STRENGTHENING U.S. LEADERSHIP IN A TURBULENT GLOBAL ECONOMY

HEARING

BEFORE THE

SUBCOMMITTEE ON MONETARY POLICY AND TRADE

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

SEPTEMBER 17, 2015

Printed for the use of the Committee on Financial Services

Serial No. 114–51

U.S. GOVERNMENT PUBLISHING OFFICE

99–730 PDF WASHINGTON : 2016

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

JEB HENSARLING, Texas, *Chairman*

PATRICK T. McHENRY, North Carolina, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
SCOTT GARRETT, New Jersey
RANDY NEUGEBAUER, Texas
STEVAN PEARCE, New Mexico
BILL POSEY, Florida
MICHAEL G. FITZPATRICK, Pennsylvania
LYNN A. WESTMORELAND, Georgia
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
ROBERT HURT, Virginia
STEVE STIVERS, Ohio
STEPHEN LEE FINCHER, Tennessee
MARLIN A. STUTZMAN, Indiana
MICK MULVANEY, South Carolina
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ROBERT PITTENGER, North Carolina
ANN WAGNER, Missouri
ANDY BARR, Kentucky
KEITH J. ROTHFUS, Pennsylvania
LUKE MESSER, Indiana
DAVID SCHWEIKERT, Arizona
FRANK GUINTA, New Hampshire
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
BRUCE POLIQUIN, Maine
MIA LOVE, Utah
FRENCH HILL, Arkansas
TOM EMMER, Minnesota

MAXINE WATERS, California, *Ranking Member*
CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
STEPHEN F. LYNCH, Massachusetts
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
GWEN MOORE, Wisconsin
KEITH ELLISON, Minnesota
ED PERLMUTTER, Colorado
JAMES A. HIMES, Connecticut
JOHN C. CARNEY, JR., Delaware
TERRI A. SEWELL, Alabama
BILL FOSTER, Illinois
DANIEL T. KILDEE, Michigan
PATRICK MURPHY, Florida
JOHN K. DELANEY, Maryland
KYRSTEN SINEMA, Arizona
JOYCE BEATTY, Ohio
DENNY HECK, Washington
JUAN VARGAS, California

SHANNON MCGAHN, *Staff Director*
JAMES H. CLINGER, *Chief Counsel*

Subcommittee on Monetary Policy and Trade

BILL HUIZENGA, Michigan, *Chairman*

MICK MULVANEY, South Carolina, *Vice Chairman*
FRANK D. LUCAS, Oklahoma
STEVAN PEARCE, New Mexico
LYNN A. WESTMORELAND, Georgia
MARLIN A. STUTZMAN, Indiana
ROBERT PITTENGER, North Carolina
LUKE MESSER, Indiana
DAVID SCHWEIKERT, Arizona
FRANK GUINTA, New Hampshire
MIA LOVE, Utah
TOM EMMER, Minnesota

GWEN MOORE, Wisconsin, *Ranking Member*
BILL FOSTER, Illinois
ED PERLMUTTER, Colorado
JAMES A. HIMES, Connecticut
JOHN C. CARNEY, Jr., Delaware
TERRI A. SEWELL, Alabama
PATRICK MURPHY, Florida
DANIEL T. KILDEE, Michigan
DENNY HECK, Washington

CONTENTS

STRENGTHENING U.S. LEADERSHIP IN A TURBULENT GLOBAL ECONOMY

Thursday, September 17, 2015

U.S. House of Representatives,
Subcommittee on Monetary
Policy and Trade,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:03 p.m., in room 2128, Rayburn House Office Building, Hon. Bill Huizenga [chairman of the subcommittee] presiding.

Members present: Representatives Huizenga, Mulvaney, Lucas, Pearce, Stutzman, Pittenger, Schweikert, Guinta, Love, Emmer; Moore, Foster, Himes, and Heck.

Chairman Huizenga. The Subcommittee on Monetary Policy and Trade will come to order. Without objection, the Chair is authorized to call a recess of the subcommittee at any time.

Today's hearing is entitled, "Strengthening U.S. Leadership in a Turbulent Global Economy."

Before I go into my opening statement, we have been given notice that they are expecting votes on the Floor sometime between 2:20 and 2:35. I would suspect that means 2:55 to 3:05. I don't know, hopefully not. But hopefully, it will be more like 2:30. And we have one vote, a rule vote, and my intention is to take that quick time and have us all go vote and then come back so that we can finish up. I don't suspect that we will have gotten through everybody at that point.

So with that, I would like to recognize myself for 3 minutes to give an opening statement.

The dictionary defines "turmoil" as a state of confusion or disorder. Unfortunately, that is the state of the global economy right now, it seems.

For instance, for more than 3 decades China has claimed an average annual GDP growth of over 10 percent. However, in the last 3 years it has seen growth of less than 8 percent and the government has announced that it is now struggling to meet a target of 7 percent for the year.

Last month, the People's Bank of China announced a surprise devaluation of their renminbi by 2 percent, sending major stock markets in Asia and Europe down and sparking fears of additional exchange rate devaluations in other countries. It was the largest devaluation in China's system in over 20 years.

In the weeks following the devaluation, however, China spent up to $150 billion in foreign reserves to prevent the currency from sliding even further.

Additionally, the MSCI Emerging Markets Stock Index has fallen by more than 15 percent since July, with Brazil's credit rating now cut to junk status.

Europe is also in dire straits. This month, the European central bank announced a new round of quantitative easing. Meanwhile, concerns over Greece and the euro's future continue.

In each of these cases, a slowdown has been precipitated by unsustainable debt and ill-advised government intervention in the economy.

For years, China had depressed the value of the yuan to fuel its exports, only recently allowing its value to rise. Meanwhile, easy credit led local and regional governments to amass nearly $4 trillion in debt in China. With little ability to find productive investments at home or abroad, the Chinese have created speculative bubbles in real estate and stocks that only now are beginning to deflate.

Europe meanwhile sees no end in sight to Greece's downturn, which continues to threaten the integrity of the entire eurozone. This summer, Greeks filed nearly $2 billion in arrears to the International Monetary Fund (IMF) and had to close banks to prevent capital flight. After negotiating a new rescue with eurozone governments, many of those voters who strongly opposed further bailouts, the country now has announced elections that may undermine its ability to carry out those reforms that it had just passed and accepted.

This combination of debt and misguided policy abroad provides the United States with an opportunity to reorient international priorities. Three policy debates are of particular relevance to the Monetary Policy and Trade Subcommittee: first, inclusion of China's RMB in the IMF's basket of elite currencies; second, the IMF participation in the next European bailout of Greece; and third, the Transpacific Partnership and its role in expanding rules-based trade overseas.

This hearing will explore these matters and some others and urge the Administration to advance a "back to basics" type of approach to economic policy, one that emphasizes fiscal responsibility and free markets.

And with that, I yield back my time.

The Chair now recognizes the ranking member of the subcommittee, the gentlelady from Wisconsin, Ms. Moore, for 5 minutes.

Ms. MOORE. Thank you so much, Chairman Huizenga, and members of the subcommittee.

And I want to welcome you, Under Secretary Sheets.

Mr. Chairman, this is absolutely a subject that deserves our close attention. And I want to thank you for convening this hearing today.

We are in an increasingly global world, for all that means, both good and bad. And one extremely important thing I think that this Congress can control, although we cannot control everything, is that we could make an immediate, tangible, and lasting impact on the prestige and confidence of the U.S. global leadership, and that would be that we should immediately ratify the new IMF quota system.

Mr. Chairman, I just learned—breaking news—that Chair Yellen has announced that there will be no interest rate hike as of right now. So, that is really important news.

But I think that one of the things that we could do right now is to ratify this new IMF quota system. There is consensus agreement that it is the rational move to make at this time and there is no reason that we have not yet acted.

U.S. leadership and engagement in economic policy is vital to the long-term interests of our country. Global economic stability, as we all know, is smart geopolitically.

Congress' lack of action has hurt the United States' standing internationally. Further delay makes even less sense. And as the chairman has pointed out, China has made a lot of movements to fill a void, and we need to take action in this Congress, as well.

I know that some have sought to tie approval of the quota system to other IMF reforms. But I respectfully disagree on that point. The quota system should be approved and then we can talk about IMF reforms.

U.S. good-faith engagement in these multinational organizations is extremely fruitful as we can flex soft power and accomplish goals that are simply not realistic or counterproductive with the use of force.

And I yield back the balance of my time.

Chairman HUIZENGA. The gentlelady yields back.

With that, the Chair recognizes the gentleman from Minnesota, Mr. Emmer, for 2 minutes for an opening statement.

Mr. EMMER. Thank you, Mr. Chairman. Thanks for holding this important hearing.

With the backdrop of Congress passing trade promotion authority and, U.S. Trade Representative negotiators laying the groundwork for historic trade agreements with Europe and the Pacific Rim, I am concerned that our Nation's interest in promoting and securing trade agreements, which are certainly important to both our economic opportunity and our national security, may collide with our sovereignty and other legitimate interests.

Sluggish growth and the debt crises in European Union member states and the devaluation of China's currency threaten current market stability and pose serious risks to future multilateral trade deals like TPP or TTIP, as well as the insurance and regulatory frameworks that will comprise these agreements.

I look forward to hearing the Under Secretary speak about how the United States is exercising its leadership to ensure our sovereignty, such as my home State's ability to regulate its insurance market further.

I am particularly interested in what the Treasury is doing to leverage U.S. influence when it comes to the International Monetary Fund's consideration of the RMB as a basket currency, its systemic exemption policy, terrorism financing, remittances, and global bailouts.

Mr. Chairman, thank you again for calling this hearing. And I yield back.

Chairman HUIZENGA. The gentleman yields back.

We will now turn to our witness. Today, we welcome the testimony of the Honorable Nathan Sheets, Under Secretary for International Affairs at the U.S. Department of the Treasury. Mr. Sheets previously worked as a global head of international economics at Citigroup. He also served for 18 years at the Federal Reserve in various capacities, and from 2006 to 2007 was a senior advisor to the U.S. executive director at the the International Monetary Fund (IMF).

Mr. Sheets, without objection, your written statement will be made a part of the record. And you will be recognized for 5 minutes.

But I should also mention that one of our Members has taken great pleasure in getting to know you by talking on local streets and in restaurants, and he has heard all the good stuff about your growing up in Mesa. So Mr. Schweikert is very pleased to start claiming you as one of his own. You grew up there, and then you were off to BYU, I believe, for your B.A., and then MIT for your Ph.D.

Yes, too many letters. Sorry, Mr. Mulvaney wasn't following how many letters.

But I do want to say thank you for your time and attention and your ability to be here today. You are now recognized for 5 minutes to give your testimony.

STATEMENT OF THE HONORABLE NATHAN SHEETS, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE TREASURY

Mr. SHEETS. Thank you. Chairman Huizenga, Ranking Member Moore, and members of the subcommittee, thank you for the opportunity to testify today to discuss Treasury's role in promoting global economic growth.

Earlier this month, I joined Secretary Lew at the G20 finance ministers and central bank governors meeting in Ankara, Turkey. Discussions at the meeting focused on the recent turbulence in global financial markets, particularly in China, as volatility in its equity and currency markets has spilled over to markets globally.

Fears of a slowdown in China have also raised concerns about the global growth outlook. Commodity producers have been especially vulnerable to lower Chinese demand.

We discussed ways to boost global growth, including through strategic infrastructure investment and structural reforms, as well as the need to continue to strengthen financial, supervisory, and regulatory practices to reduce the risk of financial crises.

As has been widely noted, the Chinese economy is undergoing a difficult but essential transition that if successful, will make growth there more reliant on domestic consumption and less reliant on exports and investment.

The Chinese government has laid out a comprehensive set of economic reforms to move toward a more market-oriented, consumer-driven economy. These reforms are largely consistent with what the United States has long advocated.

To ensure that the transition is managed in an orderly way, China must transparently communicate its policies and actions and allow the market to play a primary role in determining outcomes.

Treasury has had sustained and robust engagement with China on its policies, including in the economic track of the strategic and economic dialogue. In light of recent developments, we are encouraging the Chinese authorities to accelerate the implementation of their reform agenda, while underlining that to bolster effectiveness, these reforms must be implemented in an orderly and transparent manner.

Turning back to the global arena, our partners look to U.S. leadership to help formulate the international agenda. And we, in turn, rely on the international financial institutions to provide analytical, technical, and financial support to identify vulnerabilities, advance reforms, and smooth adjustment.

The IMF has played and continues to play an important role in providing assistance to key strategic partners of the United States. For example, in Ukraine the IMF is currently supporting a program that aims to bolster the Ukrainian government's extraordinary reform efforts.

The IMF has been a key partner in Europe's efforts to fight crisis in the region, preserve the integrity of the euro area, and frame a reform program for Greece that includes necessary adjustments, encourages growth, and puts debt on a more sustainable path. The United States and the IMF are actively supporting the need for further debt relief for Greece now.

To ensure that the IMF remains at the center of the multilateral economic system, and that we maintain an important voice in it, the United States should promptly approve the 2010 quota and governance reforms. Our interest in strengthening the Fund is based on hard-won experience that a well-resourced and effective IMF is indispensable to achieving our economic and national security interests. The proposed reforms are designed to strengthen the Fund's finances while preserving the U.S. veto by a comfortable margin.

The Treasury Department also fosters growth and prosperity by working in partnership with the Multilateral Development Banks (MDBs), including the World Bank and the regional development banks. Like the IMF, the MDB's purposes firmly align with the interests of the United States, and they are vital tools for promoting security, economic growth, environmental sustainability, and poverty reduction.

Finally, the Administration's trade agenda is also essential to our efforts to promote prosperity. We are working to secure a final Trans-Pacific Partnership agreement, or TPP, that unlocks export markets, establishes strong rules, and bolsters economic growth at home.

TPP promises to help U.S. businesses reach customers in the world's fastest-growing region, deliver more and better jobs in the United States, and elevate trade and investment standards, including on transparency, fairness, innovation, labor rights, and the environment. And we very much look forward to continuing to work with you on these objectives.

I am very happy to answer any questions that members of the subcommittee may have.

[The prepared statement of Under Secretary Sheets can be found on page 24 of the appendix.]

Chairman HUIZENGA. All right, thank you. We appreciate that. And the Chair now recognizes himself for 5 minutes.

Mr. Sheets, I think it is difficult to find anyone who argues for the continuation of the IMF's systemic exemption to its exceptional access framework which bailed out Greece creditors without restoring economic growth or competitiveness to the country. But we keep getting mixed signals from the Administration on this.

In an August 31st letter to me last month, Treasury said this systemic exemption was "important to the IMF's role in providing support in most difficult crisis cases." But when Secretary Lew testified here in June, he said in response to one of my questions, "I think exceptional access has serious questions. I have never pushed back on the kinds of questions you are asking"—in other words, questions about eliminating the systemic exemption—and again, he is saying, "I am open to a serious conversation about it. I think looking forward, finding a way for the IMF to avoid having to use tools like that is in all of our best interests. And I would be happy to have that conversation." That was Secretary Lew.

Previously, in fact just last month, IMF's former chief economist said, "The reforms now being discussed at the Fund, namely the wider use of the debt reduction rescheduling option and the elimination of the systemic exemption, are really important."

In fact, even my good ranking member had said that she was "entirely open to considering the case for IMF reforms," which I am happy to hear.

But Secretary Sheets, isn't it time to get rid of the systemic exemption?

Mr. SHEETS. This is an enormously important issue and one that is also particularly salient. Clearly, my sense is that given where the world was in the spring of 2010, using the systemic exemption was the right thing to do. There were severe spillover risks if Greece or Portugal or Ireland had been required to restructure their debt in that environment.

Chairman HUIZENGA. But you would admit that they basically bent the rules or ignored the rules to make all that happen, correct?

Mr. SHEETS. The decision was made in accordance with the powers of the IMF Executive Board. And the IMF Executive Board very much felt that moving toward a debt restructuring in that environment would be inappropriate. So they established mechanisms that allowed these programs to go forward.

Chairman HUIZENGA. I can take "yes" for that as an answer. But what about going forward?

Mr. SHEETS. Right.

Chairman HUIZENGA. We know what happened in 2010, but it is the going forward I am concerned about. And I think there are a number of us who are concerned about IMF future bailouts of Greece, as they are very concerned.

Mr. SHEETS. And as you indicate, there is a very lively debate on this issue that is ongoing inside of the IMF. One proposal on the table is to further specify the conditions under which the systemic exemption could be used. But there are also other approaches that are being articulated in that debate. And we very much look forward, as Secretary Lew said, to having a conversation with you and your staff on this issue.

Chairman HUIZENGA. Okay. I want to move on a little bit to the exclusion of financial services in the negotiations, such as TPP and TTIP.

I have been engaged in an ongoing dialogue with Treasury over its exclusion of the financial services sector. And as you well know, that is an extremely important thing, with a number of important issues including localization of information and a number of others.

To date, your colleagues at Treasury have offered varying rationales for why Treasury refuses to support strong rules to ensure foreign investment. Foreign governments do not impose such restrictions, but I am very concerned that it is going in a different direction.

I have weighed in on this issue, the Ways and Means and Finance Committees have weighed in, calling on you to—not you, you collectively—eliminate such localization requirements for all sectors, including financial services.

Does the Administration, particularly Treasury, understand that the current discriminatory approach to addressing localization barriers will jeopardize existing support for trade agreements if it is not addressed?

Mr. SHEETS. This is another issue that I personally am working on quite intensively.

Over the last 6 weeks or so, I have had the opportunity to speak in some detail with our various regulatory agencies as well as with USTR and the State Department on this.

And the sense that we get is that in pursuit of financial stability and soundness of institutions, it is absolutely imperative that the regulators have unimpeded access to various books and records associated with the operations of foreign institutions in the United States.

And it is not clear, if these institutions are not required to have books and records actually in the United States, that the regulators would have that unimpeded access. So it is a matter of regulation, it is a matter of supervision to ensure that these institutions are safe and sound. It is also a matter of law enforcement. So there are a number of issues at stake here.

Chairman HUIZENGA. My time has expired.

And with that, I recognize the gentlelady from Wisconsin for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman.

And thank you again, sir.

I was searching all over for it, but in your testimony you talked about the importance of the United States paying its share to the IMF. And I think I referred to that in my opening remarks.

Other countries have developed other institutions to sort of get around the IMF because of our lack of participation. Could you just give us a little bit, just sort of fill in the blanks of what we could expect if these other multinational development organizations take off and the IMF and the United States uses its influence in this sphere?

Mr. SHEETS. As you say, a strong, well-resourced IMF is very much in U.S. national interests, U.S. security interests, and so forth.

These are institutions that we led the establishment of 70 years ago. And if we walk away from these institutions or fail to live up to the leadership role that we have, it is at our peril.

One of the risks, as you articulate, is that other countries that feel, at present by the governance structure, underrepresented could initiate other institutions in which we have less voice or institutions whose goals and objectives are less consonant with those of the United States.

Similarly, as you say, at least arguably, we have seen that over the last year or two with the establishment of the Asia Infrastructure Investment Bank, the AIIB, led by the Chinese and the establishment of the new development bank known as the BRICS Bank by the four BRICs emerging market economies.

So I think the risk that you highlight is a real one. And it underscores how essential it is that we continue to play a leadership role in the IMF. And quite frankly, it is the leadership role that the rest of the world wants us to play. They look to us for leadership. So the quota reforms achieve a number of objectives.

Ms. MOORE. Okay. I was looking through my notes here to try to find out what the yuan, the RMB is being considered. The Chinese really want it included in the SDR. And obviously, the Chinese are meeting the first criterion of being a major exporter and the second criterion, with regard to having its currency sort of freed up or being free, is not being met. But there are indications that they are close.

Supposedly, the readjustment on August 10th, I think I was in China at the time, and their explanation was that they were trying to square it more with the actual market forces.

What is your opinion of whether or not this movement, which erased $5 trillion out of the world economy, is in fact or is not in fact moving the RMB closer to actual market conditions?

Mr. SHEETS. This is a complex set of issues. On the one hand, they have through this announcement incorporated some features into their exchange rate regime that does make the currency more market-determined and more market-oriented.

Ms. MOORE. Be careful of what we pray for, huh?

Mr. SHEETS. Exactly.

Ms. MOORE. We might get it.

Mr. SHEETS. They were moving in that direction.

But at the same time, it is important that they take these steps in a well-telegraphed, very clearly communicated way. And I think that what we saw in that move was a step toward market determination that was done in a way that raised uncertainties about what the objective was.

And I think going forward as China becomes a more market-determined, market-oriented economy, it is going to be imperative that the Chinese authorities take steps to communicate their intentions, their views, and to explain why it is they are doing what they are doing.

Had they explained up front more clearly that it was about exchange rate reform as opposed to other kinds of objectives, I think the market response would have been more positive.

Ms. MOORE. Thank you.

Thank you. My time has expired. I yield back.

Chairman HUIZENGA. The gentlelady yields back.

With that, the Chair recognizes the vice chairman of the subcommittee, Mr. Mulvaney from South Carolina, for 5 minutes.

Mr. MULVANEY. I thank the gentleman.

And Dr. Sheets, thank you.

I will move very quickly into the 2012 reauthorization of the Export-Import Bank. The last time the bank was reauthorized, Treasury was obligated by law to do some things specifically regarding negotiations on export credit facilities overseas in the airline industry.

I had submitted to the Treasury some questions for the record after Secretary Lew testified here back in March. You all were very kind, by the way, and responded, and I have the responses.

First things first. At the end of one of your questions, you said that there was a list attached of your engagements to events, and that list was, I think, inadvertently left off. If you could give us that, that would be great.

In the details, though, that you provided us, you gave us a list of things that I asked you, when have you done this? The law requires you to start negotiations, to begin discussions on getting out of this business of mutually disarming with the other countries that have export credit facilities. And I asked you to tell me what you had done along those lines.

I want to go over some of your responses.

One of the things you said was that ahead of discussions at the Organisation for Economic Co-operation and Development (OECD) in March on possible reforms to arrangement guidelines for determining interest rates, Treasury staff held several conference calls with OECD members to advocate a U.S. proposal to make the arrangement's interest rate mechanism more market reflective.

You then said you had met separately with them later in April on the same topic.

Not exactly a response, though, is it, Dr. Sheets? Interest rate was not part of the 2012 reauthorization, was it?

Mr. SHEETS. If I may, more recently, specifically on the issue that you raise, I have had consultations with my colleagues in the Airbus countries. So both the German finance ministry and the German economics ministry, the U.K. Exchequer and the French ministry of finance.

So we are in ongoing conversations specifically on working together with the Airbus—

Mr. MULVANEY. Okay. Let me ask, when did those—you said you met with or talked with the Germans, the French, and the Britains?

Mr. SHEETS. Three of those four meetings were face-to-face.

Mr. MULVANEY. Okay.

Mr. SHEETS. And the German economics ministry was on the phone.

Mr. MULVANEY. Of those four meetings, what was the earliest?

Mr. SHEETS. They were all around the time of the Ankara meeting, so it has been within the last 3 weeks or so, all 4 of them.

Mr. MULVANEY. In the last 3 weeks, okay, so after these answers were prepared for my office.

Mr. SHEETS. Correct. That is why it is not referenced.

Mr. MULVANEY. I will look forward to another time when I have more than a few minutes to talk to you.

Mr. SHEETS. Yes, we have been very busy since April.

Mr. MULVANEY. You would agree with me that a discussion on interest rate mechanisms is not really responsive to the 2012 mandate. You are required to talk to them about getting out of the export credit business, and that is not really interest rates. I am not trying to bait you; it is just not really responsive.

Mr. SHEETS. Yes. Our sense, though, is if you have a higher sear, that will increase the charges associated with going through export credit agencies, which would then motivate people to go to the private sector for the lending.

Mr. MULVANEY. Right. Let me ask you this way then: When you met in March and had discussions in April with the OECD participants, did you specifically discuss export credit arrangements?

Mr. SHEETS. I wasn't at the meeting, and I don't recall, but we did talk about this financing issue.

Mr. MULVANEY. In another area, when I asked for specifics, you say in July of 2014 Secretary Lew, you, and other senior-level officials utilized the U.S.-China strategic economic dialogue to press the Chinese counterparts on U.S. negotiating priorities. And you gave me five or six other circumstances and you mentioned U.S. negotiating priorities.

Was extricating ourselves from the export credit business part of our negotiating priorities?

Mr. SHEETS. I would say the answer to that is yes, and we have continued those conversations with the Chinese over the last year-and-a-half. I personally have met with officials, including the finance minister of China, folks from the PBOC and the president of the Chinese ex-im bank, and had those conversations, including mechanisms to—

Mr. MULVANEY. When did you meet with the chairman of the Chinese ex-im bank?

Mr. SHEETS. I believe that was in a July visit.

Mr. MULVANEY. July what?

Mr. SHEETS. In July of 2015.

Mr. MULVANEY. Why isn't that on the list of things that I asked about?

Mr. SHEETS. Because this is a response—when is this response? I had understood it was in April.

Mr. MULVANEY. I have a May 2015 meeting on this list, but not a July 2015 meeting.

Mr. SHEETS. Right. I think—when did we send it to you?

Mr. MULVANEY. I don't know. Let me ask my last question and we can come back—

Mr. SHEETS. I apologize. We will make sure that it is comprehensive.

Mr. MULVANEY. A specific question that is more up to date and more timely, this week GE announced that they may have to move jobs out of this country because they are trying to bid on a job in Indonesia with a state-owned enterprise. I have received the bid request from the Indonesian power company and it specifically requires that PLN shall finance using 30 percent equity, 70 percent debt, an export credit agency shall cover at least 50 percent of the debt of financing. It goes on to say the government of Indonesia won't guarantee the loan.

Has Treasury ever talked to other members of the OECD, other working groups that you have about getting rid of these sorts of requirements in their state-owned bid requests?

Mr. SHEETS. Not specifically on that issue, but we have worked and I have spoken to senior officials in India about increasing their dialogue and participation in the International Working Group, which is designed to extend these export credit rules in the OECD to the emerging markets and would thus have the effect you articulate.

Mr. MULVANEY. I appreciate the patience.

Why do you think that a state-owned company would require—

Chairman HUIZENGA. The gentleman's time has expired.

Mr. MULVANEY. —your export credit financing as part of their bid request?

Mr. SHEETS. Well, my understanding is—

Mr. MULVANEY. It is cheaper, isn't it?

Mr. SHEETS. —that they are doing it because it creates jobs in their economy.

Mr. MULVANEY. But why are they requiring export credit participation in their financing? It is cheaper, isn't it, than private financing?

Mr. SHEETS. I would think in India it is, and we are trying to bring them into the system of export credit that has existed in the OECD and through our work in the IWG.

Chairman HUIZENGA. The gentleman's time has expired.

Mr. MULVANEY. I appreciate the patience. Thank you, Mr. Chairman.

Chairman HUIZENGA. Just a quick announcement. They called votes a few minutes ago. We have 3 votes and I expect that will probably take about 30 minutes.

We are going to grant a question period for Mr. Foster, and what we would like to do after Mr. Foster is to take a short break, and then have us reconvene approximately 30 minutes after that. So immediately after that final vote, if you could please cast your vote and then get back here, I would appreciate it.

With that, the gentleman from Illinois is recognized for 5 minutes.

Mr. FOSTER. Thank you, Dr. Sheets, for being here today.

First, I would like to heartily endorse your support of the IMF. The point that you made about the benefits to the United States regarding the IMF's role in mitigating the 2010 eurozone crisis were exactly on point.

When U.S. markets dropped by $2 trillion, the average American lost $6,000 which, at least to my constituents, is not a small amount of money.

And I would like to add also that those who bemoan what they call the lack of U.S. leadership around the world and then take positions that directly undercut that, like opposing the IMF quota and governance reforms, really could benefit from a healthy reexamination of their logic.

My question is, in the debate over the trade promotion authority, I expressed my concerns that any free trade agreement that did not address currency manipulation would allow one of our trade partners to improve its own balance of trade by manipulating its currency to make its exports cheaper and its imports more expensive.

And I was disappointed that the TPA ultimately contained only a best-efforts clause as a negotiating objective.

Now, one of the principal, perhaps the principal objection that we heard from the Administration to stronger language was that it would preclude our own domestic monetary policy practices, such as quantitative easing. But I actually disagree with this.

I think that there are tests that many have delineated, including Dr. Bergsten's work at the Peterson Institute, that provided a very clear framework for applying the IMF requirement of intent while providing for short-term domestic intervention.

Those criteria are, first, did the nation have foreign exchange reserves greater than 6 months of goods and services imports?

Second, did the foreign exchange reserves grow rapidly over the period in question?

And third, was the current account in significant surplus relative to the GDP over that period?

Those seem to me like workable criteria that could and should be included.

And so my question to you is simply, do you believe that quantitative easing, as we exercised it during the crisis and its aftermath, would have failed these criteria? What would have prevented, if those were the criteria, what would have gone wrong in regard to the quantitative easing and other monetary policy?

Mr. SHEETS. As a matter of fact, in the WTO discussions, there were assertions from some emerging market economies that quantitative easing policies were currency manipulation, notwithstanding the fact that it was carefully constructed and delineated toward achieving the Federal Reserve's dual mandate.

So I think that is a meaningful risk. I think there are other risks as well in that having—

Mr. FOSTER. Now the risk you are referring to is that other people would complain about, other countries would complain about it, or that actually we would set up objective criteria and then find that we chaffed under those objective criteria?

Mr. SHEETS. And then it would potentially bring it in to trade adjudication channels that could be difficult.

Mr. FOSTER. But if, for example, they were the three criteria that Dr. Bergesten has outlined, if those were the criteria, would anything have gone wrong? Would there have been any case in any court for—it seems pretty clear to me that we would have been far from being out of compliance with those and that there would have been no problem.

Mr. SHEETS. It is hard to speculate as to how that might have proceeded. Certainly, it is a risk factor.

Similarly, having the United States behave in a unilateral fashion in terms of enforceable currencies, I think would create increased uncertainties in global financial markets and also damage our bilateral relationships.

The Treasury and the Administration are firmly opposed to countries doing anything that approaches currency manipulation. We just feel pretty strongly that there are other mechanisms that are better to respond than enforceable currency provisions.

Mr. FOSTER. Do you believe that any of these have been effective? That is the question.

If I look over the last 15 years, it seems to me that China and other countries have gotten away with murder. And as someone who represents an area with a strong manufacturing base that has been gutted for no good reason, I actually question the fact that we have not had effective response to currency manipulation.

Mr. SHEETS. When I look at the global economy today, my sense is that the mechanisms that we are using through bilateral engagement, this is the leading issue that we talk about when we sit down with our international counterparts, through the G7 and the G20 where we just reiterated strong language in terms of how countries should manage their exchange rates is powerful.

And consistent with that, over the last 5 years we have seen a very substantial, real appreciation of the Chinese currency.

So I think that these mechanisms are powerful and we are working to bolster them and to do more. As I said, we are foursquare against anything that smacks of currency manipulation and are ready to proceed vigorously on that front.

Mr. FOSTER. Okay. Well, I am not yet convinced of its effectiveness. Thank you.

Chairman HUIZENGA. The gentleman's time has expired.

With that, we will be taking a short recess and reconvene immediately following votes, which for information and all the Members' awareness, we expect to be about 30 minutes.

So with that, we are at recess.

[recess]

Chairman HUIZENGA. The hearing will come to order. We appreciate your patience, Mr. Secretary. We concluded with the Member from Illinois. I now recognize the gentleman from New Mexico, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman. And thanks, Mr. Secretary, for being here today.

As we think about China and admission to the SDR, a couple of questions come up. In your testimony, you talk about them being more reliable, less consumption, less on exports and investment.

Now my opinion of the Chinese economy is that the failure has been that they have just misled the entire world for the last 20 or 30 years, that they have shadow firms building entire cities that don't have a purpose, with no one living in them, so then basically looking like they are keeping activity going. And that doesn't sound like they have been relying upon exports and investment; they have been relying on deception.

So I guess my question is, do you think that China is ready to be admitted to the SDR? To the currency, there?

Mr. SHEETS. The IMF as you suggest, is in the midst of a review of its SDR basket. The IMF conducts these reviews once every 5 years.

There are two key conditions: One regarding global trade—China satisfies that—

Mr. PEARCE. I am aware of those. I am asking what is the position of this Administration—

Mr. SHEETS. —and the other one is the freely usable condition. The Chinese have taken some steps over the last 6 to 12 months—

Mr. PEARCE. No, I am just asking for your opinion. Are they or are they not ready? Does that currency fit the requirements? And will we support that? Or are we, the United States, not supporting it?

Mr. SHEETS. My bottom line is that the IMF technical staff are engaged in a review to determine whether or not the Chinese currency satisfies those conditions.

Mr. PEARCE. Basically then, the Administration is not going to go into this with an opinion; you are going to rely on the IMF staff and whatever they say, yes or no.

Mr. SHEETS. We are going to wait for that technical review to conclude. And based on that review and broader judgment, we will decide whether or not to support this and the IMF Executive Board.

Mr. PEARCE. Okay. Thank you.

Now, in response to Ms. Moore, you had talked about the other nations having some judgment on our unwillingness or inability to convey some approval of the reforms. And then in response, you said that has been one of the reasons that a couple of other banks have formed—worldwide banks have formed another—so my opinion is, and it may be incorrect, is that those currencies formed as we were deeply engaged in quantitative easing and those comments that those countries were making is that you continue to print or create currency out of thin air, and we are not going to stand for it, we are going to start trading in something other than dollars.

So is that a valid point of view? It is not reflected in your testimony, but is it a valid point of view that it was not simply a response to our unwillingness to act on the reforms?

Mr. SHEETS. I think that there are a number of factors at work that have motivated the advent of the New Development Bank and the AIIB. As I said, I think one of them is an element of frustration in terms of having sufficient voice in the existing institutions, particularly the IMF. And this governance reform would have been an important part and will be, once approved, an important step toward improving the voice in governance in the IMF.

Mr. PEARCE. Okay. So one of the comments that you make is that China needs to be more market-oriented. Is a too-big-to-fail policy market-oriented?

Mr. SHEETS. My sense is that both here in the United States and within the context of the FSB, we have worked vigorously to end too-big-to-fail.

Mr. PEARCE. I didn't ask if you tried to—I appreciate that you are trying to stop it.

I am just asking a plain question, is it market-oriented? It doesn't seem to me to be. But again, you may have a different opinion. I am willing to hear it, but I am not hearing it so far, and I am running out of time.

Mr. SHEETS. Yes.

Mr. PEARCE. I guess the accompanying question with that is, is quantitative easing market-oriented? And so we are holding China to standards that we are not willing to hold ourselves to, and I think that is an alarming thing.

I see I am about out of time, but you can spend the rest of the time answering. Thank you.

Mr. SHEETS. Yes. In both instances, I would characterize it as economic policy, monetary policy on the one hand and efforts to achieve and pursue financial stability on the other.

That said, as I indicated, both the FSB internationally and domestically here at home, we have worked to end too-big-to-fail.

Mr. PEARCE. Thank you, Mr. Chairman.

I appreciate it, Mr. Secretary.

Chairman HUIZENGA. The gentleman's time has expired.

And with that, we will go to Mr. Schweikert of Arizona for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

I have sort of a little follow-up, but maybe with a slightly different angle. I think actually in this very room before the remodel a few years ago we were talking about how frustrated we were with China not making its currency subject to market forces, the artificial peg, undervaluing. So in some ways, isn't the movement right now what we have been demanding of China?

And the fact of the matter is, the slide in their currency value as they were starting to expand, let us call it expanding the peg, it is an easier way to understand, also the fact that market forces now are actually looking at the realities of the Chinese economy, foreign currency reserves, other than just the data put out by China?

Mr. SHEETS. As you say, certain elements of this recent reform do make the Chinese renminbi more market-oriented and more market-determined. As I emphasized, along with that they need to be more transparent.

Another comment that I think is very important is that given some of the uncertainties about the Chinese economy and ongoing capital outflows, we have seen some downward pressure on the renminbi. And it is imperative that when those pressures shift, the Chinese allow the exchange rate to appreciate.

So in order to be flexible, it needs to be flexible in both ways.

Mr. SCHWEIKERT. Within that, won't the Chinese economy in some ways be punished because they don't provide enough information, they are thought to step in and engage intervention? And that is actually part of my next question. But they are going to pay a risk premium for currency traders because of the lack of sunshine, the lack of honest data, and the fear that they are going to intervene on either side of the up-or-down.

Mr. SHEETS. I feel that the lack of transparency about the policies that they have pursued created additional uncertainty about the outlook for the Chinese economy which, very much as you say, would manifest itself in Chinese financial markets and perhaps to some extent redound back into weaker economic growth for China.

Mr. SCHWEIKERT. But ultimately, would you not agree, a true market-sensitive, let us call it floating, currency coming out of China would be good for the United States?

Mr. SHEETS. Yes.

Mr. SCHWEIKERT. Okay. Second thing. In our own sovereign debt situation, I have a personal fixation coming very soon, if we do not demonstrate to the world here is our debt management plan to get through the reality of the 30-, 40-year demographic bubble, Baby Boomers, as they are retiring, we need to be telling the world how we are going to manage this skyrocketing debt that as we saw on congressional budget in their document say 2018 it is game on, the debt starts to explode.

For the protection of the value of U.S. currency, for the protection of the value of our currency as being sort of the benchmark, do we not have to telegraph to the world, here is our debt management plan?

I have ideas of long-term bonds, and a couple of other more technical things, at least to telegraph that we are taking this seriously because right now this Administration has not been taking it seriously.

I know that is hard because you work there. But am I wrong that we are going to have to start telegraphing to the world our debt management future?

Mr. SHEETS. I need to defer to my colleagues, including the Secretary, on issues related to debt management. That is not part of my portfolio.

But certainly it is also the case that having confidence in U.S. policy and confidence in U.S. securities is a critical input for there to be confidence in the U.S. dollar.

Mr. SCHWEIKERT. It comes right up against this area especially.

And in the last 50-some seconds, as we are also working on our relationships in regard to money-moving currencies, how much fixation do you see in the countries you deal with on also eliminating bad actors from using our infrastructure? I am concerned many of us, I think even the chairman have discussed of SWIFT in others of our financial backbone being used by whether it be Iran, whether it be drug cartels, or just bad actors. How often does that come up in your conversations with our—

Mr. SHEETS. This is a crucial issue that manifests itself in the so-called de-risking and correspondent banking discussions and also in discussions associated with remittance flows.

And I think there are two core objectives that we are working to achieve and, in some sense, to balance. On the one hand, to ensure the ongoing efficiency of the financial system and protect the ability of the financial system to effectively intermediate and for flows to move from one part of the system to the other.

On the other hand, it is imperative that we protect the soundness, the integrity, and make sure that it is not abused by bad actors.

Mr. SCHWEIKERT. Dr. Sheets, we have gone over time.

Thank you, Mr. Chairman.

Chairman HUIZENGA. The gentleman's time has expired.

With that, we will go to the gentleman from Minnesota, Mr. Emmer, for 5 minutes.

Mr. EMMER. Thank you, Mr. Chairman.

And thank you to the Under Secretary for being here today.

Just some insurance questions, I guess, first. With regard to all of the international insurance regulatory standards, but especially capital standards, including the higher-loss absorbency, HLA, do you support requiring international bodies to wait until the United States has established its standards and then insist that the U.S. standard be recognized as at least one way to comply?

Mr. SHEETS. I see the ongoing work on international standards for insurance as being constructive. It helps achieve financial stability and a level global playing field. So I think having that work ongoing is constructive and useful.

However, it is also important that I emphasize that these international groups that are doing this work, like the International Association of Insurance Supervisors (IAIS), which includes our insurance regulators, that the international groups do not have authority, they do not have any jurisdiction within the United States.

So they make recommendations and then depending on which part of the code it is, either the Federal Reserve in its role as looking at the systemic institutions, or the State insurance regulators, would make a decision about how and in what way they are going to implement these international recommendations.

Mr. EMMER. Speaking of the IAIS, the organization recently voted to shut out observers, including U.S. industry and consumer representatives from its working group meetings. Are Treasury representatives working to reopen those meetings? And how about with regard to the closed-door meetings of the Financial Stability Board, same question?

Mr. SHEETS. We are represented, the Treasury is represented in the IAIS, the Federal Insurance Office, and State regulators are represented in the IAIS.

Mr. EMMER. And I hate to interrupt, but it is limited time. Are you working to open those meetings to the industry and consumer representatives?

Mr. SHEETS. We are working to make those institutions as transparent as possible, including releasing documents and explanations and so on and so forth. And we see that as being a very constructive step toward increased transparency.

Mr. EMMER. Is that a yes, Mr. Under Secretary, yes you are working on it? I understand you are trying to make it more open and transparent.

Mr. SHEETS. We are working to get to a similar outcome, but we are taking a somewhat different route than the one you just articulated.

Mr. EMMER. Okay. The IMF issued a report in July criticizing the United States for the way its State insurance regulators are designated or elected and calling for a national insurance regulatory body.

To what extent did Treasury provide resources for this report? And does the Treasury agree with those comments?

Mr. SHEETS. I am not aware of the extent to which we were involved in commenting on this.

Certainly, the IMF is an independent body or the IMF does independent research, so it would not be the case that anything they said would for us have a ratification from the U.S. Treasury.

And the recommendations there are the IMF's; they are not the U.S. Treasury's.

Mr. EMMER. All right. Would the Treasury support the termination of the Financial Sector Assessment Program (FSAP) reviews of the U.S. insurance regulatory system?

Mr. SHEETS. We just went through one of those FSAPs. It is a very resource-intensive proposition for insurance in the sector, more broadly.

My instinct is that the FSAP is—it occurs once every 5 years—probably a useful exercise for all of us to go through.

Mr. EMMER. To what extent does the Treasury conduct cost-benefit analyses with regard to positions it takes on insurance regulatory issues in international bodies?

Mr. SHEETS. We are always analyzing pros and cons, costs and benefits. I am not sure that I have a formal document that I can generate.

But another important point is that as these international frameworks are developed, once they move to the point of actually being implemented by State regulators and by the Federal Reserve and others, there will, at that point, be more detailed cost-benefit and impact analysis done.

Mr. EMMER. Thank you. Very quickly in the seconds I have left, changing course, what if any role is the Treasury Department playing in coordination with the State Department in the Cuba Steering Committee to normalize banking relationships with Cuba?

As I understand it, to date only one bank has a relationship in Cuba, and I want to know what the Treasury is doing.

Mr. SHEETS. Let me get back to you on that. As far as I know, we have no formal role in that group, but I would want to check that.

Mr. EMMER. Thank you.

I yield back.

Chairman HUIZENGA. The gentleman's time has expired.

With that, we will go to the gentleman from North Carolina, Mr. Pittenger, for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman.

Secretary Sheets, regarding the snapback provisions, it is my understanding that the Europeans are going in flocks right now to Iran, their trade ministers and various individuals, looking for agreements with Iran. Is it reasonable to assume that snapback provisions will really be, at that period of time, something that we could expect given China and Russia and—the world has changed and there is a clear reluctance, it seems to me, to join in?

It seems that there has been a lot of communication that we will just go into snapback, but is that really likely? Wouldn't you agree that this is really not something we should be believing that this will occur?

Mr. SHEETS. Those issues related to Iran sanctions are outside of my purview as the Under Secretary for International Affairs.

Mr. PITTENGER. Okay.

Mr. SHEETS. And I should defer to the Secretary and to acting Under Secretary Szubin.

Mr. PITTENGER. Very good.

Mr. SHEETS. I very much apologize for that, but I should be—

Mr. PITTENGER. All right. Let us talk about the IMF systemic exemption. Could you enlighten us where the Administration stands with that? The IMF, the systemic exemption that there has been some discussion about.

Mr. SHEETS. Yes, and what about the systemic exemption?

Mr. PITTENGER. There have been a lot of mixed signals from the Administration about it. I would just like some clarification on it.

Mr. SHEETS. Yes, okay. My sense is that the systemic exemption was put into place in response to significant economic and financial risks in 2010. Had we pressed forward with debt restructuring of those peripherals at that point, there would have been a significant risk of contagion at a point when the global economy was just starting to recover from 2008–2009.

That said, also recognize that there is an ongoing conversation, an animated conversation going on about this inside the IMF. And we are open to various ideas. One is to further specify criteria that we need to be satisfied in the event of the systemic exemption. But there are other ideas.

And as I mentioned to Chairman Huizenga, I would be very happy to work with you and your staffs on this issue going forward. It is a very important issue.

Mr. PITTENGER. It certainly is. Would you be able to address some issues related to terrorism financing? There are 46 banks in Iran that will come under SWIFT authority in transfer of funds. And certainly, it should be of concern to all of us that $100 billion will be received by Iran from repatriated oil profits and how that money could be processed through the international financial system.

What efforts are being made right now through the Treasury, FinCEN and other departments to track this money?

Mr. SHEETS. Again, I have to defer those questions to my colleagues. I very much apologize for that.

Mr. PITTENGER. Okay. I yield back.

Chairman HUIZENGA. The gentleman yields back.

With that, we are—do you need a minute? All right.

Mr. Heck, then, if that is all right, we are going to go to our side, and then we will come to your side.

With that, we will recognize the gentleman from Indiana, Mr. Stutzman, for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman.

And thank you, Mr. Sheets, for being here.

I want to talk a little bit about what is going on in the Middle East. Do you support sanctions relief for individuals and groups known to sponsor terrorism?

Mr. SHEETS. Again, I think it is necessary for me to defer those questions to my colleagues. I apologize.

Mr. STUTZMAN. Who would those colleagues be?

Mr. SHEETS. Secretary Lew, and then acting Under Secretary Adam Szubin, who had his confirmation hearing today, would be the two principals, and then acting Under Secretary Szubin's staff.

It is in the TFI cone of the Treasury.

Mr. STUTZMAN. Okay. Can you talk a little bit then about the new financing options that they will have as a result of the Iran deal?

Mr. SHEETS. Similar. I regretfully cannot answer that.

Mr. STUTZMAN. Okay, all right. Let us talk about the TPP then a bit. Could you give us an update on TPP and how the negotiations are going? I am interested in your take.

Mr. SHEETS. Absolutely, thank you. I see TPP as being enormously important for the U.S. economy. It links our economy and our firms to the fastest-growing region in the world and many rapidly growing countries.

Moreover, it establishes rules of the road for international trade that emphasize transparency and openness and rules of the road where U.S. firms will be able to compete fairly and, I think, flourish.

The negotiations met with a fair amount of success and progress during the negotiations in late July. The USTR and our international counterparts are working vigorously to get this agreement concluded as soon as possible.

I don't think we have any eminent, specific date by which we will be concluded. I think soon we will be at a place where we will be done.

Mr. STUTZMAN. Are you hearing any reluctance from countries in the negotiations related to agricultural products or automobiles, medical device industry that it would affect? Are you hearing anything as far as related to those three?

Mr. SHEETS. I think that those are ongoing issues where various of our counterparties in TPP would have several of those issues that would be open and concerned. But that is where the negotiations are at this stage. It is working through those now.

Mr. STUTZMAN. Can you share what their concerns would be thus far?

Mr. SHEETS. Our work has been more in the financial sector specifically. But for Japan, it is autos and agricultural. For New Zealand, say, it is dairy. For Canada, it is agriculture. I would say that those are some examples of ongoing issues.

Mr. STUTZMAN. How about manufacturing? Anything that you know of related to manufacturing?

Mr. SHEETS. Over and above the issues on autos, I haven't heard as much about manufacturing.

Mr. STUTZMAN. Okay. What about autos? What are you hearing on autos?

Mr. SHEETS. Of course, that is an ongoing issue of discussion with the Japanese.

Mr. STUTZMAN. Okay. Could you talk quickly about Ukraine and the concern that we have about foreign aid falling into the wrong hands?

Mr. SHEETS. I think what has been happening in Ukraine over the last 18 months is truly, truly extraordinary. That on the one hand, there have been enormous stresses there as a result of the security situation.

On the other hand, we have seen the government move forward with a vigorous reform program that has put in place many of the kinds of things that the international community, the Fund has been asking the Ukrainians to do for several decades.

As a result of the vigor of this program, the IMF has provided support, the international partners have provided support, and the situation in Ukraine appears like it might be approaching a point of stability.

I should finally note that an important part, an important tier of the reform program is an anti-corruption drive where they are working to make the government more reliable and trustworthy in a number of different dimensions.

Mr. STUTZMAN. Okay, thank you.

I yield back.

Chairman HUIZENGA. The gentleman's time has expired.

With that, we will go to Mr. Heck from Washington State for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

Mr. Sheets, thanks very much for being here.

I think we are party to at least three agreements that affect our biggest export industry, namely aircraft sales: the OECD agreement; the aircraft sector understanding; and the home market agreement between us and the Airbus countries, which says we won't provide export credit on sales into each other's countries.

As I understand it, however, there are no enforcement mechanisms on any of these. They are so-called gentlemen's agreements.

But it has always seemed to me that there is also no incentive to cheat, because everyone has export credit agencies, or did, and anyone who cheats and provides subsidies would suddenly find other countries providing subsidies in response.

But now that we don't have an export credit agency, it seems like we lack this ability. If the Airbus countries want to provide deeply discounted export credit to sell planes into the United States, sir, do we have any tools to stop them and protect American jobs now that we have shut down our export credit agency?

Mr. SHEETS. I broadly agree with the argument you made that by not having an Ex-Im Bank we have much less leverage in our discussions and our interactions with the rest of the world on issues with respect to export credits.

And specifically, as this body knows well, the Treasury has a mandate to take steps globally to reduce, with an eye toward eliminating, export credits. But it is very difficult to do it if we don't have any leverage in those discussions.

Mr. HECK. Do we have any tools to deter or disincentivize their export credit agencies deeply discounting now that we have no direct retaliatory entity or potentially retaliatory entity?

Mr. SHEETS. We are very much dependent on our argumentation and our relationships. But the direct tool that we would use is now gone.

Mr. HECK. Unless you disagree, I will conclude that you have just indicated that we are being put at a competitive disadvantage.

I want to change to IMF. And I am curious as to whether you know whether U.S. cooperation with the Asian Infrastructure Investment Bank will be discussed with President Xi during his upcoming visits and what possible forms of cooperation that might take.

Mr. SHEETS. I am not sure what exactly is on the agenda. But I can say that in our bilateral discussions with the Chinese, the functioning of the AIIB is one of the issues that we discuss. And we take that opportunity very much to underscore that for the AIIB to contribute constructively to the global environment, it needs to operate according to the best practices that have been established by the multilateral development banks over the last 70 years for issues of governance and transparency and environment and social inclusion and so on and so forth.

These are points we make repeatedly, and I think these are points that we have some evidence to believe that the Chinese are starting to hear, based on the documents that this institution is generating.

Mr. HECK. Do you think there is any reason to believe that failure to adopt IMF reform may have contributed, directly or indirectly, materially or immaterially, to the creation of AIIB and the BRICS Bank?

Mr. SHEETS. I do think that was a factor, that these emerging market economies wanted a greater voice in the international institutions and the international architecture. And the 2010 quota reforms gives them that larger voice. But without it, they are left to seek opportunity to have an impact through other mechanisms, including through the creation of these new institutions.

Mr. HECK. What further consequences might there be if America fails to embrace the otherwise broadly recommended reforms? How else might we be disadvantaging ourselves in terms of an ability to provide a leadership role?

Mr. SHEETS. My sense is that a strong IMF that is led meaningfully by the United States is very much in U.S. economic and national security interests. And to the extent that we are not leading, then the IMF is going to go in other directions.

And it is imperative. The world looks for our voice, and it is an opportunity for us to take steps to ensure that the IMF is moving in directions that we see as being most compatible with global economic, financial stability and other considerations that we have.

Mr. HECK. Thank you, sir.

Chairman HUIZENGA. The gentleman's time has expired.

And again, my apologies for that little delay. We would have loved to have been able to do a second round. But I know you had a target time of about 4:00 and we want to be respectful of that.

So I would like to thank our witness today for his testimony.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, this hearing is adjourned.

[Whereupon, at 4:05 p.m., the hearing was adjourned.]

A P P E N D I X

September 17, 2015

EMBARGOED FOR DELIVERY

Testimony of Treasury Under Secretary for International Affairs Nathan Sheets
United States House of Representatives Committee on Financial Services
Subcommittee on Monetary Policy and Trade
"Strengthening U.S. Leadership in a Turbulent Global Economy"
September 17, 2015

Chairman Huizenga, Ranking Member Moore, and Members of the Committee, thank you for the opportunity to testify today. I appreciate the opportunity to discuss Treasury's role in promoting global economic growth.

Earlier this month, I joined Secretary Lew at the G-20 Finance Ministers and Central Bank Governors meeting in Ankara, Turkey. Discussions at the meeting focused on the recent turbulence in global financial markets, and in China in particular, as volatility in its equity and currency markets has spilled over to markets globally. Fears of a slowdown in China have also raised concerns about the regional and global growth outlook. Commodity producers have been especially vulnerable to lower Chinese demand. We discussed ways to boost global demand, including through fiscal policy, strategic infrastructure investment and structural reforms, as well as the need to continue to strengthen financial supervisory and regulatory practices to reduce the risk of financial crisis.

In Ankara and elsewhere there has been a great deal of interest in recent developments in China. The Chinese economy is undergoing a difficult but essential transition that, if successful, will make growth more reliant on domestic consumption and less on exports and investment. The Chinese government has laid out a comprehensive set of economic reforms to move toward a more market-oriented, consumer-driven economy. These reforms are largely consistent with what the United States has long advocated. To ensure that the transition is managed in an orderly way, China must transparently communicate its policies and actions and allow the market to play a primary role in determining outcomes. Treasury has had sustained and robust engagement with China on its policies – including in the economic track of the U.S.-China Strategic and Economic Dialogue – and in light of recent developments we are pushing the Chinese to accelerate the implementation of its reform agenda, while underlining that to bolster their effectiveness these reforms must also be implemented in a transparent manner.

Turning back to the global arena, our partners look to U.S. leadership to help formulate the international agenda. And we, in turn, rely on the international financial institutions (IFIs) to provide analytical, technical and financial support to identify vulnerabilities, advance reforms, and smooth adjustment. In the aftermath of World War II, the United States drove the creation of new institutions – the International Monetary Fund (IMF) and the World Bank – to reduce economic conflicts, avoid beggar-thy-neighbor policies, provide support for countries in crisis or transition, advance pro-growth economic reforms and promote growth in low-income economies. Over the years, we have also played a leading role in the regional development banks in Latin America, Asia, Africa, and Europe. The partnership between the United States and these institutions has continued with the support of multiple Administrations led by Presidents of both parties, because these institutions have proven their worth. They are vital to our economic interests, and our investment in these institutions means that we are able to shape their policies to maximize U.S. and global prosperity.

EMBARGOED FOR DELIVERY

By that measure, we have been quite successful. Since 1950, U.S. GDP has risen more than 7-fold and global GDP has risen more than 10-fold, while global poverty has fallen dramatically. Over this period, the improvement in economic performance and the reduction in poverty have been most pronounced in emerging market and developing economies. Stability and increased prosperity in other parts of the world not only provides growing markets for U.S. products and increasing investment opportunities for Americans, but also strengthens our security by reducing civil unrest and regional conflicts.

The IMF has played and continues to play an important role in providing assistance to key strategic partners of the United States. For example, in Ukraine, the IMF is currently supporting a program that aims to bolster the Ukrainian government's extraordinary reform efforts. Notwithstanding Russia's aggression, the authorities have taken difficult steps to improve fiscal discipline, decrease distortionary energy subsidies, improve social assistance for the most vulnerable, tackle corruption, reform state-owned enterprises, and initiate financial sector repair. This example highlights the importance of the Fund in addressing challenges that are at the core of America's interests abroad. Further, IMF financial assistance for Ukraine has been crucial for catalyzing additional support from other bilateral and multilateral partners.

In recent years, the IMF has been critical in helping Europe avoid an economic meltdown, even as the Europeans provided the lion's share of the financial assistance and bore the brunt of the financial risks. Europe's economic woes, especially in the 2010-2012 period, could have caused major harm to the United States. Between May and July of 2010, at the very time we were seeking to put the Great Recession behind us, the stock market in the United States declined by about 15 percent, largely on these European developments, wiping out about $2 trillion in capitalization. . The IMF's important technical role went far beyond its financial investment, which is currently only about one-tenth that of Europe's. The IMF's programs in Europe are proving effective, as euro-area authorities have developed new tools to fight crises and ensure financial stability and as vulnerabilities in the "peripheral" countries are greatly reduced. Ireland and Portugal have emerged from crisis and are making early repayments to the IMF.

In Greece, the IMF has been a key partner in Europe's efforts to support a difficult but necessary adjustment that encourages growth and puts debt on a more sustainable path. We stand behind the IMF Board's 2010 decision to provide the IMF with limited flexibility in its policy for exceptionally large financing, enabling the Fund to support Greece at a critical time and in a manner that meaningfully reduced the risk of renewed global crisis. In 2012, the United States supported the IMF's judgment that debt reduction was needed, and the United States and the IMF are actively supporting the need for further debt relief for Greece now.

The IMF's crisis response in the Middle East and North Africa (MENA) region has been crucial to encouraging macroeconomic stability in several countries that are significant to our national security. For example, the IMF has supported Jordan with exceptional financing as the country deals with significant economic pressures stemming from refugees and the regional crisis. And in Africa, the Fund, responding to calls by Secretary Lew, was also at the forefront of emergency financial assistance in the form of highly concessional loans and debt relief to Guinea, Liberia,

EMBARGOED FOR DELIVERY

and Sierra Leone to help counteract the scourge of the Ebola virus. Closer to home, and again after calls by the United States, the IMF has been providing support to Haiti as it goes through a difficult period of political and economic reform.

In 2010, building on earlier efforts to reflect the growing importance of major emerging markets in the global economy, the membership of the IMF agreed on a set of quota and governance reforms. These reforms are designed to strengthen the finances of the IMF and give a greater voice to dynamic emerging markets, such as Brazil, China, India and Mexico, while preserving the U.S. veto by a comfortable margin.

As the largest shareholder and the only member with veto power over major IMF decisions, our extended delay in approving the 2010 IMF quota and governance reforms has led our partners to question our commitment to the multilateral system. Some countries have pursued their interests in other ways, including by creating new institutions in which the United States has no voice, such as the New Development Bank (known as the BRICS bank) and the Asian Infrastructure Investment Bank (AIIB).

To ensure that the IMF remains at the center of the multilateral economic system – and that we maintain an important voice in it – the United States should promptly approve the 2010 quota and governance reforms. Our interest in strengthening the Fund is not based on esoteric notions of global leadership or nostalgia for institutions that the United States created. Rather, we have learned from hard-won experience that a well-resourced and effective IMF is indispensable to achieving our economic and national security interests. By stemming crises in other countries and preventing them from spreading around the globe, the IMF protects U.S. jobs and exports. The IMF's policy advice and financial support also foster countries' economic growth, thereby helping boost global demand.

The proposed reforms of the IMF's quota and governance will put the IMF's finances on more stable footing by doubling the size of quotas and reducing the IMF's reliance on borrowed resources through a reduction in the New Arrangements to Borrow (NAB). Quotas are the IMF's core resources that reflect the shares each country holds in the institution. Quota shares are directly related to voting shares and hence the voice of each member in the IMF.

Increasing our quota under the proposed reforms will not raise the current U.S. financial commitment to the IMF. The U.S. quota increase will be matched by an equal reduction in the U.S. financial participation in the NAB. But, the shift to quota resources signifies a stronger commitment to the core resources of the institution and will allow the IMF to reallocate voting shares and modernize its governance structure.

From a financial perspective, our investment in the IMF is exceptionally sound. U.S. claims on the IMF are of the highest quality – they are protected by the IMF's rock-solid balance sheet, with substantial reserves and unrealized gold profits that exceed total IMF credit outstanding.

The Treasury Department also fosters growth and prosperity by working in partnership with the multilateral development banks, including the World Bank and the regional development banks. Like the IMF, the MDBs' purposes firmly align with the interests of the United States, and they are vital tools for promoting security, economic growth, environmental sustainability, and poverty reduction. In particular, the MDBs are a cost-effective means for the United States to support critical investments in developing and emerging economies. Our $2.2 billion budget request for the MDBs for FY 2016 supports more than $100 billion in annual MDB assistance for developing countries.

The United States led the establishment of the MDB system and has been a driving force in the evolution of the MDBs over the past 70 years. We work closely with their management and other shareholders to help shape their priorities and get them quickly engaged in countries of strategic importance to the United States. In many cases, we coordinate programming so that the MDBs' extensive on the-ground-presence, diverse financing instruments (including debt, equity, and guarantees), deep data and knowledge capacity, and strong and trusted relationships with national policymakers amplifies our direct bilateral assistance.

To ensure that these institutions keep delivering on our priorities, sustained U.S. engagement will be crucial. Treasury is working to advance a robust reform agenda at the MDBs. We are focused on securing a revised set of safeguards at the World Bank that deliver improved social and environmental outcomes by providing additional protections for vulnerable and disadvantaged groups, adding new provisions on the health and safety of workers, and enhancing the implementation and monitoring of the environmental and social impacts of World Bank projects. We have supported updates to the World Bank's procurement policies that will benefit both U.S. businesses and the poor in developing countries. The MDBs must also continue to build the capacity of their independent evaluation units to increase accountability and maximize development impact.

We must also pay attention to the MDBs financial capacity to deliver on key investments needed for countries to progress on their path to sustainable development. We are exploring options for the MDBs to optimize their balance sheets, so as to expand their lending capacity while relying on existing resources. We are calling on emerging donors, including China, to contribute more to the MDBs' concessional windows, in recognition of these countries' increasing importance in the global economy. And we are urging management and staff from the MDBs to work to help countries mobilize their own domestic resources and private sector finance to support their development.

This is an important moment for the United States at the MDBs, as some countries are seeking to weaken these institutions' high standards and correspondingly questioning our leadership role. Sustaining our leadership, influence, and credibility, and maintaining our shareholding, requires fully funding our current and past commitments to the MDBs' non-concessional and concessional windows. Let me describe, through a few illustrations, the ways in which our commitments to the MDBs are vital to advancing U.S. priorities.

The MDBs complement and amplify our bilateral development assistance. The IDB is helping Central American countries implement economic and social reforms to address many of the root causes and effects of violence and migration, working closely with the World Bank and USAID. The African Development Bank (AfDB) and World Bank have pledged over $8 billion in support of the President's Power Africa Initiative, which aims to extend electricity access to over 60 million households and businesses.

The MDBs' work helps us combat threats to national security. The World Bank and European Bank for Reconstruction and Development (EBRD) provided more than $5 billion in 2014 to Ukraine for economic stabilization and energy security, and cut off new assistance for Russia. They are on track to provide a similar level of funding this year. The World Bank, AfDB, and EBRD are supporting small entrepreneurs and promoting reforms to the business climate that help create jobs in North Africa and the Middle East, reducing the lure of extremism.

The MDBs' significant investments in infrastructure facilitate the movement of people and goods and support investment, for example by reducing costly electricity cuts that stymie production. In this way, the MDBs help developing countries contribute to global growth and build new export markets for the United States. In just one example, the Asian Development Bank (AsDB) is helping to integrate markets in Southeast Asia by financing regional roads and in Central and South Asia by financing new energy connections.

The MDBs are also critical partners in preventing and responding to global crises and disasters, such as the Ebola outbreak, or the 2010 Haiti earthquake and the more recent Nepal earthquake.

Finally, the Administration's trade agenda is also essential to our efforts to promote prosperity. We are working to secure a final Trans-Pacific Partnership agreement (TPP) that unlocks export markets, establishes strong rules, and fosters stronger economic growth at home. TPP promises to help U.S. businesses reach customers in the world's fastest growing region, deliver more and better jobs in the United States, and elevate standards for trade and investment throughout the TPP region, including with regard to promoting transparency, fairness, innovation, labor rights, and the environment. By promoting important market-oriented reforms, we expect TPP to contribute to stronger and more balanced economic growth in our partner countries and to encourage closer economic integration. In addition, we are making progress with the European Union on the Transatlantic Trade and Investment Partnership (T-TIP) to expand what is already the largest trading relationship in the world. We are also negotiating a bilateral investment treaty with China to open up China's highly restrictive system to foreign investment and help create a wide range of opportunities for U.S. firms to participate in the Chinese market. Finally, negotiation of the Trade in Services Agreement with more than twenty other partners presents an opportunity to remove impediments to exports across all services sectors and boost U.S. growth and support additional jobs.

As we continue to work with Congress on promoting economic growth both here at home and throughout the world, maintaining our leadership role in the IFIs and moving forward on the Administration's trade agenda are crucial. I look forward to working in collaboration with this Subcommittee to address these critical issues.

Thank you. I am happy to answer your questions.

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Monetary Policy and Trade
Questions for the Record for Nathan Sheets
Under Secretary for International Affairs, U.S. Department of the Treasury
"Strengthening U.S. Leadership in a Turbulent Global Economy"
September 17, 2015

From Representative Huizenga

Question: **Mr. Sheets, the Treasury Department will help determine whether the IMF will include the renminbi (RMB) in the currency basket that determines the value of Special Drawing Rights (SDRs). As you know, SDRs are international reserve assets, so it is important that currencies which influence them are backed by transparent market economies.**

Treasury itself does not appear to know what to think about the RMB. In April's foreign exchange report to Congress, the Department concluded the RMB remained "significantly undervalued." But when the Chinese – to everyone's surprise – moved to a more market-oriented exchange rate in August, it led to a devaluation. Then markets panicked, leading the Chinese to spend many billions of dollars in foreign reserves to prop up the exchange rate again. Many observers contend that, were the RMB's value to be market-determined, it could fall dramatically.

In other words, Treasury wants both a stronger RMB and a market-determined RMB. But markets appear to be saying those things are mutually exclusive for now. For the record, does Treasury still believe the RMB is undervalued? And does it believe the transparency of China's exchange rate policy is comparable to that for other currencies in the IMF's SDR basket?

Answer:

Treasury has urged China to create the economic conditions conducive to an orderly transition in China's exchange rate regime to one that will respond to market forces for appreciation, as well as for depreciation. In this respect, it is important to differentiate between market volatility, short-term trends, and long-term structural mechanisms at the root of currency movements. In our October 19 semiannual report to Congress on International Economic and Exchange Policies, we stated that, given economic uncertainties, volatile capital flows, and prospects for slower growth in China, the near-term trajectory of the RMB is difficult to assess; and that remains the case today.

China has acknowledged during our engagements—including the Strategic and Economic Dialogue and President Xi's State Visit—that it is in its own interest to adopt the transparency standards of major reserve currencies. Last October, China subscribed to the IMF's Special Data Dissemination Standard (SDDS), a much-needed step toward increasing the transparency of China's foreign exchange reserves and exchange rate policy. In another step toward greater transparency, the September 30 release of the IMF's Currency Composition of Official Foreign Exchange Reserves (COFER) database included for the first time data on reserves from

China. To further increase transparency, we have encouraged China to disclose foreign exchange market interventions regularly.

Question: **According to the IMF's official criteria, the RMB could only be part of the SDR basket if the currency is "freely usable." Economists have argued that this requires China to run trade deficits and liberalize its capital account. Yet it is still extremely challenging for foreigners to buy and sell Chinese assets: in June, MSCI decided against including China in its emerging markets stock index for precisely this reason. The bond market also remains difficult to enter: though the market is large, only three percent of Chinese bonds are owned by foreigners. And in terms of global currency reserves, the RMB still lags behind the Canadian dollar and Australian dollar, according to the IMF's own research (though the RMB is not even reported in the IMF's COFER database).**

Mr. Sheets, in light of these issues, is the RMB ready to join the SDR basket and take its place alongside the dollar, euro, yen, and pound? If the IMF staff review of the SDR basket does not include a recommendation to include the RMB, would the Treasury Department vote against its inclusion?

Answer:

The IMF's definition of "freely usable" currencies are currencies which are *widely used* to make payments for international transactions and are *widely traded* in the principal exchange markets. To measure if a currency is *widely used,* the IMF looks at the composition of official reserve holdings, the share of international banking liabilities, and the share of international debt securities. To measure if a currency is *widely traded,* the IMF looks at the volume of transactions in foreign exchange markets.

This year, China has taken key steps toward making the RMB more freely usable. First, the Chinese authorities facilitated access by sovereign investors, who are SDR users, to China's foreign-exchange and capital markets. Importantly, this gives SDR users access to a range of Chinese financial instruments to hedge RMB interest and exchange-rate risks. Second, China extended its foreign exchange trading hours to overlap with that of major Western financial markets. This provides the IMF a reference for calculating the SDR basket's exchange rate. And lastly, China has increased the availability of Chinese government bonds, including by issuing for the first time a sovereign bond outside the mainland and Hong Kong. The Chinese Government also committed to selling three-month bills on a regular schedule, establishing interest rates used to calculate borrowing costs from the IMF.

When the IMF staff's assessment of these measures was presented, we closely assessed the progress that China has made in making the RMB more freely usable as well as the impact of possible inclusion of the RMB in the basket. During President Xi's recent state visit, the United States reiterated its support for the inclusion of the RMB in the SDR basket provided the currency meets the IMF's existing criteria. The IMF staff recommended that the renminbi be included in the Special Drawing Rights basket, and we supported that analysis in the Executive Board meeting on November 30, 2015. Since the IMF's decision, the Chinese authorities have continued taking steps to ease foreign investment in its capital markets. In February, the central bank significantly opened its largest bond market to foreign private investors including by removing quotas. The addition of the RMB will take effect on October 1, 2016.

Question: **According to a report by the Financial Times ("Greece Disqualified from IMF Bailout, Board Told," July 30, 2015), IMF staff has told the Fund's Board that Greece no longer qualifies for exceptional access assistance from the Fund. In order to qualify for exceptional access, Greece must meet four specific criteria. But the country fails two of them: 1) it does not meet the requirement for debt sustainability, and 2) it lacks the "institutional and political capacity" to carry out needed reforms. In addition, there would be no resort to a "systemic exemption," because the debt is now held by governments, thus removing contagion risk.**

Mr. Sheets, the Europeans have refused any haircut to Greece's debt, and it would not be credible to believe that a weakened Syriza government will have more capacity than previous Greek administrations. The unavoidable conclusion is that the IMF cannot lend to Greece without breaking its rules yet again. Can you assure the Committee that this will not occur?

Answer:

These two criteria are central to ongoing discussions between the Greeks and the Europeans. According to the IMF, debt sustainability in Greece can be restored without haircuts, perhaps through the use of maturity extensions, interest rate reductions, and/or longer grace periods in order to keep annual debt servicing costs within a sustainable threshold. European creditors have committed to provide debt relief subject to Greece meeting its reform requirements and have expressed openness to discussing non-haircut options.

With respect to "institutional and political capacity," the Greek government took important steps over the summer to reform the value-added tax system, reform the civil code of procedure to accelerate the judicial process, and adopt new corporate insolvency and bank resolution laws. While Greece continues to face very ambitious and front-loaded reform targets in its program, its efforts to date demonstrate commitment to carry out technically and politically challenging measures. To conclude the ongoing first program review, Greece will need to implement several ambitious measures, including narrowing the fiscal gap to achieve fiscal targets, strengthening the banking sector, improving the sustainability of the pension system, and undertaking further structural reforms.

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Monetary Policy and Trade
Questions for the Record for Nathan Sheets
Under Secretary for International Affairs, U.S. Department of the Treasury
"Strengthening U.S. Leadership in a Turbulent Global Economy"
September 17, 2015

Question: **Mr. Sheets, I am supportive of the TPP negotiations, and look forward to their conclusion. However, I want to raise a serious issue, which needs to be addressed.**

That issue relates to Malaysia's request to continue to maintain a screen on all foreign direct investment in the financial services sector. The screen, known as the Best Interests of Malaysia test, gives the Malaysian financial services regulator, BNM, unfettered and unchallengeable discretion to restrict or add conditions on U.S. investments in the Malaysian financial services sector. Such restrictions could include equity limits on investments or restrictions on the number of branches a U.S. invested company maintains. Securing commitments, without qualification, that ensure that a U.S. financial institution can own 100 percent of its investment should be the floor. I recall that the U.S. did not complete its bilateral FTA negotiations with Malaysia due to its unwillingness to open its financial sector and we should not give them a pass in TPP.

In fact, my understanding is the U.S. has never allowed a foreign trading partner to maintain such wide discretion to discriminate against U.S. investment under a U.S. FTA.

Under TPP, Malaysia will have open, non-discriminatory access to the U.S. market – including the U.S. financial services market. Why aren't negotiating for the same access to their market?

Answer:

Malaysia's best interest test resulted from recent financial sector reforms, and it replaced a previous regulatory regime that relied on hard, numerical limits on foreign ownership of financial institutions. Under TPP, Malaysia will retain the discretion to condition approval when an investment would result in Malaysians no longer having meaningful control of existing Malaysian financial institutions. In certain circumstances, this could include conditions on foreign acquisition of high-profile Malaysian financial institutions, particularly those remaining in sectors that already have high foreign penetration. However, TPP reflects an agreement with Malaysia that places some constraints in the application of the best interest test. For example, we would not view the best interests test as generally limiting *de novo* investments in financial services. Overall, as a direct result of TPP, Malaysia's investment regime for financial services is undeniably better than had existed previously.

The Administration recognizes that this is an issue of great concern to U.S. financial services firms. The Financial Services chapter of TPP established a committee (the Financial Services Committee) to monitor progress and the implementation of the chapter. We intend to use this committee to address any issues arising from Malaysia's application of the best interests test. In particular, we will seek to ensure that the test is applied with respect to foreign investors and investments in a manner consistent with the trade and investment liberalization objectives of TPP.

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Monetary Policy and Trade
Questions for the Record for Nathan Sheets
Under Secretary for International Affairs, U.S. Department of the Treasury
"Strengthening U.S. Leadership in a Turbulent Global Economy"
September 17, 2015

From Representative Guinta

Secretary Sheets, I understand that you represent the United States in certain Financial Stability Board (FSB) activities. Notably, you serve on the Standing Committee on Assessment of Vulnerabilities (SCAV) which is the FSB's main mechanism for identifying and assessing risks and vulnerabilities in the financial system.

Question: As you know, both the FSOC and FSB, along with IOSCO (International Organization of Securities Commissions), have indicated that an assessment of the risks posed by market-wide activities of non-bank [non-insurer] entities is the preferred course of action, rather than focusing on individual entities. However, in remarks you delivered on July 23, you said, "our regulatory approach to addressing systemic risks through entities and activities should not be seen as an either or question". Do you disagree with the current focus on market wide activities of non-banks as the more appropriate approach to assessing market-wide risks?

Answer:

I see my remarks as in line with approaches taken by the Financial Stability Oversight Council (FSOC) and Financial Stability Board (FSB).

The FSOC directed staff in July 2014 to undertake a more focused analysis of industry-wide products and activities to assess potential risks associated with the asset management industry. The FSOC is engaged in an objective, rigorous assessment of potential risks to financial stability. The process is still in the risk identification and analysis phase, and the FSOC has a number of tools at its disposal to address any potential risks to financial stability that are identified in this work. The FSOC has proceeded in a careful and transparent manner, including by hosting a public conference on this issue and issuing a request for public comment last December.

The FSB announced in July 2015 that work on financial stability risks from asset management activities began in March 2015.[1] The work will also evaluate the role that existing or additional activity-based policy measures could play in mitigating potential risks, and make policy recommendations as necessary. At the same time, the FSB announced that it will wait to finalize the assessment methodologies for non-bank non-insurer global systemically important financial institutions (NBNI G-SIFIs) until the work on financial stability risks from asset management activities is completed. In fact, the FSB noted that this timeframe will "allow further analysis of potential financial stability issues associated with asset management entities and activities to inform the revised assessment methodology."

[1] See: http://www.financialstabilityboard.org/2015/07/next-steps-on-the-nbni-g-sifi-assessment-methodologies/

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Monetary Policy and Trade
Questions for the Record for Nathan Sheets
Under Secretary for International Affairs, U.S. Department of the Treasury
"Strengthening U.S. Leadership in a Turbulent Global Economy"
September 17, 2015

Question: The SCAV is clearly a bank-centric committee. Virtually all members are central bank regulators – for example, there are four U.S. regulators on the committee but only one (the chief economist of the SEC) comes from the agency charged with oversight of the U.S. asset management industry and capital markets. Securities markets are distinct from banking activities and bank-like regulation is not appropriate or necessary for the asset management industry. How does the committee ensure that it is acknowledging and respecting the differences that exist between banking and capital markets and their respective regulatory structures?

Answer:

The FSB's Standing Committee on Assessment of Vulnerabilities (SCAV) takes into account views and expertise from central bankers, securities regulators, and finance ministry officials as it monitors the financial system for potential vulnerabilities. Many central banks have important responsibilities and authorities beyond oversight of banking, including surveillance of capital markets. SCAV, therefore, should not be considered to be overly focused on banks. The group is charged with monitoring vulnerabilities throughout the global financial system, including – but not limited to – risks that may emerge from securities markets. Its diverse membership includes a representative from the International Organization of Securities Commissions (IOSCO), the international standard setting body of the securities markets, the International Association of Insurance Supervisors (IAIS), as well as the International Monetary Fund (IMF). In addition, the SCAV also often receives input from the private sector, including representatives from the asset management industry. The SCAV takes into account and acknowledges the differences between the banking sector and capital markets.

Question: The FSB's and SCAV's process and activities are opaque at best. I understand SCAV is currently looking at liquidity in fixed income markets. Can you tell us how and when SCAV plans to solicit public comment on its activities in this area?

Answer:

The FSB, in coordination with IOSCO, continues to assess possible risks associated with market liquidity and asset management activities in the current market conditions, as well as potential structural sources of vulnerability associated with asset management activities. In September, the FSB publicly announced that it will prioritize the following areas for further analysis and policy recommendations, as necessary, to be concluded in the first half of 2016:[2]

- mismatch between liquidity of fund investments and redemption terms and conditions for fund units;
- leverage within investment funds;

[2] See: http://www.financialstabilityboard.org/wp-content/uploads/September-Plenary-press-release.pdf

- operational risk and challenges in transferring investment mandates in a stressed condition;
- securities lending activities of asset managers and funds; and
- potential vulnerabilities of pension funds and sovereign wealth funds.

Given the FSB's commitment to transparency and its extensive use of public consultations to further inform its work, it will most likely solicit public comment on potential recommendations sometime in 2016. This typically entails press releases announcing the proposal, a three month comment period, extensive discussion of comments received amongst FSB members, and sometimes a revision of the proposal for further comment.[3]

Question: You are a member of the SCAV along with three other U.S. regulators who are representatives of the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission and the Federal Reserve Bank of New York. How do you and the other U.S. regulator representatives decide what positions to take on FSB determinations? How do you interact with each other before taking such a position?

Answer:

Treasury works very closely with other U.S. authorities on all FSB Standing Committees, including SCAV. Staff and senior level principals are in constant contact regarding issues on the FSB agenda and work to coordinate appropriate U.S. positions. Staff level discussion take place on a near-daily basis, via email, phone calls, or in-person meetings.

[3] Examples of FSB documents put forward for public comment include: i) Assessment methodologies for identifying non-bank non-insurer G-SIFIs (http://www.financialstabilityboard.org/2015/03/fsb-and-iosco-propose-assessment-methodologies-for-identifying-non-bank-non-insurer-global-systemically-important-financial-institutions/); ii) Proposal for a common international standard on TLAC for systemic banks (http://www.financialstabilityboard.org/2014/11/fsb-consults-on-proposal-for-a-common-international-standard-on-total-loss-absorbing-capacity-tlac-for-global-systemic-banks/); and, iii) Cooperation and information sharing with non-crisis management host authorities (http://www.financialstabilityboard.org/2014/10/pr_141017/)

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Monetary Policy and Trade
Questions for the Record for Nathan Sheets
Under Secretary for International Affairs, U.S. Department of the Treasury
"Strengthening U.S. Leadership in a Turbulent Global Economy"
September 17, 2015

From Representative Murphy

Question: With the recent decline in both Chinese stock values and the value of the renminbi, what steps are being taken to limit the effect on the American economy of Chinese economic mismanagement and ongoing currency manipulation?

Answer:

Exchange rate policy continues to be central to our engagement with China, and we are making significant progress through bilateral and multilateral channels, such as the U.S.-China Strategic and Economic Dialogue (S&ED), G-20, G-7, and the IMF. The Administration has consistently impressed upon our Chinese counterparts first, creating the conditions conducive to an orderly transition to the importance of a market-determined exchange rate, allowing market pressure to drive the currency up, not just down; and second, the importance of implementing its Third Plenum reform agenda, which would help rebalance the economy to more sustainable and consumption-driven growth. Since June 2010, when China moved its currency off the peg against the dollar, the RMB has appreciated by 20 percent against currencies of China's major trade partners. Consequently, China's current account surplus has declined from a peak of more than 10 percent of GDP before this Administration took office to 2.7 percent of GDP last year. At the same time, U.S. exports of goods and services to China have doubled since 2009, growing twice as fast as U.S. exports to the rest of the world. Treasury officials engaged intensely with the Chinese authorities in the days following both the equity market volatility last July and the shift in how they set the midpoint fixing of their exchange rate regime in mid-August, urging them to remain committed to the reform agenda and to enhance communication and transparency to avoid unsettling markets. We continue to monitor closely the implementation of the reforms, including the new exchange rate mechanism and its responsiveness to market forces.

Question: In your testimony, you mention the new international development bank created by the Chinese, the Asian Infrastructure and Investment Bank (or AIIB), which the United Kingdom and other European nations have recently joined. Does the administration worry that China will use the AIIB to buy political patronage from other nations and dilute American influence? What action has the administration taken to prevent this from happening?

Answer:

The AIIB is a multilateral institution with over 50 shareholders. Though China is the largest single shareholder and will undoubtedly have major influence, it must still work with other shareholders on the Board of Directors to approve the bank's policies, loans, and investments. The fact that every shareholder is represented on the Board and that none has a unilateral veto limits the ability of any one country to use the AIIB for narrow political purposes.

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Monetary Policy and Trade
Questions for the Record for Nathan Sheets
Under Secretary for International Affairs, U.S. Department of the Treasury
"Strengthening U.S. Leadership in a Turbulent Global Economy"
September 17, 2015

The Administration has actively engaged with China, as well as with other prospective founding members, to help shape the AIIB. We have repeatedly stressed the need for the institution to adopt the high standards with respect to governance, environmental and social safeguards, procurement, and debt sustainability that prevail at the existing multilateral development institutions.

We have also encouraged shareholders to have the AIIB co-finance its initial loans and investments with the World Bank or Asian Development Bank, which would help ensure that these early AIIB operations meet high standards in practice. The AIIB Articles of Agreement and draft operational policies look promising and appear to be in line with other similar documents from existing international financial institutions. Of course, we will watch AIIB's early operational decisions carefully and will remain vigorously engaged with the Chinese and other members.

Finally, during President Xi's recent visit to Washington, China made an important commitment on governance at the AIIB by acknowledging (in the White House's Fact Sheet on U.S.-China Economic Relations[4]) that, to be effective, new institutions are to be, like the existing international financial institutions, properly structured and operated, in line with the principles of professionalism, transparency, efficiency, and effectiveness, and with the existing high environmental and governance standards.

[4] https://www.whitehouse.gov/the-press-office/2015/09/25/fact-sheet-us-china-economic-relations

○