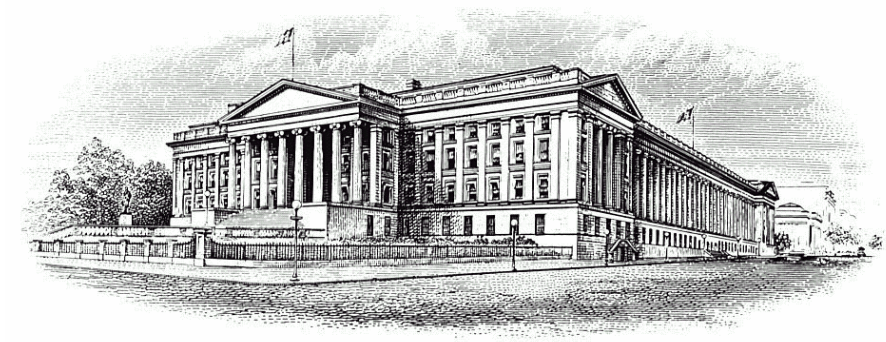

DEPARTMENT OF THE TREASURY

OFFICE OF PUBLIC AFFAIRS

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

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

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

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

Promoting Global Growth

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

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

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

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

Rebuilding Iraq and Afghanistan

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

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

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

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

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

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

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

Fostering Growth and Stability in Emerging Markets

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

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

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

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

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

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

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

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

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

Increasing Growth in Developing Countries

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

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

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

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

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

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

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

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

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

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

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

Authorization Requests

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

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

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

Legislative Mandates and Reports

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

Conclusion

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

Thank you. I welcome your questions.