success story. Combining modest grants to small and medium-sized businesses, this program has encouraged private sector development and leveraged the power of remittances throughout Central and South America. The result has been the growth of small

businesses here and abroad. And as we all know, small businesses are the engine of job growth.

We are all committed to the big projects spearheaded by development banks – water and sewer system construction, infrastructure development, the building of hospitals. Given the bang-for-the-buck we get out of the MIF at $25 million a year, however, we should seek to clone that program at the other development banks and try to do the same thing bilaterally through the Millennium Challenge Corporation and other international financial institutions. We must constantly be on the lookout for programs such as this that exhibit the best practices of government here and abroad.

Secretary Snow, I commend your continued oversight over the reform of the international financial system and your ongoing commitment to opening markets for our financial services firms abroad. Welcome back to the Financial Services Committee.

Financial Services Committee
Secretary Snow Hearing on International Financial System
Opening Statement
May 17, 2006

Chairman Oxley and Ranking Member Frank I am pleased to be here and thank Secretary Snow for coming to testify today.

It is important that we as a nation promote growth and poverty reduction in developing nations around the world.

As you know remittances play a huge role in promoting economic development.

According to a report released by the Inter-American Development Bank last week, the cost of sending money around the world has dropped significantly in the past five years from about 15 percent before 2000 to 5.6 percent last year.

Immigrants from Latin American and Caribbean sent $52 billion home last year to support their relatives so the lower fees mean more money is reaching poor families in these developing countries.

But our work is not done yet. We have a responsibility to bring unbanked individuals into the formal financial system.

An estimated 10 million Americans do not have bank accounts at mainstream financial institutions.

I have carried legislation that would allow credit unions to enter into the remittance market to bring costs down and give remittance senders wider access to financial services.

Bringing these individuals into the financial mainstream is very important for our own nation's economic well being.

I understand this is one of the priorities of the Financial Literacy and Economic Commission and look forward to seeing the findings of the upcoming GAO report on the effectiveness of the Commission's efforts.

Again, thank you for appearing before us today.

Opening Remarks
Honorable Maxine Waters
Committee on Financial Services,
Secretary of Treasury, Snow
May 16, 2006

Good morning ladies and gentlemen, Mr. Chairman. I would like to welcome the Secretary of Treasury, John Snow to this hearing on "The State of the International Financial System." Your testimony is important given the relationship of the international financial system to so many issues ---currency rates, debt relief, development reform, and globalization.

As you know, in the past few months we have been overwhelmed with reports related to the international financial system. The most recent reports have to do with the Chinese currency – the Yuan. Just yesterday it was reported that the Chinese allowed their currency to strengthen past the symbolic level of "eight to the dollar." Asian markets acted nervously, because any rise in the Yuan could signal a further slide in the dollar. Are we really ready for broader declines in the dollar? Does it matter?

The Administration has argued for sometime that the Chinese currency is undervalued. Presumably, you as the Secretary should be able to tell us whether the Chinese policies related to the Yuan are in the best interest of the international financial system. Asian markets are extremely important and any fall in the dollar will weaken the value of the Asian exports. Asian

equities would lose value and thereby, the demand for Asian currencies would be adversely affected. Tied to this issue is what is in store for our trade deficit with China --- $201.6 billion in 2005.

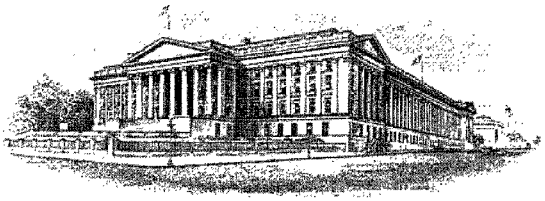
Another major issue related to the stability of the international financial system is the growth and development of the developing countries. Debt relief is an important ingredient to this equation. Poor countries will never be able to eradicate poverty as long as they must continue to make payments on loans that they can not repay. While I am pleased at the steps taken on behalf of some of the poor countries embraced in the Debt Relief Initiative for Heavily Indebted Poor Countries (HIPC), I am dismayed over efforts to date to speed up the process to provide debt relief to the poorest countries in the world. One year ago, the Group of Eight (G-8) agreed to expansive debt relief and proposed 100 percent cancellation for all countries that have completed the HIPC program. In March of this year, a bi-partisan group of Congress asked the World Bank President to cancel all of the debt, and I reintroduced the Jubilee Act, H.R. 1130, a bill to cancel completely the multilateral debts of the 50 poorest countries, including all of the countries covered by the Multilateral Debt Relief Initiative (MDRI), as well as other poor countries.

While Haiti has made some progress in complying with the terms of the World Bank and the IMF, it is unlikely that Haiti will ever be able to pay down their debt, or meet all of the HIPC conditions. According to the IMF, the key objective of the 2005/2006 program is to strengthen the fiscal position, while avoiding central bank financing, to strengthen Haiti's external position, and to advance key structural reforms." Haiti is still

saddled with more than $1 billion dollars of debt to Multilateral Financial Institutions, including $9.1 million to IMF, $566.7 million to the World Bank, and $470.9 million to the Inter-American Development Bank. However, if IMF projections are true, the above debt scenario is compounded by the fact that Haiti will have to spend $46.2 million in debt service payments in 2006.

The Haitian Debt Cancellation Resolution, which I plan to offer in the House, will eliminate this burden on Haiti. Haiti, the poorest country in the Western Hemisphere, must be given a fresh start, under new leadership at a critical point in the development of the country. I congratulate the Administration on supporting the MDRI. My hope is that you and the President will support my Resolution, sending a signal to the rest of the world that we support and promote democracy in our own back yard. Debt relief will allow Haiti to pursue a path towards economic self-sufficiency.

Again, this is a great opportunity for us to explore issues important to this Committee and to the nation. As such, I welcome Treasury Secretary Snow to the Committee and look forward to his views on the state of the international financial system. Thank you. Mr. Chairman.



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 10 A.M. EDT, MAY 17, 2006
CONTACT Tony Fratto (202) 622-2910

TESTIMONY OF TREASURY SECRETARY JOHN W. SNOW BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE ON THE INTERNATIONAL FINANCIAL SYSTEM AND THE GLOBAL ECONOMY

Chairman Oxley, Representative Frank and members of the Committee, thank you for inviting me here today. I welcome the opportunity to discuss global economic developments and the Administration's international economic policy priorities.

The Administration remains focused on achieving strong and durable economic growth in the United States and in the global economy. Our efforts within the G-7, the WTO, and the international financial institutions, as well as our bilateral and multilateral engagement with key economies around the world, are centered on this overarching objective.

While the global growth outlook is strong, the Treasury Department is focused on a number of priorities aimed at reducing risks and strengthening opportunities going forward. These include:

- Encouraging growth-enhancing reforms in key economies abroad to maintain global demand as imbalances are unwound;
- Promoting sustained economic reforms in emerging markets to reduce the chances that less benign financial conditions could lead to financial crises;
- Pressing for further opening of international trade and investment;
- Strengthening and modernizing the IMF's core functions and governance to maintain its relevance in the evolving international monetary system;
- Strengthening the integrity of the international financial system by rooting out money laundering, counterfeiting, and terrorist finance;
- Urging the Multilateral Development Banks (MDBs) to focus on policies that promote private sector-led growth, increase transparency, measure results and fight corruption; and
- Promoting long-term debt sustainability to end the decades-long lend-and-forgive cycle that has so clearly undermined growth and reform in poor countries.

U.S. Economy is Source of Strength and Stability for Global Economy

The United States has been a major driver of economic growth in the world economy for some years now, and I am pleased to report that, with our economy's outstanding health, we can likely expect the U.S. economy to continue to serve as a source of global strength and stability in the future.

Real GDP rose an impressive 4.8 percent at an annual rate in the first quarter of this year, reflecting a solid base of underlying strength in the economy. One component of strength is consumer spending. The Conference Board measure of consumer confidence rose smartly in April, reaching the highest level since May 2002. Solid consumer finances reinforce the stability of this spending; net worth is 563 percent of disposable personal income, the highest level since before the recession (2000:Q4).

I want to stress how broadly the benefits of this strong growth impact Americans.

- Average hourly earnings are picking up. We learned from this month's jobs report that average hourly earnings have risen 3.8 percent over the past 12 months – their largest increase in nearly five years. Comparing this point in the business cycle with the same point in the last business cycle, we're doing better during this recovery on wages.
- The unemployment rate is 4.7 percent – lower than the average for the 1960s, 1970s, 1980s or 1990s. The unemployment rate is dropping sharply for youths, African Americans, and for the last quarter, hit an all time low for Hispanic Americans.
- The U.S. homeownership rate reached a record 69.2 percent in 2005. The number of homeowners in the United States reached 73.4 million, the most ever. And for the first time, the majority of minority Americans own their own homes.

The strength of the economy is also visible at the Treasury, as we have seen strong revenue due to economic growth and rising employment. The Administration remains committed to cutting its fiscal deficit and meeting the President's goal of cutting the deficit in half by 2009 when it is projected to be about 1.4 percent of GDP. This will require determination, but revenue surprises are helpful. The budget deficit in fiscal year 2006 is on track to come in well below the estimate of $423 billion as projected in the FY 2007 Budget.

Global Economic Developments and Risks

The global economy is also enjoying a period of exceptional growth. The IMF projects global growth in 2006 of 4.8 percent overall and 6.9 percent for emerging markets and developing countries. Inflation remains contained, despite high oil prices, and the financial environment remains supportive of continued robust growth. This will be the fourth consecutive year of global economic growth above 4 percent – the strongest, sustained growth performance in 30 years. Global growth is particularly impressive in light of the bursting of the tech bubble, 9/11, the serious corporate governance scandals of a few years ago, and the sharp increase in energy prices. It is especially gratifying that developing economies have averaged growth of over 6 percent for the last six years.

But even in this strong growth climate we remain vigilant about potential risks. These include disruptive oil market developments, uneven economic growth amongst the advanced economies, the potential for rising protectionism, and emerging market vulnerability to potentially less benign financial conditions.

The continued rise in global imbalances – larger current account balances than were previously thought sustainable – is a development that particularly needs attending to by economies with weak growth rates, less attractive investment climates, or overly rigid exchange rate regimes. While there has been an intense focus on the U.S. current account deficit, it needs to be understood that our imbalance is a reflection of counterpart imbalances involving very high saving rates and export dependency elsewhere in the world. We believe that there will most likely be an orderly unwinding of these imbalances and we believe that the best contribution that the United States can make to this process is to continue growing at our full potential while continuing to reduce our fiscal deficit.

In discussions with key counterparts, I have emphasized that reducing global imbalances while maintaining global growth is a shared responsibility that will require contributions from Europe, Japan,

developing Asia, particularly China, and energy exporters. The United States will do its part as well and remains committed to meeting the President's goal of cutting the fiscal deficit in half by 2009. But the United States cannot resolve the problem by itself. While Japan's recovery is broadening and Europe is in a cyclical upswing, the outlook for future growth remains modest and reforms to strengthen domestic demand-led growth and improve long-run growth potential are still needed. Emerging economies with current account surpluses also need to play a more active role in managing global imbalances by adopting policies that allow for greater exchange rate flexibility, promote sustained increases in domestic consumption, and accelerate the pace of financial sector reform. Greater growth-enhancing spending by energy exporters, and, where appropriate, exchange rate flexibility, is also needed.

Among emerging economies, China has a particularly important role to play in addressing global imbalances. Rapid growth in investment and exports has fueled external imbalances and heightened risk of boom/bust cycles in the Chinese economy. The Chinese authorities recognize the need to shift the sources of Chinese growth away from external demand and credit-fueled investment. In this regard, China has placed strong emphasis on consumption and rural development in its most recent Five-Year Plan. Increased exchange rate flexibility, which would give the authorities greater scope to use more market-based policy tools such as interest rates to manage the economy, is a necessary part of this internal and external rebalancing, as are reforms in the financial system and a host of policies to support reduced household and enterprise savings. We are intensively engaged with China in an effort to bring about greater exchange rate flexibility, balanced growth and financial sector modernization.

We are closely monitoring ongoing developments in emerging market economies, especially those having weaker fiscal positions, higher debt burdens, and/or dependence on commodity prices as they could be tested if financial conditions become less benign. We have encouraged emerging market finance officials to take advantage of present conditions to undertake fiscal consolidation and improve their debt structures, and we have encouraged the IMF to press for structural fiscal reforms in its emerging market surveillance. Low interest rates, favorable global liquidity conditions, and improvements in macroeconomic fundamentals and debt management capabilities have fueled capital inflows and reduced the borrowing costs for emerging markets. Emerging market spreads are unusually low, having fallen in recent weeks to record lows of around 170 basis points.

One of the Administration's international economic policy goals is to increase global financial stability. With this in mind, I want to emphasize the importance of reducing the vulnerability of the global financial system, including emerging economies, by fostering compliance with international financial standards. Countries where the institutional environment is well-regulated and transparent tend to demonstrate better economic performance and greater financial stability. Treasury promotes compliance with international standards in bilateral dialogues, in multilateral fora such as the Financial Stability Forum, and in the IMF and World Bank through support for financial sector assessment programs and integration of financial sector reform priorities identified by these programs into broader surveillance and country programs. Treasury is also actively engaged with the standard-setting bodies, international organizations, and other national authorities in the process of creating and revising the international financial standards themselves. The Treasury Department and U.S. financial regulators conduct bilateral dialogues with our counterparts from a number of key countries – including China, Japan, India and the EU – with the objective of encouraging movement toward more competitive, better regulated financial regimes and mitigating actual or potential cross-border frictions in the financial services realm, thereby contributing to a stronger economy.

Promoting International Trade and Investment

Free trade and the free flow of capital are key pillars of global prosperity and stability. The United States remains fully committed to achieving a very robust Doha package, with emphasis on real, additional market access in the core areas of negotiations – agriculture, manufactures, and services (including financial services) – which would boost growth and provide new economic opportunities

domestically and globally. Given the Treasury Department's specific role in the financial services talks, we actively draw attention to the benefits of financial services opening in our bilateral discussions with governments around the world.

The potential benefits from these important trade reforms are enormous. The World Bank estimates that the global gains from full liberalization of merchandise trade would amount to $287 billion by 2015, including $142 billion in gains for developing countries. This would lift an estimated 66 million people out of poverty by 2015. Additional World Bank analysis also suggests that the benefits of services liberalization in developing countries could provide income gains more than four times greater than the gains from goods liberalization alone. Financial sector openness, in particular, has been shown to increase growth rates by over one percentage point in developing countries and to disproportionately help the poor, making commitments in the financial sector a win-win proposition. Of note, cross-country analysis shows that greater involvement by private and foreign banks leads to real benefits for consumers through more efficient lending and higher growth.

But the promise of Doha will not be realized unless we can break the current negotiating logjam. We are putting the full force of our policy efforts into finding a way forward. The door to a successful Round is agriculture, and the key to that door is a much more ambitious agriculture market access proposal from the EU. In addition, major developing countries such as China, India, and Brazil have to be willing to open up their markets in goods and services. We are very mindful that time is running short, with Trade Promotion Authority scheduled to expire in mid-2007.

In the meantime, we are continuing to press forward with an aggressive program of free trade agreements. The latest countries to be added to our FTA agenda are Korea and Malaysia. Overall, the Administration has completed FTA negotiations covering 15 countries, and implemented FTAs with eight countries thus far. The FTAs concluded by this Administration since 2001, combined with the three earlier accords, now cover roughly $925 billion in two-way trade – nearly 36 percent of total U.S. trade with the world and 45 percent of our exports. Where we have a FTA, our exports are growing a healthy 20 percent per year on average, more than twice the rate of growth for our exports where we do not have a FTA.

Greater openness to foreign investment also provides significant benefits to countries, whatever their level of development. The United States has concluded close to 50 Bilateral Investment Treaties that promote open and transparent investment climates abroad while ensuring that U.S. investors receive the same non-discriminatory treatment given to foreign investors in the United States. Our own country's openness to cross-border investment is one reason for the strong performance of the U.S. economy. U.S. affiliates of foreign companies employ about five million U.S. workers, account for about 20 percent of U.S. exports, and spend some $30 billion annually on research and development. It is critical that as we reform the process for reviewing foreign investment in the United States that we not unnecessarily harm this critical source of our economic strength.

Modernizing the IMF

The world economy is changing dramatically, and with it the environment in which the IMF operates. The global financial system is now dominated by private capital. Large emerging market countries account for much of the impetus for global growth. Payments imbalances unimaginable two decades ago now exist. A growing number of countries are building up foreign reserves as a form of self-insurance, and IMF credit outstanding is presently at a 25-year low, which represents a welcome decline in dependence on IMF lending. Despite these changes, the IMF's basic purposes – promoting growth, stability and monetary cooperation – are as important today as ever. The international monetary system needs a strong and central IMF, but, to continue to play a vital role the IMF needs fundamental reform – in its policies and its governance.

Partly in response to calls from the United States, the IMF Managing Director has set out a medium-term strategy that recognizes the need for fundamental reform. There is initial progress to report on several of the reforms we believe are of highest priority.

We have emphasized the need for greater attention to the Fund's core mandate of firm surveillance of exchange rate policies and their consistency with domestic policies and the international system. The IMF has followed our lead on this issue, and the Managing Director has stressed the need for the IMF to strengthen its focus on exchange rates. The Managing Director has also proposed new multilateral consultations, which can bring together the IMF, countries engaged in questionable currency policies, and countries most affected by those policies.

Critical to maintaining the Fund's legitimacy in many parts of the world is reforming its governance structure to reflect the growing importance of new economies. The United States strongly supports the effort to realign quotas and Board representation at the IMF in order to reflect changes in the global economy. Fundamental reform is needed if the IMF is to remain legitimate and relevant to its membership. We have agreed that a first step could consist of a limited ad hoc increase for the most under-represented members. But we have emphasized that an ad hoc quota increase by itself is inadequate to resolve the quota and representation issues that are steadily eroding the IMF's legitimacy and effectiveness. We are only willing to support a limited ad hoc quota increase at the IMF Annual Meeting in Singapore if it is credibly linked to a second step that delivers fundamental reform. This must include revising the IMF's quota formulas with GDP as the predominant variable, broadening the number of emerging market countries receiving increases in quota shares, and taking concrete actions to rationalize Executive Board representation.

There has been much discussion about the fall in the IMF's outstanding lending, to $35 billion from $107 billion at end-2003. The fall reflects early repayments by Brazil and Argentina, as well as more generally better emerging market policies and an exceptionally benign external environment. This is of course a welcome development – the appropriate measure of IMF effectiveness is how well it helps countries and the global system avert or recover from financial crises, not by the volume of Fund lending.

We are optimistic that a refocused IMF will strengthen market institutions and market discipline over financial decisions, helping to promote a stable and prosperous global economy. By doing so, over time markets and the private sector can supplant the need for the IMF to perform in its current role.

Supporting Economic Growth in Developing Countries

The private sector is the engine of growth in most countries and we continue to press for the adoption of policies which unleash the power of the private sector. This includes policies that improve the investment climate, increase access to finance for entrepreneurs, and facilitate business development. Over 70 percent of the population lacks access to financial services. Continued support for programs that support micro and SME lending as well as other financial services for the poor are critical to broadening and deepening economic growth.

Good governance and fighting corruption are fundamental to creating the investment climate necessary to sustain private sector-driven growth. It is imperative that development institutions attack corruption around the world that helps keep nations poor. We support World Bank President Wolfowitz's leadership on the anti-corruption agenda, and his commitment to develop a framework to address corruption systematically. We think such a framework should embody clear and strict criteria consistent with a zero-tolerance approach to corruption.

All MDBs need to be equipped to attack corruption in borrowing nations, and to demonstrate this leadership each MDB must have its own house in order. This requires MDB agreement on a common

definition of fraud and corruption, work which is to be completed by the September World Bank Annual Meeting. It also requires that the MDBs increase the transparency of their own operations, strengthen procurement oversight, and implement appropriate incentive structures for staff.

In borrowing countries, strengthening public financial management is essential to improving governance and fighting corruption. We have encouraged the World Bank to expand the coverage of its Public Expenditure and Financial Accountability indicators so that they can provide a consistent benchmark of country strengths and weaknesses. MDB procurement must also adhere to the highest standards – such as those embodied in the World Bank's current policies – rather than rush to use local systems that do not yet meet such standards. Finally, we have advocated for increased transparency and accountability, including through the extractive industries transparency initiative which sets standards for accounting for natural resources revenues.

Deep debt relief through the enhanced Heavily Indebted Poor Countries initiative and the Multilateral Debt Relief Initiative (MDRI), along with the introduction of a non-borrowing policy support instrument at the IMF and the use of grants for poor, debt-vulnerable borrowers in the MDBs, offer prospects for ending the dysfunctional cycle of lend-and-forgive. But to make this happen, debt sustainability must become a central focus of international financial institution engagement in low-income countries. Otherwise, the push to help countries achieve the Millennium Development Goals could lead to another round of over-borrowing, leaving countries vulnerable once again to debt distress. To ensure that the hard-fought gains from debt relief are not squandered, it is essential for the World Bank and the IMF to remain vigilant on low-income country imprudent borrowing. We will continue to press the Bank and the IMF to improve their joint Debt Sustainability Framework for low-income countries. Toward this end, we have developed a proposal for IDA that would limit the pace of debt re-accumulation, and are discussing the proposal with our G-7 counterparts.

A particularly disturbing development is the emergence of new non-concessional lending that seeks to take advantage of realized or anticipated debt relief. This type of "free riding" behavior merits a firm international response. For example, the Chinese government is vigorously pursuing lending in Sudan and Mozambique, both of which are expecting eventual MDRI debt relief. In Sudan's case the lending terms are non-concessional; in Mozambique the terms are still being worked out, but based on the Sudan case we have serious concern. We have been working with our G-7 partners and in the Boards of the Fund and the Bank to push for a presumption of zero new non-concessional debt for countries which are candidates for debt relief. We are also working through the Paris Club and the international financial institutions and engaging directly with creditor countries to gain the adoption of more responsible lending practices.

Fighting Terrorist Finance

Continued terrorist attacks overseas remind us of the urgency of fighting terrorism and its illicit finance. We have been at the forefront of a concerted effort to collect, share, and analyze all available information to track and disrupt the financial activities of terrorists. Finance ministries and central banks play a key role in this effort, as financial intelligence is among our most valuable sources of data for waging this fight. Our goal is to draw upon all available financial information to detect and disrupt terrorist money flows.

Comprehensive integration of the IMF and the other international financial institutions as part of the global war on terrorism has been a consistent policy priority for the United States. We have encouraged close collaboration between the international financial institutions and the Financial Action Task Force (FATF) to assess global compliance with the anti-money laundering and counter-terrorist financing standards set by FATF.

As a result of U.S. leadership, in 2004 the IMF and World Bank Boards endorsed a common assessment methodology drafted by the FATF that provides a consistent framework for assessing compliance with FATF anti-money laundering and counter terrorist finance recommendations. The Boards reaffirmed this decision this May and have agreed that comprehensive anti-money laundering/combating the financing of terrorism assessments will be included as a regular part of all financial sector assessments and on-going surveillance. By the end of 2005, the IMF and World Bank conducted over 50 country assessments. The IMF and World Bank are also a key source of technical assistance for countries seeking to strengthen their counter-terrorist finance and anti-money laundering regimes, and the frequency of technical assistance missions has increased in recent years, partly due to U.S. leadership on this issue within the G-7 and the international financial institutions.

We will continue to emphasize that protecting the financial system from abuse is integral to international financial stability and to call on the international financial institutions to collaborate more closely with FATF toward this end.

Conclusion

Mr. Chairman, you can see that, while we have accomplished a great deal with respect to our international economic agenda, we remain cognizant of the risks and opportunities ahead and are focusing our efforts on addressing them.

I look forward to working with your committee and would be happy to answer any questions.

-30-

UNDER SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

MAY 1 0 2006

The Honorable Rubén Hinojosa
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Hinojosa:

Thank you for your recent letters on the North American Development Bank (NADBank). I appreciate your concern.

There are no immediate plans to close the Bank, but serious concerns remain. The Bank has not been performing as effectively as intended, and taxpayers' dollars are not being used as effectively as they should be, as a result of the inherent difficulties of the Bank's mission. I have enclosed some additional information which I hope is helpful to you.

Sincerely,

Timothy D. Adams
Under Secretary for International Affairs

Enclosure

cc: EPA Deputy Administrator Peacock
Under Secretary of State Shiner

A MESSAGE FROM THE SECRETARY OF THE TREASURY

Our objective in preparing the fiscal year *2005 Financial Report of the U.S. Government* is to give the Congress and the American people a timely and useful report on the cost of the Federal Government's operations, the sources used to fund them, and the implications of our long-term financial commitments and obligations.

As Treasury and the Office of Management and Budget reported in October in our 2005 fiscal-year-end budget report, the growing economy brought 2005 revenues to a level of $2.2 trillion. This increase of almost $275 billion over 2004 revenues was nearly a 15 percent increase and was also the largest year-over-year percentage increase in receipts in over 20 years. These increased revenues resulted in a much lower-than-expected 2005 budget deficit. While deficits are never welcome, the 2005 deficit of $319 billion, when expressed as a percent of Gross Domestic Product, was lower than the deficits in 16 of the last 25 years.

In comparison with the October budget report, the *Financial Report* presents the government's accrual-based net operating cost, which was $760 billion in 2005. There is a difference in the amounts reported for the budget deficit and the net operating cost because of the distinct methods of accounting used. This year, the difference of $441 billion is due principally to a $198 billion increase in Veterans Affairs' actuarial costs, mainly a reflection of changes in interest rate assumptions.

In addition to looking at the financial results of this past year, this report looks toward our nation's fiscal future. An important measure of the government's fiscal position is the cost of its responsibilities for social insurance programs such as Social Security and Medicare. Including these future financial responsibilities in this report gives a more complete and long-range look at the government's finances.

These government-wide financial statements reflect the Treasury Department's long-standing responsibility and commitment to report on the Nation's finances and our desire to inform and support the financial decision making that is critical to the nation's fiscal future.

John W. Snow

John W. Snow

○