FOREIGN POLICY IMPLICATIONS OF U.S. EFFORTS TO ADDRESS THE INTERNATIONAL FINANCIAL CRISIS: TARP, TALF AND THE G–20 PLAN

HEARING

BEFORE THE

SUBCOMMITTEE ON TERRORISM, NONPROLIFERATION AND TRADE

OF THE

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FOREIGN POLICY IMPLICATIONS OF U.S. EFFORTS TO ADDRESS THE INTERNATIONAL FINANCIAL CRISIS: TARP, TALF AND THE G–20 PLAN

WEDNESDAY, JUNE 10, 2009

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TERRORISM,
NONPROLIFERATION AND TRADE,
COMMITTEE ON FOREIGN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 1:05 p.m. in room 2172, Rayburn House Office Building, Hon. Brad J. Sherman (chairman of the subcommittee) presiding.

Mr. SHERMAN. In advance of the Group of 20 meeting in London, this subcommittee held a hearing to explore the foreign policy implications of the possible commitments that would be made there. President Obama then went to the G–20 where, along with other G–20 summit leaders, he committed $500 billion in contributions to the IMF, roughly $109 billion of that to come from the United States. He also committed us to joining a $250 billion expansion of special drawing rights, monetary reserves for all members.

I should point out that nearly $2 billion of this $250 billion will go to Iran. Hundreds of millions will go to Sudan, and Sudan has already used its prior receipt of special drawing rights by borrowing against it, turning it into cash, and financing its military. Additionally, the world leaders pledged at least $100 billion of additional lending by multilateral development banks, including a commitment to the World Bank which would triple its lending to $35 billion.

No effort was made, that I am aware of, to say that before we make additional commitments to the World Bank, we get that organization to cease and desist its disbursements on loans previously approved to the Government of Iran. It also seems that as the President was making these commitments, he did not adequately explain to foreign leaders that in our country and with our Constitution, the President speaks for the executive branch, and that where legislation or appropriations are necessary, there is a coequal branch of government, it is right there in Article I of the Constitution, and foreign leaders are often misled into believing that a President speaks for all branches of the Federal Government.

In fact, they need to be warned that a commitment of the executive branch is a commitment to use the executive branch's power and a commitment to come to Congress and to try to persuade us to move in the same direction. My concern is that the policies reached at the G–20 meeting, while aimed at solving the world's economic problems or at least ameliorating them, seem to have been utterly blind to our anti-genocide, antiproliferation and antiterrorism policies.

That may be the decision of the executive branch. It does not have to be the decision of the legislative branch. It appears that a number of our friends in Europe simply don't agree with us on anti-genocide, antiproliferation or antiterrorism. That doesn't mean they are pro-terrorist or pro-genocide, it just means they think that we should conduct business as usual while turning a blind eye to those concerns, and it is clear that those who wish to be applauded by European leaders best ignore those considerations.

The question is whether ignoring those considerations is also a way to be applauded by Congress and the American people. Last week, and I am glad he got here in time for this favorable mention, I and Ranking Member Royce organized and signed a letter to House appropriators urging the inclusion of important safeguards in any congressional authorization of U.S. Government funds to multilateral institutions. Specifically, we want to prevent countries that are identified as supporting terrorism or involved in nuclear proliferation, most notably Iran, from benefitting from policies of the IMF and the World Bank at the same time that the U.S. Government is transferring billions of dollars to those institutions.

I should point out that the Senate war appropriations bill includes a $109 billion transfer or commitment of funds, if you will, to the IMF, and also over $3 billion is authorized for the World Bank. Nothing in that bill asks those institutions, in return for our largesse, to alter their policy: Business as usual, toward Iran, Sudan and other terrorist regimes. Now, these concerns are not new, as I have pointed out before. From 2000 to 2005, the World Bank approved $1.4 billion in loans to Iran, some $0.5 billion is yet to be disbursed, and I believe the United States should not provide additional funds to the World Bank until those disbursements are stopped.

Similarly, according to a May 26 report in the Financial Times, Hezbollah, in anticipation of potential success at the Lebanese election, began meeting with IMF officials. Fortunately, the Lebanese people were unwilling to embrace Hezbollah. Unfortunately, what these discussions show is that the IMF administrators were willing to embrace Hezbollah, should it have been successful in those elections. The international community should not expect Americans to contribute or put at risk more than $100 billion without focusing on the demands of the American people that these international organizations do not benefit terrorism, proliferation or genocide.

As noted in a CRS report, the most effective way that Congress can influence U.S. policies toward multilateral institutions is by attaching enforceable conditions to new funding arrangements. Now, our discussion at these hearings goes beyond the multilateral institutions. Our domestic, or at least called domestic, stimulus efforts and bailouts through TARP, TALF and the stimulus bill, play a major role in the world economy, and one focus of this is the AIG bailout.

Foreign-owned institutions have benefitted from the bailout of what are called U.S. companies. Most notable was our nearly $200 billion committed to AIG. Let me focus a little bit on the AIG bailout. The word is clear to investors worldwide. If you loan money to an American auto company, like Chrysler, you may get only 20 cents on the dollar, but if you take your money and, "invest it at the AIG casino," not putting it into anything productive, not actually building anything, you just play the casino, the American taxpayer will be squeezed into making sure you get every penny, and so while the Chrysler bond holders are getting about 20 cents on the dollar, the AIG counter-parties haven't lost a penny, and I realize I have gone a little bit long but I know that Mr. Royce would want to hear at least a full contingent of this opening statement, so in deference to him, I will continue.

Now, when you focus on the AIG, we notice that Société Générale was paid $4.1 billion, U.S. Government money, on their credit default swap. They didn't have to give up a penny, and it is alarming and unacceptable that we sent this money to an institution that has continuously operated a bank in Iran since 1974. On the same note, UBS, the biggest Swiss-owned bank, is known as a haven for tax evaders.

It received $800 million of U.S. taxpayer money in the AIG bailout. While the Swiss authorities have provided the United States with details on 300 Americans suspected of tax fraud, UBS and the Swiss Government officials have failed to identify more than 50,000 U.S. account holders. Claiming that further cooperation would violate the law, they are unwilling to change, so U.S. tax money goes to support a bank that makes it much, much more difficult to collect U.S. tax money from those who owe it, placing the burden of that United States tax collection on working families who do not have Swiss bank accounts.

Now, there are American values and there are what I would call the accepted values of Wall Street and the world economic elite. Sometimes these values coincide, and were reflected at the G–20 conference, which was dedicated to alleviating global poverty and stimulating the world economy. But, there are three T's where Wall Street values and world economic elite values clash with American values. I call them the three T's: Tax evasion, terrorism and total protection of the biggest financial institutions, whether U.S. or foreign, at the expense of the U.S. taxpayer.

I would hope that American foreign and economic policy will reflect American values, and I hope that at least this branch of government keeps that in mind and asserts its authority, rather than serving as a rubber stamp for the administration. With that, I yield to our ranking member, Mr. Royce.

Mr. ROYCE. Thank you very much, Mr. Chairman, and I thank you not only for calling this hearing but, as you know, the international financial crisis has impacted the full range of our foreign policy and national security interests, and that is part of the objective here, is to hear from our witnesses on that. Let me begin by saying I share the chairman's concern about IMF aiding Iran, and I very much appreciate the letter, Mr. Chairman, that you led, and which I signed, calling for this funding to be pulled out of the pending supplemental, and I think it is very, very important that at a time when we should be squeezing Iran because of its nuclear program, and recognizing that the Iranian economy, frankly, is hurting, that this policy of allowing Iran to receive new IMF money, and some suggest, Mr. Chairman, that this could go as high as $1.7 billion—$1.7 billion, a lot of this at United States taxpayer expense. This is clearly nonsense, and that is just one concern.

We also have Sudan. We also have Syria. We have the other beneficiaries, frankly, that we need to be worried about as well. Now, admittedly, I am not big on IMF spending to begin with, and I don't see ramping up its lending as central to the global economic recovery. I certainly don't trust it to play a critical regulatory role, as some advocate, and I suspect that with its levels of lending plummeting over the last 5 years, the IMF is probably desperate for a new mission, and I think that this is part of that push, but I think this opaque institution certainly hasn't made the case for a claim on U.S. resources, and I think it is especially important that we consider the fact that these are resources that we are going to have to go out and borrow.

It is not as though we have reserves ready to fund this. This will be done through borrowing, and I think the popular media enjoys labeling the financial crisis, by the way, as a crisis of free markets. It rarely explains the harmful impact of government actions such as policies and political pressure to sacrifice lending standards, to resist meaningful reform. I would recommend Tom Sowell's book for those interested, the economist book, *The Housing Boom and Bust*, that gives you a full range of government interventions made in the domestic market here, where Congress was pushing in one way while the regulators were saying, wait a minute, wait a minute, the GSEs are overleveraged 100 to 1. You know, why aren't we allowed to go in and de-leverage them? Why can't we put some limit on the government-sponsored enterprises, Fannie and Freddie? Why should we have these 3 percent loans or zero down payment loans?

Well, it was political pressure that drove that, you know, CRA driving subprime lending here. There are a lot of issues that, in fact, emanate from government intervention in the market, and Congress's crippling of the regulators to do their job. I had legislation, for example, to have a regulator look at insurance institutions, like AIG, and have access to all of the information at the Federal level in order to be able to get past this patchwork quilt of regulation, but how does the Fed's bad decision to keep interest rates effectively negative for 4 years running, how does that have anything to do with free markets?

How do the central banks in Europe, following the Fed's lead and having interest rates negative in Europe for 4 years running when adjusted for inflation and the resulting bubble that that created in terms of housing, in terms of an economic bubble, how does that have anything to do with the free market? No, no. These are mistakes made at the governmental level, and these are examples of interventions where we didn't get the regulation right.

That is what this is about, and the fact is that free markets have done more to eliminate poverty than all of the government programs that free markets combined fund, because it is ultimately the market, through taxation, that funds the programs that we are passing out of here, such as the funding that goes to the IMF. At least the G–20 has agreed, on a hopeful note here, in my view, to reject protectionism, yet too many countries are moving toward protectionism.

The Obama administration is willing to spend aid money for trade. The G–20 agreed to spend $250 billion on trade aid, but it is unwilling to get an actual trade deal done. It is tied in knots over the Panama deal, a deal of very minor economic consequences, but it sends enormous signals worldwide in terms of liberalized trade, or resistance to it in terms of protectionism. It is setting on a Korea deal. You know, finishing the Doha trade round could boost the global economy by at least $150 billion a year, yet there is no American leadership on getting that done.

Nothing would more advance our interests abroad than an economic recovery at home. It is hard to see how today's massive deficit spending is going to help on that, as we look at government's attempt to spend. This year alone we will have somewhere—we won't hit a $2 trillion deficit, but by the end of the year, we will come close. Does anyone really believe this administration's claim that we will get deficits under control? I don't see the political understanding nor discipline to do that, and the Fed Chairman, again, raised a warning last week.

Meanwhile, government bureaucrats and politicians are assuming ever-greater economic power. Who knows the powers the massively expansive Obama health proposal will transfer into public hands? TARP has brought the American people Government Motors, $50 billion of GM being Government Motors. The political economy is only beginning. The Hill reports that one prominent Member of Congress "was able to get GM to undo a planned parts distribution center closure in his district." So political pull is beginning to replace market forces.

One witness suggests that next will come graft and corruption. As Venezuela and others nationalize companies and embrace statism, their economic demise is going to intensify. Let us not join that club. Let us try to embrace markets. Let us try to keep politics out of it, and let us try, when the regulators want to take effective action against institutions, whether it be government sponsored enterprises like Fannie or Freddie, let us not have politicians stand in the way and prevent that proper regulatory role from occurring.

Mr. Chairman, thank you again for this hearing.

Mr. SHERMAN. Thank you, Mr. Royce. I should point out that as scheduling has worked out on the Hill, the Foreign Affairs Authorization Bill is on the floor now. I am watching it here on this screen, just for a second. I was paying full attention to Mr. Royce—and that is why so few of our colleagues can be here. Almost our entire committee is down on the floor. This hearing was scheduled first, but the floor needs to go forward. I am going to resist, and it is very difficult for me, commenting on Mr. Royce's views on trade, and instead recognize the vice chair of this committee, Mr. Scott.

Mr. SCOTT. I won't mind saving you from Mr. Royce. This is a very timely hearing, and very much needed. I really can't think of any more single threatening issue for the future welfare of our country than our financial situation, not just here at home, but abroad. I have just returned from Europe from our NATO meetings, and needless to say, the financial crisis, the world's financial crisis was center stage, but the greater bout of attention was paid to what is going on in the United States, and surprisingly, that which got more attention than the domestic side was our debt, and the part of our debt that got the greatest attention was the debt that is being held in the hands of foreign countries.

Many of you may not know, but just in the last 9 years, our country has borrowed more money from foreign governments than in the entire preceding, what, 211 years. Just think about that. That means, since the foundation of the United States of America, all of the money that was borrowed up through from 1789 up through 2002 does not come up to the amount of money we have borrowed from foreign countries in the last 9 years. That is an extraordinarily threatening situation.

Now, yesterday, I was on the Voice of America television program, and it aired exclusively into China. And you know the question that the Chinese were asking me over and over and over again was while North Korea, certainly in the news and they are right next door, the Chinese were concerned about that, but they were more concerned about whether or not they should continue to buy our debt. That is an amazing situation. So, and just today, Reuters has reported that Russia is beginning to question their continuance at the level of purchasing our debt.

And so, I think with that backdrop, this hearing is extraordinarily important, and so I want to thank you, Mr. Chairman, for examining the foreign policy implications of the United States' response to our current financial crisis. The United States has been, and certainly still is, the financial backstop of the world. Make no mistake about it. We are still number one, hanging on by our fingernails, but we are still number one.

We still provide the lion's share of funding for most multinational, financial and developmental institutions. The U.S. dollar has been the currency of choice for international transactions and investments for decades. Investing in U.S. treasuries has been the safest form of investment for even longer, and moreover, the American consumer has been the driver of economic engines, not just in this country but in numerous developing countries, through our purchasing power.

This is what makes and will continue to make America the greatest nation in the world. Some say it is our military strength, and it is certainly there, but it is our financial capacity, it is our economic capacity, that drives the world. We have historically been able to wield our tremendous economic power alongside our military might to undergird our diplomatic efforts and achieve our foreign policy objectives, but it has been not just military, it has been economic power.

However, it seems that in the wake of our ongoing financial crisis, our economic power, or at least the perception of that power, as I alluded to at the very beginning with my remarks on China and Russia, is beginning to unravel, and so while much of the discussion today will focus on multinational financial institutions such as IMF and the World Bank, I think it is worth examining the effect that a changed perception of U.S. financial prowess will have on our efforts to influence events around the world.

Everything is image. It is not what we think of ourselves. It is what other people think about us. So much like the view of our military strength has been lessened by the quagmires in Iraq and Afghanistan, so too, it seems, the view of our economic might has become more negative as we are bogged down in this recession. We have already seen talk from OPEC about shifting away from dollar-based pricing of oil. So our economic leverage is beginning to wane somewhat. So as we move forward with our domestic financial rescue plans and with finding multinational institutions in an effort to spark global recovery, I feel that we must keep in mind that our ability to influence other nations lies largely in our economic right, real and perceived.

Thank you, Mr. Chairman.

Mr. SHERMAN. I thank the vice chairman. Without objection, the full statement of each witness will be entered into the record. We will ask each witness to summarize that statement orally in 5 minutes. Once we hear from the witnesses, we will be asking questions and I will depart from the usual procedure in that I will have our vice chair, then our ranking member, ask questions before I do.

Mr. CONNOLLY. Mr. Chairman, could I just ask, I have an opening statement.

Mr. SHERMAN. Oh, yes, go right ahead. I didn't know you had one, but I look forward to hearing it.

Mr. CONNOLLY. Thank you. I am sorry I am late, but I was on the floor with the State Department Authorization Bill.

Mr. SHERMAN. As I pointed out to our colleagues, that is why so many people—they all want to be here. They are all on the floor.

Mr. CONNOLLY. They all want to be at this hearing but we are fighting for the State Department on the floor of the House.

Mr. SHERMAN. Yes.

Mr. CONNOLLY. Thank you, Mr. Chairman. Thank you so much. Mr. Chairman, if this crisis has taught us anything, it is that our economies are linked. Vulnerability in one system can have global effects. Last fall's collapse of Lehman Brothers, for example, displayed the ripple effect one catastrophic event can have on the global economic landscape. The ripple effect, of course, is not confined to just the financial sector. We have all seen the effects in our respective districts, here in Congress.

Fairfax County, my home county, for example, is home to more than 360 foreign-owned firms, representing nearly 40 countries. These international companies are dealing with financial challenges on both fronts. The U.S. Federal Reserve and the Bank of England have taken necessary steps to insulate our economies from further damage by buying debt. The U.S. and the U.K. are sharing much of the burden for insulating the rest of the world from further damage, though this situation is far from ideal.

In a report released this week, the IMF warned that economic recovery in Europe, specifically the Euro zone, could be stymied by banks burdened with bad assets. I fear that some European nations are not doing their fair share with regard to properly cushioning the international economy from further damage. For example, last month, the IMF called for European authorities to follow the United States in conducting stress tests. The EU stress test, which will be national and not European-wide, will not even take place until September.

European banks must be on the same page as the United States when it comes to cleaning up this mess. According to an IMF report published Monday, the lack of a coordinated and aggressive cleanup plan for European banks could hamper economic recovery in the 16 countries that share the Euro. The same report discusses the need for more decisive and thorough action on the part of European authorities.

Mr. Chairman, German Chancellor Merkel has expressed skepticism about the effectiveness of major economic stimulus packages. Earlier this week she stated that "the independence of the central bank must be preserved and the things that other central banks are doing now must be reversed." Though their more conservative approaches led to political gains, perhaps, for her party, I fear the long-term consequences in terms of economic recovery in the Western hemisphere. I look forward to hearing from our witnesses today. Thank you, Mr. Chairman.

Mr. SHERMAN. Thank you. I am told the gentleman from Arkansas does not have an opening statement, and so we will hear from our witnesses, the first of which is Damon Silvers, who serves as associate general counsel for the AFL–CIO. Mr. Silvers is also deputy chairman of the three-member Congressional Oversight Panel. There are many Congressional Oversight Panels. This one is not made up of Members of Congress, but is perhaps the most important of the oversight panels since it oversees the TARP program. Mr. Silvers?

STATEMENT OF DAMON SILVERS, ESQ., ASSOCIATE GENERAL COUNSEL, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS (DEPUTY CHAIR OF THE CONGRESSIONAL OVERSIGHT PANEL)

Mr. SILVERS. Thank you, Chairman Sherman, and good afternoon to you and to Ranking Member Royce. Thank you for the opportunity to testify today. As you noted, I am associate general counsel of the AFL–CIO and deputy chair of the Oversight Board for the TARP. I hope you won't mind if I mention that we have five members and one of them is actually a Member of Congress, Jeb Hensarling. I think I would be remiss if I didn't correct the record on that. My——

Mr. SHERMAN. The—go on. Go on.

Mr. SILVERS. My remarks today, though, are my own, and are not necessarily the views of the Panel, its staff or its chair, Professor Elizabeth Warren. I am going to try very briefly to address two issues. One is the interaction of TARP with foreign institutions, and the second is the G–20 from the perspective of the global labor movement.

When Congress enacted the Emergency Economic Stabilization Act of 2008, Congress provided that funds under that act could only be expended to support U.S.-based financial institutions. It is built into the definition of the term "financial institution." However, Congress did not bar foreign financial institutions from indirectly benefitting from EESA expenditures, and in particular, as you noted, Mr. Chairman, in your opening statement, a large portion of the funds provided to AIG, one of the primary beneficiaries of the EESA, have been transferred directly to foreign bank counterparties to AIG derivatives contracts, including, as you mentioned, Société Générale and UBS.

Now, I do not believe that at this time, either the documents that the Oversight Panel has obtained or the publicly available information in this area includes sufficient information to clearly understand the basic question of how the economic relationship between AIG and its derivative counterparties evolved during the critical month of September 2008, which led to the bailout of AIG. As a result, it is really impossible to responsibly express with any certainty an opinion about these transactions or provide answers to questions such as, were these transactions in the form undertaken unavoidable, or, were they in the public interest?

I think we can say, however, that none of the institutions on the AIG counterparty list, as disclosed earlier this year, would appear to have been bankrupted had they not received that money. Now, more broadly, the National Intelligence Director in the Annual Threat Assessment presented to the Senate Select Committee on Intelligence in February of this year identified the economic and financial crisis as "the primary near-term security concern of the United States," and the activities of the Treasury Department, the FDIC and the Federal Reserve, which constitute collectively the financial bailout, a set of activities larger than the activities under the EESA that our Panel oversees, raise several questions in relation to the global interests of the United States. First, the question, what is the impact of the approach we are taking to refinancing our banking system on the perception among foreign investors of the strength of our currency, the state of the Federal Reserve's balance sheet, and the extent to which we have or have not actually dealt with the capital shortfalls in our major banks?

Secondly, to the extent to which our approach to resolving our banking crisis is succeeding through providing low-cost liquidity and an implicit guarantee to our major banks with an international presence, is this approach causing U.S. banks operating overseas to be perceived as having an unfair advantage over their domestic competitors, with obvious foreign policy and potentially national security consequences?

Thirdly, are we seeking to perpetuate the basic international financial arrangements that appear to have contributed to the bubble and the subsequent crisis, namely, high degrees of leverage funded by cheap debt, financed by global trade and currency imbalances? And fourthly, is it true, as some have asserted that we today have no means of resolving an insolvent global financial institution?

Now, the global labor movement has urged the governments of the G–20 countries to "put employment and fairness" at the center of government's response to the crisis. In general, the global labor movement has supported the direction taken by the G–20, and in a number of cases, following the lead of the Obama administration. However, we are concerned that, first, the financial regulatory reform proposals in the G–20 London communiqué at the international level may be too weak.

Secondly, that banks in key countries are being propped up rather than restructured, risking a Japanese "lost decade" scenario globally. Thirdly, that the governance of multinational bodies such as the Financial Stability Board and the IMF, charged with addressing the crisis, is both opaque and too narrow in terms of who is involved globally. And fourthly, that despite the very positive statements coming out of the London meeting, that the resources committed to fiscal stimulus, particularly in the Euro zone, and job creation, are not increasing, while the downward spiral globally is increasing. I have attached to my testimony a detailed commentary from the global labor movement on the G–20 meeting in London.

Thank you, in conclusion, for the opportunity to appear before you today. Obviously, these subjects are somewhat more complex than the 5 minutes allow, and though I do not speak for the Oversight Panel in any respect, I hope I could speak in the respect of offering the Panel's assistance to the committee in any way you would find useful. I can say with certainty that the AFL–CIO and the global labor movement do so offer that assistance. Thank you.

[The prepared statement of Mr. Silvers follows:]

Testimony of Damon A. Silvers

Associate General Counsel

American Federation of Labor and Congress of Industrial Organizations

House Committee on Foreign Affairs
Subcommittee on Terrorism, Nonproliferation and Trade

Hearing on The Foreign Policy Implications of U.S. Efforts to Address the International Financial Crisis: TARP, TALF, and the G-20 Plan

June 10, 2009

Good afternoon, Chairman Sherman and Ranking Member Royce. Thank you for the opportunity to testify today. My name is Damon Silvers. I am Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO). I was appointed to the Congressional Oversight Panel created by the Emergency Economic Stabilization Act of 2008 jointly by Speaker Nancy Pelosi and Senate Majority Leader Harry Reid, and I serve as the Panel's Deputy Chair. My remarks today though are my own, and do not necessarily reflect the views of the Panel, its staff or its chair, Professor Elizabeth Warren.

The Subcommittee asked that I address issues relating to the international impact of the steps taken under the Emergency Economic Stabilization Act, including both TARP and TALF, and initiatives taken by theG-20 to address the global economic and financial crisis, and that in particular I speak to the views of the global labor movement on the G-20 initiatives.

Along with global macroeconomic imbalances, credit practices and deregulatory policies in the United States were fundamental causes of the current crisis. These practices and policies had analogues in a number of other developed countries, particularly in the United Kingdom, Ireland, Spain and parts of Eastern Europe. Furthermore, toxic assets, including mortgage-backed securities and credit default swaps originating in the U.S. were sold in global credit markets, finding their way into portfolios in countries such as Norway whose domestic mortgage markets were well regulated.

Consequently, as the financial crisis developed and evolved into a severe global recession, there was a clear need for a coordinated response by the governments of the world's largest economies to both the immediate financial and economic distress and to the weaknesses in financial regulatory structures. Initially, this urgent need produced the coordinated recapitalization of major banks by the U.S. and U.K. governments in October, 2008, the first use of funds under the EESA.

When the G-20 subsequently met in December, 2008 in Washington, there was a clear sense that there needed to be coordinated international action to address both the worsening economic crisis and its underlying structural causes. The resulting statements from that meeting and a second G-20 meeting in London in April of 2009 embodied commitments on the part of the participating countries to support a strengthening of the international financial regulatory framework through expanding the Financial Stability Forum and the role of the IMF, and to continue to coordinate the immediate work of responding to the global financial crisis.

At the same time of course, the United States government dramatically escalated its interventions in our financial system through the EESA, including the Capital Purchase Program, the Systemically Significant Failing Institutions Program, the Targeted Investment Program that gave extraordinary assistance to Citigroup and Bank of America, and the TALF program that financed investments in asset-backed securities by private parties. In conjunction with these programs, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve provided a variety of guarantees and credit facilities separate from the EESA. Collectively, these initiatives have provided close to $4 trillion in financing to U.S. based financial institutions.

When Congress enacted the EESA, Congress provided that EESA funds could only be expended to support U.S.-based financial institutions.[1] As a result, the Congressional Oversight Panel has not identified any non-U.S. institutions receiving public funds directly under the Capital Purchase Program, the Systemically Significant Financial Institutions Program, the Targeted Investment Program, or the TALF program. This limitation on TARP I believe reflects a judgment that in general rescue plans for financial institutions should be funded by their home country governments.

However, Congress did not bar foreign financial institutions from indirectly benefitting from EESA expenditures, and in my judgment given the nature of EESA there would be no practical way to enact or enforce such a ban on indirect benefits should Congress feel such a ban were desirable. However some indirect expenditures are more indirect than others. In particular, a very large proportion of the funds provided to AIG under a credit facility from the Federal Reserve Bank of New York and then from EESA funds under the Systemically Significant Failing Institutions program have been transferred directly to AIG's counterparties in derivatives contracts, including a number of non-U.S.-based banks.[2] According to AIG, 55% of the $52 billion in collateral posted by AIG following September 16, 2008, the date when federal assistance to AIG began, was provided to

[1] The definition section of the Emergency Economic Stabilization Act of 2008 includes the following definition of "financial institution":

(5) Financial institution--the term ``financial institution'' means any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State, territory, or possession of the United States, the District of Columbia, Commonwealth of Puerto Rico, Commonwealth of Northern Mariana Islands, Guam, American Samoa, or the United States Virgin Islands, and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.

[2] http://www.aig.com/aigweb/internet/en/files/CounterpartyAttachments031809_tcm385-155645.pdf

foreign banks. Sixty-five percent of $43.7 billion in payments to AIG's securities lending counterparties during the same period went to foreign banks. Maiden Lane III, an entity created by the new Federal Reserve Bank of New York to facilitate government aid to AIG, made 27.1 billion in payments to AIG counterparties, of which 59% went to foreign banks. These banks include Societe Generale and UBS. Societe Generale has been the subject of criticism for its operations in Iran, and UBS has been the focus of a large-scale tax fraud investigation by the IRS, the Justice Department and the FBI.[3]

There are a number of unresolved questions about the uses of EESA and Federal Reserve funds in the case of AIG. Although COP staff has been reviewing documents provided by the Treasury Department relating to AIG, I do not believe that at this time either the documents we have or the publicly available information in this area includes sufficient information to clearly understand how the economic relationship between AIG and its derivative counterparties evolved during the critical month of September, 2008. As a result, it is impossible to express with any certainty an opinion about the implications of the indirect expenditure of EESA funds to benefit non-U.S. AIG counterparties such as UBS and Societe General or provide answers to questions such as: "Was this expenditure unavoidable or in the public interest?" It does not appear that absent the money provided by the Federal Reserve and the Treasury to AIG's counterparties those counterparties would have faced insolvency threats of their own.

Many of the issues associated with the federal government's rescue of AIG are likely to reoccur should the Treasury Department and the FDIC move ahead with the Public Private Investment Partnerships, or PPIP. While final rules have yet to be issued, the Treasury Department's initial description of the PPIP partnerships suggest that it will be possible for non-U.S. investors to participate in the PPIP partnerships. The basic structure of the PPIP partnership is one that assigns disproportionate upside to the investors in the partnerships compared to their capital at risk.

My view is that both the AIG intervention and the PPIP structures are problematic in and of themselves, rather than because foreign investors may benefit or have benefited from these initiatives. Furthermore, the question of whether financial institutions that are supporting terrorism or assisting in tax fraud are benefitting directly or indirectly from EESA should be taken up based on conduct, rather than based on whether such institutions are U.S. based or foreign based.

At a more general policy level, the activities of the Treasury Department, the FDIC and the Federal Reserve raise several questions in relation to the foreign relations of the United States.

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[3] For Societe Generale's operations in Iran see:
http://www.sgcib.com/country_focus.rha?c=country_focus%7Bunid=EE6E304ED6242732C125673F0056AA7D%7D

For UBS's U.S. tax issues see, for example:
http://www.nytimes.com/2009/03/05/business/worldbusiness/05tax.html

1) What is the impact of the approach we are taking to refinancing our banking system on the perception among foreign investors of the strength of our currency, the stability of our Federal Reserve, and the extent to which we have actually dealt with the capital shortfalls in our major banks? Please see in this regard the April Report of the Congressional Oversight Panel.

2) To the extent to which our approach to resolving our banking crisis is succeeding through providing low-cost liquidity and an explicit guarantee to our major banks with an international presence, is this approach causing U.S. banks operating overseas to be perceived as having an unfair advantage over their domestic competitors?

3) Are we seeking to perpetuate the basic international financial arrangements that appear to have contributed to the bubble and the subsequent crisis—namely high degrees of leverage funded by cheap debt that can be only be financed as a by-product of the hoarding of dollars by our trading partners and emerging market nations seeking to protect themselves against currency bear raids?

This week the Bank for International Settlements, in its Quarterly Review stated, "have been associated with tangible improvements in a number of key markets (as noted in this Overview). Ultimately, however, the effectiveness of central bank actions in attenuating the impact of the crisis and restoring the functioning of markets depends on the extent to which they have a catalytic effect on private sector intermediation. Thus the ultimate success of central bank interventions depends on the appropriate design and forceful implementation of policies that address directly the fundamental weaknesses in bank balance sheets."[4]

The seriousness of these questions underlies in part the importance of a thoughtful comprehensive response to the crisis by all the world's major economic powers. The AFL-CIO is involved in a global labor movement effort coordinated by the International Trade Union Confederation, representing over – million workers in – countries, to ensure that working peoples' concerns are heard in the G-20 process. John Sweeney, the President of the AFL-CIO and the Trade Union Advisory Committee to the OECD participates in leading that process.

The global labor movement has urged the governments of the G-20 countries to "put employment and fairness" at the center of governments' response to the crisis. Specifically, that means the global labor movement is looking to all G-20 countries to follow the recommendations of the IMF that all the major economies engage in significant programs of fiscal stimulus. In general, the global labor movement has supported the direction taken by the G-20, in a number of cases following the lead of the Obama Administration. However, the global labor movement also has serious concerns about the vigor with which key initiatives are being pursued, and the question of the

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[4] Bank for International Settlements, BIS Quarterly Review, June 2009, pg. 7

ability of the international institutional framework to accomplish the tasks set by the G-20.

Specifically, the global labor movement is concerned that:

(1) financial regulatory reform proposed by the G-20 communique at the international level is too weak and that the Financial Stability Forum is an inadequate institution with insufficient independence from the financial sector to act as a serious regulatory coordinator.

(2) that banks in key countries—the UK, Germany and the United States--are being propped up rather than restructured, resulting in regressive redistribution of wealth and risking a Japanese "lost decade" scenario both in those specific countries and globally, given the role the U.S. and the U.K play in the world financial system;

(3) that the governance of multinational institutions such as the FSF and the IMF, charged with addressing the crisis is both opaque and too narrow in terms of constituencies involved; and

(4) that despite the very positive statements coming out of the London meeting, that the resources committed to fiscal stimulus and job creation are not increasing, while the downward spiral globally is increasing.

More recently, in the aftermath of the London and Rome meetings, the AFL-CIO has been encouraged by the Obama Administration's efforts to address how to get beyond debt-financed consumer spending in the U.S. as the engine of global growth.

I have attached to this testimony a copy of the Trade Union Evaluation of the most recent G-20 meeting in London.

In conclusion, the measure of whether economic policy in the U.S. and worldwide is successful at addressing the economic crisis is whether real economies are reviving and whether financial institutions are playing their proper role as effective, efficient and stable providers of credit to the real economy. The labor movement globally is united in calling on governments to take effective action in the areas of fiscal stimulus, bank restructuring and financial reregulation.

In the longer run, the global labor movement believes that the G-20 must focus on developing a global economic model that is sustainable and democratic both in its governance and in its results.

Thank you for the opportunity to appear today. Though I do not speak for the Congressional Oversight Panel in general, I think I am safe in saying that the Panel stands ready to assist the Subcommittee in your work, and I am certain that is also true for the AFL-CIO and the global labor movement.

ITUC CSI IGB

TUAC

ITUC/TUAC EVALUATION OF THE OUTCOME OF THE G20 LONDON SUMMIT

2 APRIL 2009

Overview

1. Jobs and social issues moved up the agenda in the communiqué[1] of the G20 London Summit by comparison with the November 2008 G20 Summit and with earlier drafts of the G20's communiqué. The International Labour Organisation (ILO) will take part in follow-up to the summit, having been asked to assess the actions being taken by the G20 on employment. The Summit also supported further discussion on a "charter" as proposed by Chancellor Merkel and others to achieve a new global consensus on the key values and principles for sustainable economic activity. 1.1 trillion dollars of largely new funding was agreed for major lending facilities, including Special Drawing Rights - the bulk of which will go to the IMF. However, no new money was agreed for further global stimulus packages. Forward agreement was reached to strengthen international financial regulation, including that of "systemically important" hedge funds; however this is to be in the hands of an expanded Financial Stability Forum – renamed as a "Board" but itself made up of central bankers. This remains far short of trade union proposals for supra-national regulatory authorities, or the "World Finance Organisation" proposed by the French President. An agreement was reached to take action against "non-cooperative" tax havens as identified by the OECD if necessary through sanctions. Leaders agreed to meet again before the end of 2009 "to review progress on our commitments", hence reinforcing the principle of multilateral cooperation and action on global economic issues. It is likely that this will take place in September in New York around the meeting of the General Assembly of the United Nations.

Employment and Social Issues

2. On the eve of the Summit the OECD published its latest interim forecasts for the world economy. These present an appalling picture of the global economy shrinking by 2.7 per cent and the OECD countries by 4.3 percent in 2009. As a result unemployment is likely to double over the course of the year in some major economies. Against this background trade unions conducted advocacy work around the world on the jobs issue, including meetings with G20 leaders in the days prior to the Summit and in London itself. This had its impact. The communiqué emphasises the depths of the crisis facing the world economy and calls for a

[1] http://www.londonsummit.gov.uk/resources/en/PDF/final-communique

global solution (#2). It stresses the importance of "the needs and jobs of hard-working families" (#3) and the need to "restore confidence, growth and jobs" (#4, bullet 1), while its first substantive section is titled "Restoring growth and jobs" and makes reference thereafter (#6) to job saving and creation as a central purpose of fiscal expansion. A major paragraph (#26) considers employment in some detail: creating employment opportunities for those affected by the crisis, including income support measures; building "a fair and family-friendly labour market for both women and men"; welcoming the reports of the G20 London Jobs Conference held on 24 March 2009, and the Rome Social Summit (29-30 March 2009) and the key principles they proposed; supporting employment by stimulating growth, investing in education and training, and active labour market policies, focusing on the most vulnerable; and calling on the ILO with other relevant organisations to assess the actions taken and those required for the future. References in earlier drafts to the OECD were removed, apparently at the request of China and some other non-OECD G20 countries.

3. The Summit did not agree on additional fiscal stimulus measures – it agreed to "take what ever action is necessary" to restore growth and called on the IMF to assess the actions taken. However three points are significant: Firstly, reference to the report of the Rome Social Summit of G8 Labour Minsters means that the generally positive conclusions of that Summit are also endorsed, including its referencing the discussions of the 2009 International Labour Conference in proposals for a Global Jobs Pact[2]. Secondly, the ILO is given an explicit mandate "working with other relevant organisations" both to assess the effectiveness of government policies proposed to date, and to make recommendations for further action by governments in the future. Thirdly, reference to the London Jobs Summit provides the basis for the G20 to constitute further structured cooperation as a follow-up measure, in particular through the potential constitution of a G20 working group on the jobs impact of the crisis. These are all issues on which Global Unions will continue to press.

4. Social and labour issues are further highlighted in reference to the need to adopt "a new global consensus on the key values and principles that will promote sustainable economic activity" (#21). The G20 Leaders state their support for "discussion on such a charter for sustainable economic activity with a view to further discussion at our next meeting", stating "We take note of the work started in other fora in this regard and look forward to further discussion of this charter for sustainable economic activity." The importance of the reference is that a compendium is being prepared by the OECD (most recent draft being late March 2009) which brings together the major international economic and social standards, including the labour standards of the ILO with similar instruments of the IMF, World Bank, WTO and OECD. Labour standards are given equal footing to the main internationally ratified instruments covering trade, finance, development and investment. The G20 statement constitutes progress for this "Merkel-Tremonti" initiative (reflecting the sponsorship of the German Chancellor and Italian Finance Minister) for a global "legal charter" to combine key standards of these five institutions. The next steps taken by the G20 will be key in this process.

Financial Supervision and Regulation

5. The G20 communiqué and its Annex, "Declaration on Strengthening the Financial System"[3] show clear progress when set against the Action Plan agreed in Washington in

[2] http://www.tuac.org/en/public/e-docs/00/00/04/80/document_doc.phtml
[3] http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf

November 2008. Alongside the G20 Summit, reports by G20 Working Groups were also published[4], as were a series of recommendations by the Financial Stability Forum (FSF)[5]. Most of the measures agreed in Washington have been further developed with, in many cases, a stronger emphasis on restoring public supervision and regulation than on markets and self-regulation. In particular the G20 reached a breakthrough agreement on tax havens, claiming that "the era of banking secrecy is over" (#15). Yet by remaining within the parameters set by the Washington discussion, the G20 continues to disregard central regulatory issues, such as household credit consumer protection. Moreover, the G20 is almost silent on the design and risk-sharing aspects of the bailout of the banking sector, which to date represents over a quarter of the GDP of the G20.

Commitment to re-regulation

6. The G20 communiqué reveals a new emphasis on the need for regulation. While the November Washington Declaration blamed "policy-makers, regulators and supervisors" for failing to "adequately appreciate and address the risks building up in financial markets", the London statement acknowledges that "major failures in [...] financial regulation and supervision were fundamental causes of the crisis" (#13). The need to enhance the mandate of financial authorities to "monitor substantial changes in asset prices" (and hence to prevent speculative asset bubbles), which was stated in Washington is reinforced in London. G20 governments have made a commitment to "amend [their] regulatory systems" to take account of "macro-prudential risks across the financial system including, in the case of regulated banks, shadow banks and private pools of capital" (annex p3).

Uncertainty about the reform of the FSF

7. Regarding international supervision, the G20 is still a step away from the much-needed regional or international consolidation. It does, however, commit to the immediate implementation of FSF Principles for cross-border crisis management and to continue establishing new "supervisory colleges for significant cross-border firms" in addition to the 28 existing (but yet undisclosed) colleges already in place (annex p2). The G20 also announced the transformation of the FSF into the "Financial Stability Board" (FSB), which would have a "stronger institutional basis and enhanced capacity" (annex p1), as well as a broader membership (all G20 countries, Spain and the European Commission). Whether this change will make international financial architecture more accountable and transparent to citizens is an entirely open question. In his press conference, the French President spoke of a new "World Finance Organisation" to emerge from this transformation. Yet the day after the Summit, the FSF issued a press release informing on its re-establishment into the FSB; a press release that reads very much as business as usual[6].

Breakthrough on tax havens, improvements on private pools of capital

8. On regulation, the main achievement is on tax havens. The G20 "notes" the release by the OECD of a list of countries (#15), including a "grey" and a "black" list, for which exchange agreements on tax information between national authorities do not meet international standards. Importantly the G20 will "deploy sanctions to protect our public finances and financial systems" against jurisdictions on the OECD's list (#15). There is,

[4] http://www.g20.org/366.aspx
[5] http://www.fsforum.org/press/pr_090402a.pdf
[6] http://www.fsforum.org/press/pr_090402b.pdf

however, a need for further explanation about the OECD list[7] according to which Belgium, Uruguay and Guatemala pose a greater threat to global tax systems than Jersey, the Isle of Man, Macao and the State of Delaware.

9. The G20 also achieved progress on the issue of private pools of capital. Instead of a "review of the scope" of regulation for institutions "that are currently unregulated", the G20 has committed to "extend regulation and oversight to all systemically important financial institutions [including] important hedge funds" (#15). The IMF and the FSB will have the task of deciding what constitute "systemically important" institutions (annex p3). Hedge funds or their managers "will be registered and will be required to disclose appropriate information on an ongoing basis to supervisors or regulators, including on their leverage". Similarly, "supervisors should require that institutions which have hedge funds as their counterparties have effective risk management and disclose their holdings" (annex p3).

Supervisors' say on bankers' remuneration contradicts shareholder value doctrine

10. The G20 has made commitments to implementing the FSF programme of work (April 2008), including improving international accounting standards and regulating credit rating agencies. Within that important commitments have been made on mitigating pro-cyclicality of bank executive remunerations and capital adequacy regimes and with regard to the regulation of credit derivatives and securitisation. The G20 has endorsed "tough new" principles by the FSF[8] on pay and compensation (#15): the FSF calls for compensation schemes to be risk adjusted, for risk management staff to have sufficient authority and for shareholders to be actively informed of compensation schemes. It also calls for national supervisory authorities to be given the powers to intervene in case of "deficiencies" in the implementation of FSF principles "with responses that can include increased capital requirements" (annex p4). This significant development constitutes a break with the "shareholder value" doctrine of the past, which prescribes that risk management within the firm is optimal as long as shareholders – and shareholders only – exercise active ownership and oversight over the board of directors. The G20 statement further refers to the "corporate social responsibility of all firms" (#15).

G20 agreement on off-balance sheets and securitisation going beyond FSF recommendations

11. Regarding pro-cyclicality of capital adequacy rules – moving toward risk-based regimes, preventing excessive leverage, building buffers in good times – the London Summit commitments have gone further than would have been expected on the basis of FSF recommendations[9] released the same day as the Summit. The G20 calls for agreement on "a simple, transparent, non-risk based measure [of capital] which [...] properly takes into account off-balance sheet exposures" (annex p2). Extending capital rules to off-balance sheet exposures would reduce the attraction of such arrangements for banks. Similarly, regarding securitisation, the London statement calls for the Basel Committee "and authorities [to] take forward work on improving incentives for risk management of securitisation, including considering due diligence and quantitative retention requirements, by 2010" (annex p2). The requirement that banks retain partial ownership of the underlying assets of the products that they securitize is called for in recent EC proposals but is not in the corresponding FSF recommendation on pro-cyclicality. The G20 text also contains improved wording on bringing stronger oversight securitisation and credit derivative transactions. While the

[7] http://www.oecd.org/dataoecd/38/14/42497950.pdf
[8] http://www.fsforum.org/publications/r_0904b.pdf
[9] http://www.fsforum.org/publications/r_0904a.pdf

Washington G20 Declaration spoke of industry-led "clearing houses" for credit default swaps (CDS) and over-the-counter (OTC) derivatives transactions, the London communiqué refers to "central clearing counterparties subject to effective regulation and supervision" (annex p3), thus recommending the public supervision of these private exchanges.

Other regulatory issues are missing

12. The main regulatory issue missing from the communiqué regards household credit consumer protection. Inadequate regulation of household credit lay at the heart of the 'subprime' crisis in the US and has been identified as key by other global fora including the UN Stiglitz Commission, the OECD and the US Congress Oversight Panel. Other issues raised by trade unions that are not taken up by the G20 include: "pro-cyclicality" of shareholder remuneration (dividends and share buy-backs); leveraged buy-outs; linking the 'colleges of supervisors' with employee representative structures in the financial sector (e.g. works councils and international framework agreements); international taxation; impact of the crisis on pre-funded pension schemes; promotion of alternative banking models such as credit unions, cooperative banking and public financial services.

Also missing: the bailouts of the banking sector

13. The G20 communiqué barely addresses the issue of recapitalizing the banking sector and restoring the credit market for the real economy. It limits itself to describing efforts undertaken so far and calling for the mitigation of impacts on developing countries and the avoidance of "financial protectionism"(#22). Yet the design of the bailouts and risk-sharing between tax payers and bankers vary considerably within the OECD. According to IMF and the OECD[10] taxpayers' money equivalent to 28% of G20 GDP has been spent or exposed so far. Upfront financing alone (i.e. capital injections and repurchasing of toxic assets) represent: 6.3% of GDP for the US; 19.8% of GDP for the UK; 6.2% for the Netherlands; 5.8% for Sweden; 8.8% for Canada; 3.7% for Germany; and 1.5% for France. Banks are still not lending credit despite the hundreds of billions poured into them to save them; the next stage may well see the worsening of 'credit quality' in banks' balance sheets, most likely repeating the scenario of a credit meltdown from last autumn. The G20 communiqué does not deliver answers to these concerns.

Development, IFIs, Trade And Environment

The IFIs

14. The G20 Summit reinforced the IMF's position of leadership in treating the impact of the global financial crisis by endorsing expansion of resources to the IFIs (IMF, World Bank and regional development banks) for the purpose of financing "counter-cyclical spending, bank recapitalisation, infrastructure, trade finance, debt rollover, and social support" in developing countries (#17). G20 leaders agreed to triple IMF core resources to reach $750 billion and to allocate $100 billion for Multilateral Development Banks (#17).

15. The G20 Summit supported an allocation of $250 billion of additional SDRs (#19) and gold sales by the IMF (#25, third bullet) and endorsed implementation of the Fund's new

[10] OECD Committee on Financial Markets, April 2009 & IMF "The State of Public Finances: Outlook and Medium-Term Policies After the 2008 Crisis" March, 2009

Flexible Credit Line (for countries that meet stringent pre-conditions but otherwise without ongoing conditionality) and its "reformed lending and conditionality framework" (#18). While welcome, this needs to be contrasted against the fact that when the IMF recently introduced its new conditionality framework, one of the features of which was the discontinuation of structural performance criteria, it insisted that "structural reforms will continue to be integral to Fund-supported programmes" and be monitored at the time of loan reviews by the Fund's board. It should also be noted that the IMF has made no move to discontinue quantitative performance criteria, which have been used to impose austerity conditions in most of the emergency loans granted by the Fund over the past six months. If the IMF is to live up to the G20 commitment that additional resources to the IFIs must help "finance counter-cyclical spending", a substantial further reform of IMF conditionality will be necessary. However, the communiqué does emphasise the importance of reforming and modernising the international financial institutions, and to increase their credibility and accountability (#20).

16. It should be noted that of the additional $1.1 trillion of financing promised for the IFIs, less than 5 per cent will be for low-income developing countries and not all of it will be allocated on concessionary (interest-free) terms. It is nevertheless a far greater sum for developing country financial support than was previously made available. It is important, especially in a context where some donor countries have announced a reduction in development assistance budgets, that the commitments made by the G20 are fully financed and implemented and the financial support allocated quickly and without structural adjustment and austerity conditionality. Developing countries must be supported in their efforts to participate in global economic recovery, to fund employment creation projects and to provide assistance to the most vulnerable. A part of the new financial resources for the IFIs, notably the sale of IMF gold, should be used to extend the cancellation of unsustainable debts to a greater number of poor countries.

17. Regarding IMF governance, reference in an earlier draft to the creation of a Ministerial-level council to oversee the IMF's strategy has been replaced in the final version by a statement merely that "consideration should be given to greater involvement of the Fund's Governors in providing strategic direction to the IMF" (#20, second bullet). The IMF is, however, called upon to implement its existing agreement on quota and voice reforms and to complete a new review by 2011 (#20, first bullet). The references to World Bank governance reform are slightly weaker than in earlier drafts, calling for World Bank governance reforms to be decided by the 2010 Spring Meetings of the IFIs, which may mean that real reform is slow to come (#20, third bullet).

18. Additionally, other than endorsing the vague concept of "greater voice and representation" at the IFIs for emerging and developing economies (#20), the G20 communiqué sets no specific parameters for the results of the reform process. The ITUC and several other organisations have proposed that the representation of developing countries at the IFIs be at least equal to that of the industrialised countries.

19. Both institutions are required to select their heads and senior leadership "through an open, transparent and merit-based selection process" (#20, fifth bullet).

Development

20. Commitment to meeting the Millennium Development Goals and to meeting earlier pledges on ODA and on debt relief is reaffirmed (#25, first bullet), in the context of recognition of a "collective responsibility to mitigate the social impact of the crisis". Social protection is singled out for mention (#25, first and second bullets), although the amount for social protection specifically is not identified, within $50 billion that is mentioned for low income countries; the mechanisms for transmitting such funds are to include World Bank facilities.

21. A role is given to the UN with the call on "the UN, working with other global institutions, to establish an effective mechanism to monitor the impact of the crisis on the poorest and most vulnerable" ($25, fifth bullet).

Trade

22. On trade issues, G20 countries reiterated the commitment they made in Washington not to raise new barriers to trade or investment, or any measures to stimulate exports inconsistent with WTO rules, up to the end of 2010 (#22, first bullet). They undertook to notify any measures to protect domestic sectors to the WTO and called on the WTO together with other bodies to monitor and report publicly on these undertakings every three months (#22, third bullet), thus creating a form of "name and shame" system. G20 governments say that they will make available $250 billion for trade finance over the next two years (#22, last bullet). There is a commitment to reaching a conclusion to the Doha Round "building on the progress already made, including with regard to modalities" (#23). The last point must be considered as providing cause for serious concern, in light of the negative development implications of the most recent level of modalities negotiated seriously in the context of the WTO negotiations.

Environment

23. With regard to the environment, it is agreed that fiscal stimulus programmes will particularly seek to build a "sustainable and green recovery" with "transition towards....low carbon technologies and infrastructure", partly financed by the MDBs (#27). The G20 governments "reaffirm our commitment to address the threat of irreversible climate change, based on the principle of common but differentiated responsibilities, and to reach agreement at the UN Climate Change conference in Copenhagen in December 2009" (#28) – the wording on "common but differentiated" was added only in the final draft, clearly as a way of achieving agreement of the developing country members of the G20 to include the paragraph.

Conclusions

24. The G20 London communiqué opens the door to further monitoring of action on jobs. This could lead to a G20 working group on the jobs impact of the crisis. This will be desperately needed so as to generate further action to combat the jobs crisis as the situation worsens over the months ahead. The references to the role of the ILO mean that it will need to be invited to the next G20 Summit in the autumn also strengthening its monitoring role. The progress on financial regulation, including tax havens, is positive although the key organisation is to be the Financial Stability Forum – now constituted as a "Board". Trade unions must have the opportunity to influence the structure and workings of the new Board, and ongoing access to its decision-making and work programme, which has to be fully

transparent and accountable. As we have said repeatedly over recent months, the same people who were supposed to avert this crisis and failed cannot be given the job of designing the rules for the future. The IMF is given key roles – making it essential for governments to ensure that changes do occur in the conditionality of the IMF lending so that it encourages growth-based, counter-cyclical crisis responses. It is also essential to continue to press for a more equal voting structure for developing countries at the IMF and World Bank; and the development of a charter of international rules that puts labour standards on an equal footing to trade and finance. Trade unions will need to work intensively over coming weeks and months to maintain pressure on governments and international organisations to undertake practical action to implement the aspirations of the London G20 Summit.

25. Beyond these immediate priorities governments must begin work on a framework of governance that changes the failed paradigm of market fundamentalism that has dominated policy and major international institutions for the past three decades.

Mr. SHERMAN. Thank you. It makes you wonder whether some of these institutions were too big to fail. It said they were too interconnected to fail. Arguably, they are just too well-connected to fail. With that, we welcome Kevin Kearns, president of the United States Business and Industry Council, which represents the interests of family-owned and closely held U.S. manufacturing companies. Mr. Kearns?

STATEMENT OF MR. KEVIN L. KEARNS, PRESIDENT, UNITED STATES BUSINESS AND INDUSTRY COUNCIL

Mr. KEARNS. Thank you, Mr. Chairman, Mr. Ranking Member, other members of the committee, and it is a very timely hearing. Five minutes isn't much time. I am going to take a 500-foot overview of the crisis, and that is, there is cascading failure going on in domestic manufacturing. We seem to think, collective "we," that it is trillions for banks, financial institutions, insurance companies, but really not much for manufacturing, and if we give General Motors and Chrysler some money, who else is going to line up?

We Americans just seem to love to hate our manufacturers, but I would ask the question, where is the wealth generation coming from to pay off the debt we have already incurred that Mr. Scott referred to and the massive debt we are incurring now? Any basic economic textbook will tell you there are three ways you create wealth. You create it by making it, mining it or resource extraction, and growing it. Banks and financial institutions properly understood, as opposed to creating derivatives and complex instruments that no one can understand, should make money on a spread, you know, they pay their depositors such and such and they take in a little bit more from customers they lend to.

Even if we were to wave a wand and straighten out the financial institutions today, I can guarantee you that no domestic manufacturer, given our trade policies, given the unfair advantages, the currency treating, the VAT tax inequity—150 of our trading partners have VAT taxes, we don't—the IP theft, the subsidies, etc., etc., the list goes on. It is like Whac-A-Mole at the beach, you know, each time you hit the mole, another one pops up faster.

I mean, they can create ways to subsidize their companies faster than we can address them in, you know, years and years of negotiation. When I was in the Foreign Service in Japan, I saw the SII, Strategic Impediments Initiative, talks that went on forever, the Moss talks that went on forever. Jim Rill tried to turn the Japanese Fair Trade Commission into an antitrust division of the Justice Department, etc., etc. The time for chitchat diplomacy is over.

Our situation right now reminds me of England in 1946. You know, they thought they had all the experience, but they lost all their money, they lost their industrial base during the war. They thought they were going to run the world and the Americans were going to pay for it. Well, guess what? That didn't happen, and it is not going to happen to us. So, we need to find ways to re-energize our industrial base. We need to do so unilaterally if necessary, because sometimes power and unilateralism are necessary to bring other nations to the table.

The Obama administration, as far as we are concerned, is trying to restore the status quo ante. Everyone up here yelped at a $789 billion stimulus bill. I didn't hear any yelping, or from certain quarters I did, but about $750 billion trade deficits year after year after year. I mean, we have had almost 40 years of trade deficits. How many years do we have to keep going down that path, whether it is Panama, Mr. Royce, and you are right, it is small potatoes, but how long do we have to follow a failed model before we stop and re-evaluate it, as opposed to rushing ahead with more?

Manufacturing does 60 percent of the R&D in this country. It provides the best-paying jobs. It is critical to our defense and our technology base. It is what we need. So when Congress has, for instance, the Big Three CEOs in here and rakes them over the coals, and they want a plan in 60 days or 90 days or whatever it was, you know, what is Congress's plan to address currency manipulation?

The Secretary of State signed on to Bunning-Stabenow-Bayh. The President signed on to that bill. There were 180 cosponsors in the House. Why isn't that on the President's desk today? What are we doing about other trade cheating, intellectual property theft, subsidies? Every other nation in the world seems to think it is important to have a car industry, a steel industry, chemical industry, technology industries, other heavy industries. We don't seem to care. We seem indifferent, but any basic economics textbook will tell you that it is important who owns the rents or the profits.

They make the decisions. They are the ones in control, and we are not in control of our destiny anymore. We may think we are, but I associate myself with Mr. Scott's remarks, except to the extent that the economic power is not there. We are not generating the wealth, and there is no plan that I can see, either in the Congress or the administration, to get our wealth-generating industries back on track, to spend the money on them. None of the 1,900 businesses I represent, and I will just say this in conclusion, no business owner is going to expand his factory or build a new factory in the United States until we change our trade policy, until we call our allies and other trading partners on their trade cheating, you know, you are flushing your money down the toilet.

So, from the point of view of manufacturers, nothing is going right in Washington, and they are pulling their money out of their businesses and they are preparing to fail.

[The prepared statement of Mr. Kearns follows:]

Testimony of Kevin L. Kearns
President, U.S. Business and Industry Council
before the
Subcommittee on Terrorism, Nuclear Proliferation, and Trade
Committee on Foreign Affairs
U.S. House of Representatives
June 10, 2009

Good afternoon, Mr. Chairman, Mr. Ranking Member, and Members of the subcommittee. My name is Kevin L. Kearns and I am the President of the U.S. Business and Industry Council. On behalf of our 1,900 member companies, I thank you for the opportunity to testify before the subcommittee on "The Foreign Policy Implications of U.S. Efforts to Address the International Financial Crisis." No set of issues will have more impact on America's future security and prosperity, and I believe that our organization has a uniquely valuable perspective to offer.

As a business organization, USBIC has since its founding in 1933 spoken out on a wide range of economic issues. But the Council has always been deeply concerned about U.S. national security. This focus reflects the nature of our membership, which is mainly comprised of small and medium-sized manufacturers with deep roots in their communities, strongly held Main Street values, and a fundamental awareness that the country's safety depends heavily on a strong productive, innovation, and wealth-creating industrial base at home. Manufacturing has long dominated this base quantitatively, and it will remain dominant for the foreseeable future.

As President Obama and so many others have said, the economic crisis represents a genuine crossroads for our country. Washington's responses will greatly determine whether America will emerge at least as safe and prosperous as it has been since the end of World War II, or much weaker, much poorer, much less politically independent, and much less influential.

In our opinion, the Obama administration's responses, like those of the Clinton and Bush administrations before it, are making that bleaker future much more likely for the United States. In the process, they are also undermining prospects for acceptable levels of global security and prosperity.

The main problem stems from the administration's refusal, like that of its predecessors, to rethink fundamental and longstanding U.S. strategies that recent circumstances have made dangerously obsolete – essentially that we can buy friends, allies, and influence around. These strategies – carried out in varying versions, and with numerous lapses since the end of World War II – achieved some vital successes in the early postwar decades. But they laid the groundwork for today's crisis -- as we paid off various allies for their cooperation with various chunks of our technology and industrial base and now find ourselves unable to pay our way in the world.

The current Great Recession was delayed mainly because the nation has been living off the fruits of a much different strategy than was pursued for most of our previous history. We created wealth at home, through manufacturing, agriculture and resource extraction, and were the world's largest creditor nation. When we borrowed abroad, we did so not to consume the latest Japanese automobiles but to build productive capacity. We could then pay off those loans when the productive capacity came on line. Ironically, this older strategy not only has major attractions as a full-blown alternative to today's borrow and consume approach but also is critical to any remaining chances of salvaging our economy.

The essence of America's current economic and security strategies has been voiced repeatedly by President Obama since his inauguration, and by all of his post-World War II predecessors on countless occasions. It holds that the world's security and prosperity are indivisible – that neither the United States nor any other country can be acceptably safe and secure unless every other country is as well. Therefore, although each of the world's governments can and should take certain steps to shore up their own defenses and economies, these measures should all be consistent with broader efforts to tackle international problems cooperatively – including the creation of new systems and institutions of cooperation, and the strengthening of existing ones that retain value.

This approach to international policy – which has been labeled the multilateral approach – holds that efforts to "go it alone" are both impossible and dangerous. Indeed, if too many countries, and especially too many major countries, pursue such policies, the world is likely to repeat disastrous mistakes of previous eras, especially the 1930s.

In the security sphere, a strong belief in multilateralism has led the Obama administration to concentrate on repairing ostensibly fraying U.S. security alliances and assuring international audiences that the United States now rejects the alleged unilateralism of the Bush years. The President has frequently promised to restore the prominent role supposedly played in American foreign policymaking by international institutions and global public opinion.

It is true that the President has emphasized to America's NATO partners in particular that the alliance must become more of a two-way street, and that more European military involvement in Afghanistan is especially important. He has also encouraged other prospective American partners – notably in the Middle East – to assume greater responsibilities for regional security. And he has signaled that such changes would help the United States to accommodate the avowed desire of these countries for a lower local U.S. profile.

Yet regarding NATO in particular, the President has never mentioned any penalties or adverse consequences for ignoring his entreaties. And he has made clear that his bottom line is preserving harmony among friends. The President, however, has also declared that he recognizes America's preeminence in existing arrangements, and its consequent interests in shouldering a corresponding share of the collective load. Thus his total message has contained many unmistakable elements of ambiguity.

In economics, multilateralism to President Obama means exactly what it has meant to his predecessors for decades – a firm commitment to open global goods and services markets, unfettered global capital flows, and strong mechanisms for resolving disputes. The President's agreement at the latest G-20 summit with European calls for more effective international regulation of financial activity represents a logical, crisis-borne extension of this position.

At the summit, the President did indeed state that international economic imbalances need to be reduced. More specifically, he insisted that American consumption could no longer be relied on to fuel global recovery, and that greater stimulus measures are needed in other major economies. At the same time, President Obama also asserted American leadership responsibilities in resolving the crisis globally, in part because he believes that failures of U.S. financial regulatory policies deserve considerable blame for its outbreak, and in part because of America's status as the world's largest economy.

As a result, ambivalence has characterized the administration's economic message as well. Perhaps this helps to explain why the European countries in particular balked at increasing their stimulus spending. And the President presented no ideas for overcoming their obstinacy.

If maintaining the global status quo on the security and economic fronts was still consistent with U.S. interests, the Obama policies would make sense. They might even arguably reflect the administration's portrayal of them – the entire world's best hope of avoiding 1930s-style calamities.

Yet the inadequacy – and indeed dangers – of both facets of the status quo could not be more obvious. In fact, most of the rest of the administration's policies signal strong agreement with this proposition. From fiscal and monetary policy to housing policy to financial regulatory policy to health care and energy policy to the bedrock relationships between government and business, the administration has either endorsed the seismic changes begun by its predecessor, expanded them, or proposed vastly bolder departures. Only in international security and economic policy are existing strategies and even tactics defended. Indeed, they are defended vigorously.

Unfortunately, these are the two areas where big change is needed the most, and the most urgently. These are also two areas where change must go hand in hand. America's material wherewithal profoundly affects the viability of its security goals, and its security goals have just as profoundly affected its policies for creating and maintaining that wherewithal. Even keeping U.S. policies in these two spheres on a viable multilateral course will require a thoroughgoing and mutually reenforcing transformation of American tactics on both fronts. Specifically, it will require adopting key techniques and even objectives of unilateralism.

The related weaknesses of current American international security and economic policy fall into two categories. First, as suggested above, they are incapable by themselves of producing significant progress toward meaningful multilateral cooperation to address major problems and threats. Second, and more important, they are undermining America's security and prosperity itself, and thus its ability to carry out any sensible international strategy successfully.

The Obama administration's multilateral failures stems from widely held misconceptions about the relationship between unilateralism and multilateralism themselves, and about the relationships between power and diplomacy. Distinctive as they are in theory, none of these concepts exists in isolation in the realm of practice. And they are anything but mutually exclusive. Like all strategies and tactics, they have various strengths and weaknesses, and their effectiveness depends crucially on circumstances – which in the international sphere are not only exceedingly complex and diverse, but highly dynamic.

Thus it should not be surprising that unilateralist means are regularly needed to achieve multilateral ends. Nor should it be surprising that effective diplomacy often requires the use of power, and vice versa. Yet judging from much of the debate recently surrounding American national security and international economic policies, these observations are at best muddled and at worst distasteful.

Power and unilateralism are in fact vital instruments of any successful multilateral diplomacy. Their role is usually inescapable because of the intrinsic nature of international politics and the current system of states. These dominant actors on the world scene possess dramatically differing characteristics – in terms of size, location, and other physical features, resource endowment, economic systems, cultural heritages, and historical experiences. It is inevitable, therefore, that on a regular basis, these differences will produce significantly differing definitions of national interests and objectives. In other words, international consensus on myriad security and economic issues does not exist.

The differing characteristics of states will even produce differing definitions of national interest even when problems and threats are transnational in nature, and therefore presumably shared. For their intrinsic differences mean that various states will tend to be affected in different ways and to different degrees by these challenges. These differential effects will often generate differing judgments on the most beneficial responses, and the most sensible compromises and sacrifices to accept.

Global climate change is one key example. In part because they stand at different stages of economic development, the United States and many developing countries perceive significantly different costs and benefits to various proposed climate change regulatory regimes and obligations. And in part because the energy intensiveness of their economies differs (because of different sizes and other geographical features), a divide exists between the United States and many other high-income countries as well.

Global terrorism is another key example. As many analysts have suggested, it is entirely possible that European and American responses differ significantly because Europe and America find themselves in significantly different situations vis-a-vis the region that is the source of most major terrorism – the Middle East. Europe is much closer. A corresponding sense of vulnerability might be responsible for Europe's traditionally strong emphasis on addressing the problem by resolving the Arab-Israeli conflict, and its relative un-interest in building stronger border controls and other barriers to travel. The United States is located halfway around the world from the Middle East; therefore, fence-building seems more promising to more Americans.

In some cases, such gaps can be narrowed and even eliminated with superior argumentation or compelling rhetoric. But in many other cases, the only possibilities for success are offered by the use of power – to compel, to bribe, or simply to create realities and faits accompli to which others must adapt. Power, moreover, can also be used to threaten credibly the withholding of cooperation – to underscore assertions that a country has other and better options than accepting unappealing compromises and lower common denominators. That is to say, power can also be used to threaten credibly the decision to "go it alone."

And this is where for decades, American economic policies in particular have been sorely deficient. They have seriously neglected the imperative of maintaining the relative strength needed to wield power effectively on behalf of multilateral diplomacy. Combined with America's traditional willingness – and often declared preference – to make outsized provisions of public security and economic goods, the results have been minimal progress towards tackling security and economic challenges cooperatively; and endemic free-riding by U.S. treaty allies in the security sphere, and by virtually all U.S. trade partners in the economic sphere.

In security affairs, these dismal results have in turn led to dangerous U.S. military over-extension, the needless exposure of the United States to certain security threats, and a failure by Washington to explore adequately America's capability to carry out less ambitious, but less costly and less dangerous policies in selected cases. In economic affairs, the equally dismal results have produced an American acceptance of highly unequal trade arrangements that have stunted the U.S. economy's productive base; consequently addicted the nation to financing prosperity with debt, not with earnings; created unprecedentedly and unsustainable lopsided global economic flows and imbalances; and led directly to the current global economic crisis.

More recently, the nation's addiction to debt has produced a new danger – the loss of economic and political independence to foreign creditors. On the one hand, the optimists so far have been right, in that the nation's foreign creditors have shown few significant signs of even controlling their purchases of U.S. government debt, in particular, despite the virtual disappearance of yields. On the other hand, it surely did not escape the notice of China, in particular, that during the Democratic primaries, both candidate Obama and candidate Clinton spoke of the new obstacles to asserting America's interests vis-a-vis Beijing stemming from China's role as "America's banker." Growing foreign purchases of non-financial U.S. assets can pose similar dangers, especially when they are carried out by government- controlled sovereign wealth funds.

Another potential danger worth mentioning is the U.S. military's growing dependence on foreign-made parts and components for weapons systems and other defense-related goods. For years, under both Democratic and Republican presidents alike, the Defense Department has resisted Congressional and other entreaties to produce serious studies of the situation. Yet research by the U.S. Business and Industry Council has conclusively shown that high and rising levels of import penetration exist in literally dozens of capital- and technology-intensive domestic industries. Given the increasingly blurry line between civilian and defense-specific manufactures, it is inconceivable that the nation's defense production base has substantially escaped such import penetration.

The Obama administration has displayed virtually no interest in acknowledging these deficiencies, much less realistically addressing them. Achieving greater energy independence is the only exception. Otherwise, on the level of specific policies, President Obama has strongly indicated a willingness to pursue the types of trade agreements sought by his predecessors since Mexico was added to the U.S.-Canada Free Trade Agreement to create the North American Free

Trade Agreement. Because the targets overwhelmingly have been low-income developing countries following export-led growth strategies, these deals have greatly boosted the U.S. trade deficit, suppressed growth and job creation in the heavily traded manufacturing sector, and accelerated the U.S. economy's shift from healthy income-generated prosperity to artificial debt-generated prosperity. In the process, they contributed decisively to the global imbalances that sparked the current crisis. Because the foreign markets at stake have been so relatively meager, and the results so lopsided, it is not even accurate to call these deals trade agreements – as "trade" implies a proportionate and sustainable form of exchange. Instead, these deals have mainly be outsourcing agreements, aimed mainly at encouraging large multinational companies to send production overseas to very low-cost, regulation-free production bases, keep the U.S. market wide open, and supply it from abroad

The President has also refused to act decisively against currency manipulation by China and other trading powers, thereby missing a huge opportunity to reduce these global imbalances. More generally, he and his aides have promised to place new emphasis on enforcing the terms of existing trade treaties and free market trade norms, but seem determined to rely on multilateral and unilateral tools that are proven failures.

In addition, President Obama has strived to limit the effectiveness of Buy-American provisions for government procurement added by Congress to his stimulus bill. This stance has created another big missed opportunity to reduce dangerous U.S. and global economic imbalances. Indeed, such provisions should be extended to all U.S. government procurement. Nor does the President seem to understand the importance and potential of attaching such conditions to government support for specific industries. The various auto rescue plans and emerging schemes to promote green manufacturing are two of the most obvious examples. The GM rescue plan approved by his auto task force would have even increased the share of GM production supplied by imports from low-income countries.

More broadly, with the lone and limited exception of auto industry policy, President Obama has continued the Bush policy of showering the financial sector, the housing sector, and the consumer with enormous bailouts and subsidies, but neglecting the productive sectors of the economy whose restored health is essential for generating the earnings and incomes needed to escape the current debt trap.

Consequently, President Obama's economic policies promise to make the United States more dependent on imports, consequently more dependent on foreign borrowing, and therefore more vulnerable to the inflation and bursting of a new credit bubble that could be more damaging than the one just witnessed.

On the strategic plane, as mentioned, the President has spoken of the need to reduce U.S.-centric global economic imbalances. He has also urged China specifically to help solve the problem by shifting its economy away from exporting toward consuming. But overall, his administration's messages on this score have been mixed at best, and therefore ineffective. Just before the April G-20 summit, National Economic Council chief Lawrence Summers told the Financial Times that, due to the global crisis, the China rebalancing agenda needed to be put on hold in favor of promoting more global stimulus spending from every possible source. And on his recently completed first trip to Beijing, Treasury Secretary Geithners' highest priority clearly was convincing China to keep buying U.S. debt and thus propping up U.S. consumption levels – not halting currency manipulation and other predatory trade practices, and eliminating trade barriers in order to rebalance U.S. and global accounts.

Similarly, the administration seems unaware that even much greater stimulus spending by all the world's major economies will not resolve the crisis unless accompanies by major structural changes and, in particular, ka shift away from export-led growth. As being made clear by the unfolding of China's vaunted stimulus program, when export-dependent economies simply stimulate growth, the lion's share of the resources tends to wind up strengthening the export base – which is best positioned to attract and effectively use new capital.

The Obama administration shows every sign of making the same fundamental economic mistake as all its recent predecessors – assuming that the United States has virtually no ability to pursue a significantly more unilateral economic strategy. Hence, like these predecessors, it has failed even to consider or strongly opposed steps such as those mentioned above – which are needed both to empower a viable strategy of multilateralism, and providing the country with acceptable fallback positions if that strategy ultimately fails.

Ironically, exactly the opposite is the case. Of all the world's major economies, the United States is far and away the one most capable of "going it alone" at acceptable cost and risk. Despite nearly two decades of outsourcing agreements and consistent failure to respond effectively to predatory foreign trade practices, trade still represents a much smaller share of the U.S. economy than of most major foreign economies. The United States still has ready access to investment capital; a broad, world-class productive base in numerous industries; the world's leading complex of research universities; a huge domestic market; ample resource endowments; financial markets with great potential to allocate capital efficiently (however poor their recent actual performance); and economic, social, and legal systems that have historically fostered entrepreneurship and dynamism. With the right international policies – indeed, with the kinds of international policies in place for most of U.S. history – there is every reason to think that these advantages can be maximized again.

The President owes it to the American people to explore these options. No strategy devoid of such a hedging element is worthy of the name. In addition, however, he owes it to the rest of the world. For the United States and a market that has not only been wide open but enormous has long been the goose that has laid the golden eggs for its export-obsessed trade partners. This has been especially true of low-income countries. If this market shrinks in a dramatic, disorderly way, the global results would be catastrophic. Unfortunately, in large part because American leaders have been willing to maintain the U.S. economy as the world's importer and market of last resort, even during a full-blown crisis, its trade partners have had little inclination to change their free-riding ways. Therefore, it is difficult to envision multilateral progress emerging quickly enough to contain the damage without credible U.S. unilateral action to kick-start the process.

In many ways, the crisis facing President Obama and the nation today is just as dangerous as that which faced Americans 60 years ago after the end of World War II. His responsibility – and that of the Congress – is not to pretend that their solutions can simply be transplanted into the present, but to display a willingness to jettison outmoded ideas and to start thinking outside the box.

Mr. SHERMAN. On that happy note, we now turn——[Laughter.]

I thank you, Mr. Kearns, for your comments and agree with almost all of them.

We would now like to turn to Dr. Nancy Birdsall, founding president of the Center for Global Development. The Center for Global Development is an independent non-profit policy research organization that is dedicated to reducing global poverty. Dr. Birdsall?

STATEMENT OF NANCY BIRDSALL, PH.D., PRESIDENT, CENTER FOR GLOBAL DEVELOPMENT

Ms. BIRDSALL. Thank you very much, Mr. Chairman and other members of the committee. I am going to concentrate on the G–20 agenda, and in particular, its implications for U.S. support to the IMF package, and essentially, my statement has to do with saying that I support fully the idea that Congress would go ahead and endorse that package in the upcoming supplemental bill. Let me start by saying that, as some of you have already indicated in your remarks, in this century we are seeing really big shifts in the landscape.

We are seeing the rise of China and other powers in Asia in particular, and we see more and more that we face transnational threats. Today's global challenges do not respect borders. They threaten security globally and they threaten our own security here at home, and the fact is, as some of your remarks have indicated, the U.S. cannot hide from these problems and we cannot manage these challenges anymore by ourselves. That is what the G–20 leaders, as a group, recognized at the London summit.

Let me quote from something that former Under Secretary Tim Adams said at a hearing of the House Financial Services Subcommittee on International Monetary Policy and Trade, in which I also participated:

> "Failed states and extreme poverty breed unrest and instability and create the types of conditions that allow dictators, extremists and terrorists to thrive. In short, it is in our national security interest to ensure that financial and economic crises don't destabilize fragile states."

He pointed out that in the recent period, recipients of IMF loans have included Mexico, Colombia, Poland, Ukraine, Pakistan, all key allies and/or crucial players in the success or failure of United States foreign policy and in addressing our national security objectives. We have a global village that we constructed. We live in the center of that village. We are in the biggest house, but there are fires spreading, and the G–20 leaders essentially said, we need the IMF as a fire brigade to deal with these spreading fires, and I think the Obama administration and the Congress need to, in a sense, make the commitments that will help ensure that the fire doesn't come back to haunt us here at home.

Let me make four points very quickly. First is that the U.S. economic recovery and our national security do depend in part on substantially increasing those resources at the IMF and at the multilateral banks. In a sense, I have said that already, but I just want to emphasize that stimulating the global economy is absolutely vital for our own domestic recovery. Emerging markets are important in terms of our exports. In 2008, virtually all of our growth was export-driven and one-third of those exports went to emerging markets and developing countries.

There is also a security issue. Here I want to be positive about it and say that this crisis risks undermining tremendous progress supported in very important ways by the United States in places like sub-Saharan Africa. We now have in Africa 20 democracies, compared to three in 1989, 6 percent rate of economic growth over the last decade, very good macroeconomic management in most countries. All of that is put at risk now by this crisis, which is leading to the withdrawal of capital, the reduction of foreign aid, tremendous fiscal shortfalls, $15 billion alone for Africa in lost trade taxes, which they will have to make up to pay doctors, to pay health workers, to keep their teachers in school and so on.

So, it is in our interest on the security side to lock in those kinds of gains. What does the IMF have to do with this? As I suggested, it is the fire brigade in our global village. The G–20 basically endorsed the idea that there should be $1 trillion available for emerging markets and poor countries. That includes and needs to include $100 billion from the U.S. for the new arrangements to borrow. The idea, the CBO has suggested that be scored at $5 billion. The $5 billion will leverage $500 billion.

The cost to the U.S. taxpayer would be $5 billion, and there would be no cost to the U.S. taxpayer through the issuance of additional special drawing rights. I would be happy to answer questions about that. Now, the second point I want to make is the IMF today is not the IMF of old.

Mr. SHERMAN. Dr. Birdsall, it appears your time has expired. That is why I was tapping.

Ms. BIRDSALL. Thank you very much.

Mr. SHERMAN. Yes.

Ms. BIRDSALL. May I just repeat my three other points, just say what they are?

Mr. SHERMAN. You don't need to repeat. I was tapping to indicate that you were already over time.

Ms. BIRDSALL. All right. Thank you.

Mr. SHERMAN. And that is what this tapping is. It is not a nervous affectation.

Ms. BIRDSALL. I didn't hear it. That is all right. Thank you very much, Mr. Chairman.

[The prepared statement of Ms. Birdsall follows:]

Center for Global Development

Foreign Policy Implications of U.S. Efforts to Address the International Financial Crisis: TARP, TALF, and the G20 Plan

Testimony for the House Foreign Affairs Subcommittee on Terrorism, Nonproliferation and Trade

Nancy Birdsall
President, Center for Global Development
June 10, 2009

Thank you Chairman Sherman, Ranking Member Royce and other members of the subcommittee. I appreciate the opportunity to appear before the subcommittee today to talk about the foreign policy implications of U.S. efforts to address the international financial crisis, including through the G20 plan.

Introduction

The twenty-first century is bringing tectonic shifts in the world's political and economic landscape. Today's global challenges—disease, human and food insecurity, climate change, and financial crises—do not respect borders; they threaten security globally and at home. Trade, remittances, and private investment tie rich and poor countries together, creating shared opportunities for prosperity but also the potential for shared instability as in our current global economic downturn.

The U.S. cannot hide from these problems nor can we manage global challenges alone or with one or two allies. Rather, we must engage actively in cooperative institutions designed to help member countries manage global challenges through collective action. The G20 leaders recognized the urgent challenge of ensuring that developing countries have the resources to cope with the global economic crisis—avoiding setbacks in Asia, Africa, the Middle East and Latin America that would not only undermine the fight against poverty and disease worldwide but would create the instability and associated security risks for everyone including here at home.

I want to emphasize that what happens in developing countries—where more than 5 billion of the world's 6 billion people live, and where about one-third of world GDP is now produced—matters for Americans' security and for our economic recovery. When former Under Secretary of Treasury for International Affairs Tim Adams and I testified about these issues for the House Financial Services Subcommittee last month, Adams spoke of the risks the poorest developing countries pose for us. He said, "Failed states and extreme poverty breed unrest and instability and create the types of conditions that allow dictators, extremists and terrorists to thrive. In short, it is in our national security interest to ensure that financial and economic crises don't destabilize fragile states." He further explained that many of the recent recipients of International Monetary

Fund (IMF) support (e.g. Mexico, Colombia, Poland, Ukraine, and Pakistan) are key allies and crucial players in the success or failure of our foreign policy and national security objectives.

In the global village we have constructed, we live in the center in what is still the biggest house. We accidently started a fire at the center that spread quickly to the poorer neighborhoods. We are taking necessary steps to stanch the flames at home but we will not be safe so long as the fire burns elsewhere—it can easily sweep back to our own house. We have a responsibility to protect our global neighbors that is tied to our responsibility to protect ourselves.

I am pleased to be here today to offer my perspective on the foreign policy implications of the G20 recommendations and U.S. response to the international financial crisis. I will focus my remarks on four points:

- **U.S. economic recovery and national security depend on substantially increased resources at international institutions and especially the IMF. The Congress should support fully the proposed increases in resources for the IMF, including the U.S. contribution, which at low cost and risk to American taxpayers, is likely to leverage substantial additional contributions from other countries.**
- **The IMF today is not the IMF of old; additional resources will be used effectively to support stimulus packages and sustained demand in the developing world and in turn support our own economic recovery.**
- **The Congress should endorse the proposed sale of gold to increase IMF resources for financial and other surveillance, and to the maximum extent possible to increase grant and debt relief funds available to low-income countries.**
- **The Congress should urge the Treasury to take the leadership in negotiating, particularly with the recalcitrant Europeans, the governance reforms endorsed by the G20 heads of state, in part because this is likely to trigger increased contributions from China and other emerging market economies, thus reducing even further the potential burden on the American taxpayer.**

1. U.S. economic recovery and national security depend in part on substantially increased resources at international institutions and especially the IMF.

There are two reasons why the U.S. should support multilateral financial institutions, and especially the IMF, right now.

- First: The U.S. recovery from the economic crisis depends not only on our own stimulus package, fiscal and monetary policy and credit and related programs to sustain domestic demand, but on sustaining demand abroad, including in emerging markets and developing countries.
- Second: U.S. prosperity and in the broad sense U.S. security beyond the crisis rely on the open, rules-based international economic order created under our leadership at the end of World War II. The IMF plays a key role in that order, and that order in turn supports the safer, more prosperous and more humane global community Americans want beyond as well as within our borders.

Ensuring our economic recovery
Emerging market and developing economies have driven much of recent world growth. In 2008, U.S. growth relied almost completely on our exports—about one-third of which went to China, India, Brazil, Mexico and other emerging markets. An estimated 10 percent of U.S. jobs—about 12 million—depends directly on these exports. Now those markets are experiencing dramatic withdrawals of capital and drying up of credit, including trade finance. Remittances are declining as immigrants return home. As commodity prices and exports decline, most developing countries can expect big shortfalls in fiscal revenue this year, meaning that they will not be able to fund the costs of teachers and health workers, let alone their existing bare-bones safety nets.

Helping emerging and developing countries to cope is in our national interest. President Obama explained in his letter to congressional leaders about the G20 commitments that lower global growth, as in the Asian financial crisis, will cause U.S. growth, jobs, and exports to fall more sharply. Collapsing economies overseas will exacerbate the contracting economy at home. Stimulating the global economy is vital for our domestic recovery.

Beyond the crisis: a safer and more humane global community
Continued economic growth in the developing world is not only good for our economic recovery. Economic growth in the developing world reduces the risks of social and political unrest abroad and shores up countries' own efforts to help their own people escape poverty. It also strengthens governments' ability in low-income regions to participate in international programs to strengthen disease surveillance and combat drug and sex trafficking. (Consider how fortunate the U.S. is that its neighbor Mexico handled quickly and effectively the outbreak of the recent influenza virus.)

Now economic growth abroad is threatened by what began as a financial crisis in the U.S. Most of the more than five billion innocent victims of this crisis live in developing countries with limited resources for stimulus packages, let alone for food stamps and unemployment insurance. This is true even in the many developing countries that have had responsible government and economic management for some two decades.

In sub-Saharan Africa, for example, where the number of democracies has risen from just three in 1989 to 20 today, governments are increasingly committed to sensible macroeconomic management and effective health and schooling programs. They have achieved faster economic growth, continued reduction in poverty rates and improvements in social indicators. But they are not in a position to borrow to support countercyclical fiscal spending, the poorer among them face likely declines in bilateral aid, private capital has withdrawn (in a flight to the relatively safe haven of U.S. treasuries) and their governments cannot borrow on dried-up private capital markets. For the poorer countries especially, external resources are critical to avoid extensive human suffering and political instability. The International Labor Organization predicted earlier this year that as many as 50 million jobs will be lost in the developing world (and that estimate has probably risen with a reported 20 million jobs lost in China export industries alone). The World Bank is projecting zero growth in per-capita income in Africa.

The United States, as the catalyst for this crisis, has a particular responsibility to help poor countries cope with the fallout. Though in the major developing countries there is as yet no sign of rejection of our market-based and democratic model, it is not surprising that their leaders and their peoples look to us for leadership in helping those with fewer resources to cope. Were we to walk away from that leadership, a backlash of anger at the United States and opposition to U.S. values, institutions, investment and trade could develop; certainly the leaders of Venezuela, Iran and even Russia might exploit the situation in ways against our interests.

The role of the global financial institutions

To return to the metaphor I used at the start of my testimony, I'd like you to think of the IMF as the fire brigade in our global village. That is the approach that the G20 leaders took. They resolved to rapidly increase the fire brigade's resources to minimize the risks of the financial fire spreading worldwide and damaging everyone – and strengthen its capacity to participate in a more effective regulatory regime within and across countries to minimize the likelihood of future fires. They also acknowledged the importance of the work of the World Bank and the other multilateral banks in supporting continued and compensatory spending in affected countries on social safety net programs and infrastructure and other investments to speed recovery.

What this means in terms of resources for the IMF

Leaders from more than 20 major nations resolved in the April G20 London Summit communiqué to make available an additional $1 trillion through the IMF and other institutions to help developing countries cope with the global financial crisis.[1] The Obama administration played a key role in getting the ball rolling in March when Treasury Secretary Timothy Geithner urged that IMF member countries agree to a $500 billion increase in the amount the IMF can borrow from members through the New Arrangements to Borrow (NAB) emergency financing mechanism and indicated he would seek $100 billion from the United States.

President Obama has asked Congress to include provision for the $100 billion loan in legislation as early as possible and I urge this subcommittee to support that request. The U.S. contribution will help ensure other announced contributions: $100 billion from the Europeans, another $100 billion from Japan (additional to $100 billion announced prior to the London Summit, see http://www.imf.org/external/pubs/ft/survey/so/2009/NEW021309A.htm), and smaller contributions from Canada, Saudi Arabia, and others. The "contribution" from the U.S. would have a minimal effect on the U.S. budget; when the U.S. contributes to the NAB, Treasury receives an interest-bearing account at the fund in return. I understand the current plan is to score the $100 billion contribution as $5 billion on the federal budget. The $5 billion scored on the budget is likely to leverage a total of $500 billion increase in the amount the IMF can borrow through this emergency financing mechanism.

The G20 leaders also agreed to IMF issuing $250 billion in new Special Drawing Rights (SDRs— an IMF asset based on a basket of key currencies against which member countries can borrow). Issuing new SDRs is the equivalent of creating additional international liquidity for IMF member countries, a reasonable idea when many credit-worthy sovereigns have poor access to credit, exacerbating the downturn and increasing the risks of global deflation. An allocation

[1] I proposed that $1 trillion could and should be made available in mid-February ("How to Unlock the $1 Trillion that Developing Countries Urgently Need to Cope with the Crisis" at http://www.cgdev.org/content/publications/detail/1421143), primarily by exploiting then-current resources but also by channeling reasonable amounts of additional resources from the U.S., Europe, and China and other surplus reserve countries through the IMF and multilateral development banks.

of $250 billion is permitted under U.S. law following a 90-day period of consultation with Congress; I understand Treasury informed Congress on April 13. SDRs are allocated to countries in line with their current "quota shares" in the IMF. 32 percent of the $250 billion ($80 billion) would be available for developing countries, including about $11 billion for low-income countries (corresponding to the 4.5 percent of IMF quotas they have). I support the idea of an additional $250 billion of SDRs being created and called for this before the London G20 summit.[2] Today, I urge the Congress to endorse this move.

II. The IMF today is not the IMF of old.

Congress is currently considering legislation in the war supplemental that stems from the G20 summit and calls for a major increase in resources at the IMF. I thought it would be helpful for me to address some of the concerns I have heard from members of Congress (including in the "Dear Colleague" letter signed by several of you on the subcommittee).

First and foremost, the IMF of today is not the IMF of old. In particular in response to the global economic crisis, it has recognized the logic of supporting deficit spending during a downturn, has encouraged and indeed urged countries to protect their spending on health, education and the social safety net in general. The IMF Board has approved creation of a new precautionary facility (the Flexible Credit Line or FCL) that makes substantially more resources available more quickly on better terms, on request, to countries with an adequate record of good policies and sound management.[3] Fiscal targets have been loosened in 18 of 23 African countries with active IMF programs. On average, fiscal deficits are widening by 2 percent of GDP.

The FCL is one of a series of steps the institution is taking that are making it more pragmatic and responsive. My understanding is that the IMF is developing a proposal to finance temporary relief from interest payments on debt for low-income countries hit by the crisis.[4] I strongly support this idea and hope the U.S. will back its endorsement by the IMF Board.[5]

I am particularly impressed with the increasing attention in IMF programs to the economic logic of protecting social program spending during downturns. The IMF has long come under fire from critics concerned that IMF programs in low-income countries unnecessarily limited health spending, hurting poor people. A report by my colleague David Goldsbrough at the Center for Global Development who led a working group on the IMF and health spending, found that IMF

[2] See Nancy Birdsall, "How to Unlock the $1 Trillion that Developing Countries Urgently Need to Cope with the Crisis," Center for Global Development, February 2009, http://www.cgdev.org/content/publications/detail/1421143.

[3] The FCL is available for countries that pre-qualify based on rigorous policy criteria and track records for good implementation. So far, Colombia, Mexico and Poland have been approved for the FCL and other good performing countries are likely to gain future approval.

[4] This is akin to an approach I encouraged in testimony before the Senate Foreign Relations Committee on the Jubilee Act for Responsible Lending and Expanded Debt Cancellation of 2007. I called for the Senators to encourage the U.S. Treasury to work with its counterparts in the World Bank and IMF to develop a facility, possibly at the IMF, that would provide temporary financing to relieve debt service burdens in the case of shocks to low-income countries' economies beyond their own control. See "Building on International Debt Relief Initiatives: Testimony for the Senate Foreign Relations Committee", April 2008, http://www.cgdev.org/content/opinion/detail/15880/ and Nancy Birdsall and Brian Deese, "Delivering on Debt Relief," Center for Global Development, April 2002, available at http://www.cgdev.org/content/publications/detail/2862/.

[5] CGD's first book, *Delivering on Debt Relief: From IMF Gold to a New Aid Architecture* by president Nancy Birdsall and John Williamson, a senior fellow at the Peterson Institute for International Economics, proposed a similar idea. See http://www.cgdev.org/content/publications/detail/2922.

programs could have important indirect effects on the health sector through the size of overall public spending and other influences.[6] He and the working group urged the IMF to be more ambitious in exploring policy options for higher spending and aid and to drop wage bill ceilings expect for the rarest circumstances where loss of control of payroll threatens macroeconomic stability.

Today's IMF programs no longer include binding structural conditionality but they do include targets to *preserve* or *increase* social spending. IMF programs have promoted higher social spending in countries like Costa Rica, Guatemala, and Pakistan that aim to strengthen social safety nets. The IMF Board, in June 2007, also emphasized a longer-term view of spending plans in developing countries, including attention to protecting priority expenditures from adverse shocks and reducing the use of wage bill ceilings. Today, none of the IMF programs in the 31 low-income countries includes a wage bill ceiling as a performance criterion and only four include indicative targets on the wage bill. All of these efforts are helping to buffer developing and emerging countries from the effects of the global financial fires.

III. Support the sale of IMF gold to strengthen surveillance and help poor countries
Low-income countries are suffering disproportionately as a result of the global financial crisis not of their making, as acknowledged by several of you in the letter on these issues. House Financial Services Committee Chairman Barney Frank, other members of Congress, and development advocacy groups like ONE have argued that the IMF should ensure that some of the revenue from the sale of IMF gold and/or other sources of income be used to provide funding for the world's poorest countries. President Obama has also requested congressional approval for the sale of a limited amount of the IMF's gold reserves, for two purposes: to support an endowment at the Fund, explained below, and to increase the Fund's resources for concessional lending to low-income countries.

As I said in my testimony last month before the House Financial Services Subcommittee on International Monetary Policy and Trade, I urge the committee to recommend approval of the gold sales request and provide guidance to the Treasury for its discussions with other IMF members on the allocation of the sales revenue between the two purposes.

In 2008, the IMF Board agreed, subject to approval by its members, to the sale of a small amount of its gold to finance an endowment account, the annual returns to which would be available to support the administrative costs of two key public goods the IMF provides: periodic surveillance of countries' macroeconomic and financial situations, and capacity building. Effective surveillance is a core IMF duty and no more so than now, when the IMF is assessing whether the macroeconomic and financial sector policies of its members are adequate given the crisis. The surveillance function can be thought as equivalent to the fire brigade checking to see if fire alarms are working and buildings are up to code. A strengthened IMF surveillance function would not only help individual countries to avoid big mistakes and but also help identify—*before a crisis strikes*—systemic risks to global financial stability.

[6] "Does the IMF Constrain Health Spending in Poor Countries? Evidence and an Agenda for Action," David Goldsbrough, Center for Global Development, July 2007, http://www.cgdev.org/content/publications/detail/14104.

For this to work, the IMF needs dedicated funding for independent surveillance on an ongoing basis, not only in times of crisis. In the past the surveillance and capacity building functions have been supported by income from the IMF's loans. But the ability of the IMF to carry out these key functions should not be a function of member countries' needs to borrow (which ideally will return within a few years to being relatively limited) nor on the cost of borrowing, which should be as stable and predictable for borrowers as credit markets allow.

The board of the IMF has endorsed the sale of gold including in order to generate resources for an endowment—apparently in an amount of about $6 billion. (A target amount of $6 billion in income for an endowment fund would generate annual income on the order of about $200 million, an amount that today would cover about 20 percent of current annual administrative expenses.) The exact amount that would be available for support to low-income countries depends on the price of gold at the time of sales over the next several years, and the allocation for the endowment already agreed by the IMF Board.

To summarize, I believe Congress should authorize IMF gold sales for the two purposes, and provide guidance to Treasury along the following lines: to ensure the proposed endowment is adequately funded and to support use of any additional revenue from gold sales and/or from other revenue sources to increase as much as possible resources available to low-income countries, ideally for grants or relief of interest payments on debt.

IV. The Congress should urge the Treasury to take the leadership in negotiating, particularly with the recalcitrant Europeans, the governance reforms endorsed by the G20 heads of state; among other benefits this is likely to trigger increased contributions from China and other emerging market economies, thus reducing even further the potential burden on the American taxpayer.

The global financial crisis requires a global response not unlike what the IMF was designed to do after World War II. But while the economic weight of countries has shifted dramatically since the 1940s, IMF decision-making rules have remained largely unchanged. Belgium and the Netherlands together have more voting power than China; Belgium alone has more voting power than India. The allocation of quotas (votes) and the make-up of the board, where Europe holds 9 out of 24 seats are among the out-dated mid-twentieth century governance arrangements that have seen the rising Asian powers withdraw in spirit if not yet in fact from the IMF orbit. A continued withdrawal would be the canary in the mine – making the IMF irrelevant and ineffective in addressing the current crisis and averting future global financial disruptions.

That would be a big loss for America and its citizens and taxpayers. No country stands to gain more from a legitimate and effective IMF than the U.S. Strengthening the IMF's role in supporting global economic recovery and restoring global economic and political stability will only be possible if major emerging market countries believe they will soon secure appropriate influence in IMF decision-making. The G20 leaders recognized this implicit link at the summit in April and their call for additional resources for the IMF is twinned, smartly, with calls for governance reform.

The IMF Board last year approved a proposal for revision of IMF quotas (voting weights that determine contributions to IMF resources and access to IMF financing) to begin increasing the quotas of several underrepresented emerging markets. The reform requires congressional approval and the Obama administration has asked for that approval. The proposed changes are very modest (e.g. China's voting share would increase from 3.7 to 5.6 percent); they are sometimes called "a mouse" compared to the extent of reforms needed.

Despite the modesty of the reform efforts, I believe that Congress should now endorse the proposed 2008 governance reforms as a first step, a down-payment, towards broader governance reform. The G20 called for the next review of IMF quota reforms to be completed by January 2011; an IMF internal report moves this forward to 2010. The U.S. should support an accelerated review process and urge further changes, which can in turn push the Europeans towards accepting deeper reforms—including the important step of reducing the number of board chairs they currently occupy.[7]

Conclusion

As this subcommittee and your colleagues consider how best to support the spirit of the G20 commitments and global economic recovery, I urge you to keep in mind three things:

1. **Stimulating the global economy—including in developing and emerging countries—is vital for our domestic recovery and security, and it is urgent.** While I believe that there is more work to be done to tie additional resources to governance reform, I fully support the administration's efforts to move the IMF funding bill as quickly as possible through Congress in order to support the IMF's critical role in helping stabilize and monitor the global economy. The human impact of the global crisis will be dire, but the cost of inaction will be even greater for global economic and political stability. Congress should support expeditious approval of the administration's requests stemming from the G20 summit, including providing additional resources to the IMF. Congress should also recognize the enormous leveraging power its contributions to the Fund create—a small contribution from the U.S. will be matched with enormous resources from around the globe in a world-wide effort to stem the worst ramifications of the crisis.

2. **U.S. congressional support for the G20 commitments, including additional IMF resources, is critical for reshaping our image in the world**. Many blame the current crisis on the U.S. and are looking for U.S. leadership to respond. The administration took a significant step towards coordinated, global response to the crisis at the G20, and congressional support is needed to maintain U.S. credibility in leading a global response to the crisis. The U.S. has traditionally played an important role in the global institutions and helps strike the right balance between generosity in our self-interest and avoiding throwing money down the drain. The U.S. has been a particularly strong leader in insisting on accountability and standards for lending through these institutions. The U.S. has the opportunity and responsibility to continue to lead in these institutions and ensure an effective, coordinated global response to the crisis.

[7] As recommended in the Trevor Manuel report: http://www.imf.org/external/np/omd/2009/govref/032409.pdf.

3. **Monitor but don't micromanage further IMF reforms**. Further and deeper governance reforms are needed at the IMF, but I worry that the tendency for Congress to dictate what the IMF can and can't do undermines the U.S. role in global institutional decision-making and ultimately weakens the effectiveness of the IMF. Interest, advice and close monitoring of the IMF by Congress are critical, but the U.S. executive director reporting to the Treasury Secretary should be permitted enough flexibility to be a credible player in IMF decision-making. If the U.S. executive director is overly constrained by Congress from the outset, she or he loses the ability to negotiate and thus play an effective leadership role among our allies and partners.

In an increasingly interdependent world, economic growth, improved well-being and good political relations with developing countries—where five of six people in the world live—are fundamental to sustaining and increasing the economic opportunities Americans enjoy and to reducing the threats we face. In this context, shared institutions matter more, and a better approach to organizing and supporting these institutions can have high returns for the goals and interests of the United States.

The challenge is to use America's still substantial influence to reform international institutions into effective organizations for collective, global problem solving. The G20 members, with substantial leadership from the U.S., have taken the first steps towards strengthening the IMF's ability to provide the global public good of financial stability for all. I hope that the Congress and the administration continue to support strong U.S. leadership on these issues and believe that we and our fellow global citizens stand to benefit greatly from these steps towards more legitimate and effective global institutions.

This committee knows well the important relations we have with emerging and developing countries, particularly related to trade and the fight against global terrorism. The G20 plan, including support for resources and reform at the IMF, is vital to our domestic economic recovery and to security globally and at home. While many blame the U.S. for the current crisis, we can and should leverage our leadership and resources through global institutions like the IMF to respond to the current crisis, help restore the U.S. image in the world as a global partner, protect our shared economy, and promote our common security.

Mr. SHERMAN. We will get louder next time. We will move on to Ambassador Miller, director of the Center for International Trade and Economics at the Heritage Foundation. He has previously served as Ambassador to the United Nations Economic and Social Council. Ambassador Miller?

STATEMENT OF THE HONORABLE TERRY MILLER, DIRECTOR, CENTER FOR INTERNATIONAL TRADE AND ECONOMICS, THE HERITAGE FOUNDATION (FORMER AMBASSADOR TO THE UNITED NATIONS ECONOMIC AND SOCIAL COUNCIL)

Ambassador MILLER. Thank you very much, Mr. Chairman, for the opportunity to testify here today. The views I express are my own and do not represent an official position of the Heritage Foundation. I think there are three issues here, Mr. Chairman. The first is the nature of the globalized international trade and financial system. I am going to talk a little bit about that. The second are the institutions of that system, the IMF, the World Bank, the World Trade Organization.

You yourself, Mr. Chairman, expressed some concerns about those institutions and some of their concerns. I share those flaws, particularly the possibility that financing might go through those institutions to rogue states or others that support terrorism, but the final issue is the impact of the U.S. Government actions, our current actions and interventions in economic activity, both in the U.S. and other countries, and I do want to talk about that.

What we do to keep our economic house in order here is far more important to our well-being than anything we do through international organizations or through cooperation in groups like the G–20. First about the overall system, Mr. Chairman, though we are in a recession today, it is important to remember that in recent decades, our world economic system has been producing strong, broad-based growth that has increased prosperity and reduced poverty around the world.

Over the last 10 years, average world incomes have increased by over one-third. Some criticize the free market system that has produced this growth as good for the rich but not for the poor. The data show otherwise. Countries that moved toward greater economic freedom in the last decade reduced poverty significantly, while those that turned their backs on freedom saw poverty levels increase. Economic freedom's positive impact is also evident in areas like education, health, maternal mortality, life expectancy, as well as in protection of the environment, where countries that are more economically free do a far better job than their less free counterparts. The free market system works.

The record of government interference in economies is not so pretty. The TARP program, initiated under the previous administration, is a good example of the problems of government interference in markets. The TARP in particular has created confusion, interfered with the establishment of market clearing prices for the assets in question, and there has been a lack of transparency in the program. It has done little to get the troubled assets off the books of financial institutions.

The Fiscal Stimulus Package, passed under the current administration, is even worse. One estimate is that only about $37 billion of that money has actually been spent. Most of it is going to be spent far in the future at a time when government stimulus will no longer be appropriate but will lead only to inflation in the U.S. economy. The cost of these programs is creating a huge debt for our children, and we are going to have to finance it somehow.

If we continue them, we are going to see either inflation or increased taxes, or both, as well as a fall in the value of the dollar, decreased foreign investment in the United States, lower productivity overall, and reduced economic growth. Some have expressed the hope that international cooperation, such as among the G–20, could speed recovery. This is unrealistic. The most important macro-variables, the money supply and spending levels, are going to remain under the control of individual governments.

There was also a lot of talk about regulatory reform at the recent G–20 summit. Our current regulations are overly complex and subject to manipulation. We don't need more of them, but reforms to improve transparency and clarity could do a lot to improve competition and decrease risk. There are other imminent risks to the U.S. and world economies. Policies that would greatly and artificially increase the cost of energy will decrease U.S. and world growth and lead to increased poverty.

Actions that would restrict trade flows would also have a devastating impact. Trade restrictions go by the name of protectionism, Mr. Chairman, but what they protect are the unfair privileges of politically connected special interests. Finally, as the size and reach of the Federal Government increases in the U.S., there is the ever-present risk of increased corruption, which thrives where government regulations are complex and pervasive.

Mr. Chairman, a time of crisis may be a time to examine what has been done and what might be done better, but it is surely not the time to fundamentally undo the policies and practices that have brought so much benefit to so many. Thank you very much.

[The prepared statement of Ambassador Miller follows:]

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CONGRESSIONAL TESTIMONY

Government Intervention: A Threat to Economic Recovery

Testimony before
The House Committee on Foreign Affairs'
Subcommittee on Terrorism, Nonproliferation and Trade

June 10, 2009

Ambassador Terry Miller
Director, Center for International Trade and Economics
The Heritage Foundation

My name is Terry Miller. I am Director of the Center for International Trade and Economics at The Heritage Foundation and editor of the Index of Economic Freedom. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Though we sit today at what may well be the low point of a recession that has seen world economic growth slow to near zero, it is important to remember that what we are experiencing is a temporary setback. If one takes a longer view, it is clear that the economic policies that have come to dominate world economic thinking over the last 60 years, and especially since the fall of the Soviet Union, are producing strong broad-based growth, growth that is increasing prosperity and reducing poverty around the world.

The numbers are not ambiguous. Over the last decade, per capita income in all countries of the world combined has increased by an average of about three percent per year. Over the 10 years, that adds up to an increase of over one third in average world incomes.

The growth in incomes is remarkably broad-based, not concentrated in just a few countries or regions. Of the 156 countries for which we have reliable data, only 12 failed to participate in this positive growth over the decade.

The economic system that has been producing these remarkable results is known by various names. Most economists would call it the free market system or capitalism. Some identify it with globalization. Some call it the Washington Consensus, because it represents the consensus of views and policies espoused by the World Bank, the International Monetary Fund and, at least until recently, the government of the United States.

At The Heritage Foundation, we call it economic freedom, and we measure it each year in the Index of Economic Freedom, which we publish jointly with The Wall Street Journal.

The key principles of economic freedom are individual empowerment, non-discrimination, and the dispersion of power:

- Individual empowerment means that individuals retain control of where they live and how much they work. They have the right to own property and decide when and how to spend their wealth and income.

- Non-discrimination means that there should be no preferences based on race, gender, religion, class, family connections or any other such trait. Each individual deserves an equal opportunity to prosper to the full extent of their ability and effort. Transparency in decision-making is a key aspect in ensuring such fairness; it is behind walls of secrecy that discrimination most often flourishes.

- Dispersion of power means pursuing policies and practices that foster competition in labor markets, in capital markets, between firms and even among countries. The separation of political and economic power is a key aspect in the dispersion of power.

Countries that respect these principles of economic freedom do far better on average economically than countries in which governments play a more intrusive role. The countries ranked as most free in the 2009 Index of Economic Freedom had average per capita incomes of over $40,000, more than 10 times the income levels in countries where economic freedoms are repressed.

Some criticize the free market system as good for the rich but not for the poor. The data show otherwise. When we compare economic freedom scores with poverty levels as measured in the United Nations Human Poverty Index, we find that countries that gained at least 5 points of economic freedom in the decade between 1997 and 2007 moved almost 6 percent of their populations out of poverty on average. Countries that lost at least 5 points of economic freedom, by contrast, saw poverty levels increase.

Economic freedom's positive influence is also evident in connection with social development in areas like education, health, child or maternal mortality, and overall life expectancy, as well as in protection of the environment, where countries that are more economically free do a far better job than their less free counterparts.

Given these positive long term trends, and the proven good economic results in countries around the world that respect principles of economic freedom and market-based decision-making, I would submit that the first responsibility of policy makers in leading economies, especially in a time of downturn or crisis, is to preserve the capitalist system and to do no harm. Markets are by and large self-correcting. Government interventions, which are almost always designed to restore or protect the status quo ante, impede the corrective action of the market and thus slow recovery.

The record of government interference in the economy, whether in the United States or in countries around the world, is not pretty. The TARP and TALF programs, both initiated under the previous administration, are good examples of the problems of government interference in markets. The policy-makers involved argued that the programs were necessary to avoid an immediate melt-down in financial markets. We cannot, of course, know what would have happened in the programs' absence. However, from the perspective of six months following their passage, we can see that their lasting result has been not the hoped for increase in stability and lending in credit markets, but rather greater uncertainty and volatility. Markets need sure and stable government laws and policies in order to properly price assets. The TARP, in particular, has created confusion and interfered with the establishment of a market-clearing price for the troubled assets in question. There has been a disappointing lack of transparency in the program's decision-making processes that leaves potential investors uncertain of the direction of the market and therefore unwilling to invest. The TARP may have artificially inflated the value of the troubled assets, but it has done little to get them off the books of the financial institutions.

The fiscal stimulus package passed under the current administration is even worse. Even if one accepts the Keynesian notion that increased government spending can increase economic growth, and there are real doubts about this, almost none of the money has actually been spent, or will be spent, in a timely fashion. One estimate this month is that only about $37 billion of the $787 billion stimulus package has been spent so far. Most of the money is projected to be spent in the future when government stimulus will no longer be appropriate and will most likely only contribute to inflationary pressure.

The cost of these programs is creating a huge debt for our children that will have to be financed somehow. If we continue them, we are going to see either inflation or increased taxes or both, as well as a fall in the value of the dollar and decreased foreign investment in the United States, lower productivity overall, and reduced economic growth in the future. That is far from doing no harm.

Between January and April this year, the International Monetary Fund reduced its projection of U.S. economic growth in 2010 from a positive 1.6 percent to zero. The most significant U.S. public policy change during this period was the passage of the stimulus package. Now we are seeing bond markets driving up the cost of Treasury borrowing in response to unprecedented government spending. This is a path to impoverishment rather than recovery. We need to stop.

Some have expressed the hope that increased international cooperation, such as among the G-20, could contribute to a solution to the problem. I have very modest expectations in this regard. The G-20 can play a positive role in exchanging information and promoting mutual confidence among governments, but the most important macro-economic variables under the control of governments, the money supply and spending levels, must and will remain the province of individual governments.

There was much talk about regulatory reform at the recent G-20 summit, and such reform is, in fact, needed. Financial market regulation needs to change to encourage more transparency, greater competition, and a reduction in regulatory distortions that increase lending risk. The probability, unfortunately, is that international cooperation will lead to just the opposite, a regulatory system that is more complex, more subject to manipulation, and more restrictive.

The general rule is that more regulation leads ultimately to the provision of less of the regulated product. It is extremely unlikely that increasing regulation of financial and credit markets could lead to any result in the end other than a reduction in the availability of credit to individuals and businesses and an increase in its cost.

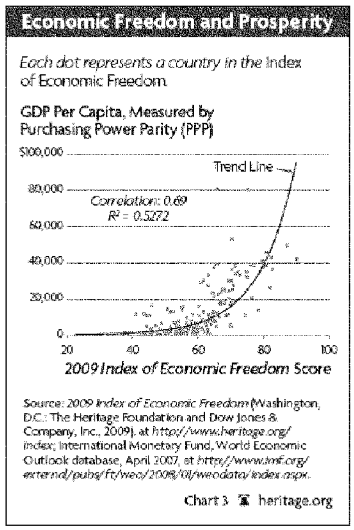
Looking forward, as we begin to recover from the financial crisis, there are different and even greater potential risks to the U.S. and world economies. Policies that would greatly and artificially increase the cost of energy will cut U.S. and world growth and lead to increased poverty worldwide. It is imperative that these costs be fully considered in the development of any policies to address climate change.

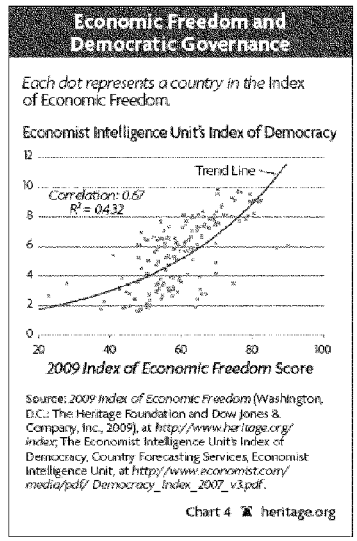
In addition, actions that would restrict or reduce the flows of goods and services or capital among the countries of the world would also have a devastating impact on world growth. Trade flows increase productivity and growth rates. Income from trade dwarfs all other aspects of financing for development in poorer countries. Trade restrictions go by the name of protectionism, but what they protect are the unfair privileges of politically-connected special interests.

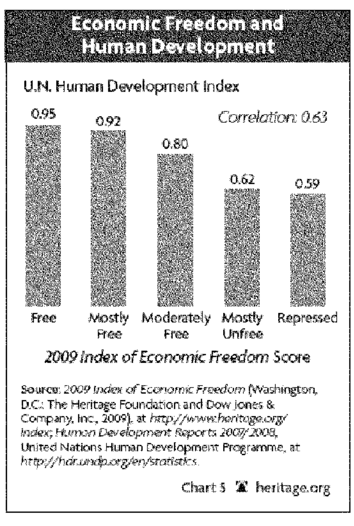
If policies must be developed in any of these areas, it is most important that they be as simple, straight-forward and transparent as possible. As the size and reach of the Federal Government increases in the U.S. economy, there is an ever-present risk of increased graft and corruption. These factors, more than any others, account for low levels of development in much of the world. Corruption thrives where economic regulations are complex and government involvement pervasive. It must not be allowed to take root here.

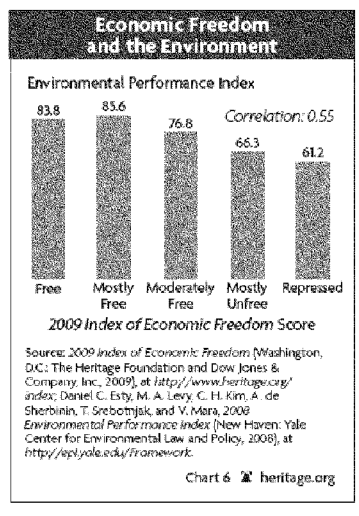
Over the past decades we have maintained in America, and exported to most of the rest of the world, a free market economic system that encourages openness, the free flow of goods, services and capital, and interconnectedness among the nations and people of the world. The result has been greatly increased prosperity for all. A time of crisis may be a time to examine what has been done and what might be done better, but it is surely not the time to fundamentally undo the policies and practices that have brought so much benefit to so many.

Economic Freedom Improves Lives









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Mr. SHERMAN. Thank you. One scheduling note, you will be happy to know that while we are up here we are missing the opportunity to debate an additional 27 amendments that they are debating on the floor to the Foreign Affairs Authorization Bill, so the good news of that is we will not be interrupted by votes on the floor, and the other news is that the other colleagues on our subcommittee, you know, have a perfect excuse for not being here.

Finally, I want to welcome Roger Robinson, Jr., president and CEO of the Conflict Securities Advisory Group. He has over 25 years of experience in identifying and analyzing international security risks. Mr. Robinson?

STATEMENT OF MR. ROGER ROBINSON, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, CONFLICT SECURITIES ADVISORY GROUP (FORMER SENIOR DIRECTOR OF INTERNATIONAL ECONOMIC AFFAIRS AT THE NATIONAL SECURITY COUNCIL)

Mr. ROBINSON. Thank you, Mr. Chairman and members of the committee for the opportunity to appear before you today. As you mentioned, I have been working on a nexus between international security concerns and global finance for some 30 years now. The views that I am expressing today are my own and don't necessarily reflect the views of my firm, Conflict Securities Advisory Group, which is an independent, impartial research provider specializing in global security risk.

Today, despite the valiant efforts of the Treasury Department and others to curtail financial flows to global bad actors, Iran, Sudan, Syria, North Korea and other regimes continue to benefit from lawful inflows of hard currency and external financing. In this connection, I have several observations I would like to share with the committee. First, concerning the role of publicly traded foreign companies, it is important to understand that these public firms represent the principal source of financial and economic support for Iran and certain other countries of concern.

Most Americans hold at least some of these companies in their retirement accounts and other investment portfolios. Mr. Chairman, you have certainly been a leader in addressing this particular concern. The second involves the international financial institutions, notably, the IMF. In your opening remarks, Mr. Chairman, you reviewed the troubling amounts of taxpayer dollars committed to this enterprise, including the likely $250 billion general allocation this summer, from which Iran could reportedly see more than $1.7 billion. The direct cash infusions potentially provided by the IMF and other IFIs to these governments are legitimate national security issues, particularly as these funds are relatively undisciplined and easily divertable.

The third issue deals with Federal contractors. We have calculated that among the top 100 recipients of Federal contract awards for Fiscal Year 2009, roughly 20 percent have engaged in some kind of business activity within the borders of a state sponsor of terrorism during the past 3 years. The Congress could play a catalytic role here that needs to transcend traditional "name and shame" tactics and should be aimed at the mitigation of legitimate business and financial risks.

Should it be of interest, our firm, Conflict Securities, has researched the number of publicly traded companies worldwide with business interests in each of the terrorist-sponsoring states, but in the shortness of time, and I am racing the clock, I would like to move to what more can be done. I have several recommendations in this connection. First, strengthen corporate awareness of global security risk. It is defined as the risk to share value and corporate reputation stemming from business ties to U.S.-sanctioned countries, including the terrorist states. The SEC has an Office of Global Security Risk that could be leveraged in this connection and could communicate with foreign firms.

Second, we could highlight Iran's use of foreign correspondent banks that facilitate the money transfers, foreign exchange transactions, letters of credit, interbank deposits and related financial activities with most of their major trading partners, and that is something that should be on the agenda. Third, capitalize on existing private investment initiatives in the markets by mandating investment options for Federal employees that take into account these security concerns.

And finally, pass legislation to sanction Iran's refined petroleum industry and encourage the Obama administration to, for the first time, enforce the Iran Sanctions Act.

In conclusion, without the support of their state sponsors, terrorist groups are apt to shrivel like a virus without a host. Accordingly, the time is past due to take a more serious inventory of financial measures that could be brought to bear to hobble these regimes and change their cost-benefit calculations, much as happened with Libya.

Mr. Chairman, I am persuaded that the market-oriented measures referenced above could serve as the most potent, nonmilitary means available to the U.S. to curtail terrorist sponsorship and WMD development and proliferation. In the best of worlds, the U.S. would receive robust and cohesive multilateral support for such initiatives, support which has traditionally been in short supply. If this is not possible, the U.S. would be well-advised to proceed unilaterally.

The American financial system remains, as was stated by Mr. Scott, the dominant force on the global landscape that few responsible foreign financial institutions and companies can live without from a shareholder and reputational perspective. Regrettably, requiring these hard choices on the part of primarily foreign firms and banks is now a necessity. Postponing this day of financial reckoning will make more likely a nuclear Iran and more capable and dangerous United States adversaries worldwide.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Robinson follows:]

Testimony of Hon. Roger W. Robinson, Jr.
United States House of Representatives Committee on Foreign Affairs'
Subcommittee on Terrorism, Nonproliferation and Trade
June 10, 2009

TESTIMONY OF ROGER W. ROBINSON, JR.
FORMER SENIOR DIRECTOR OF INTERNATIONAL ECONOMIC AFFAIRS AT THE NATIONAL SECURITY COUNCIL

BEFORE THE

SUBCOMMITTEE ON TERRORISM, NONPROLIFERATION AND TRADE OF THE HOUSE COMMITTEE ON FOREIGN AFFAIRS

RAYBURN HOUSE OFFICE BUILDING
JUNE 10, 2009

Thank you, Mr. Chairman and members of the Committee, for the opportunity to appear before you today. I am President and Chief Executive Officer of Conflict Securities Advisory Group, Inc. (CSAG), an independent, impartial research provider specializing in the field of global security risk management and terror-free investing. For some 30 years, I have been evaluating the nexus between international security concerns and global finance. The views expressed herein are my own and do not necessarily reflect those of CSAG.

In the way of background, I am an international banker by training, having served as a Vice President in the International Department of the Chase Manhattan Bank with responsibility for Chase's loan portfolios in the former Soviet Union, Eastern and Central Europe and Yugoslavia. I was also an assistant to then-Chase Chairman David Rockefeller. In government, I served as Senior Director of International Economic Affairs at the National Security Council from March 1982 to September 1985 and later served as Chairman of the Congressional U.S.-China Economic and Security Review Commission until January 2006.

I have been requested by the Committee to provide testimony with respect to the potential transfers of American taxpayer dollars by International Financial Institutions (IFIs), notably the International Monetary Fund, to terrorist-sponsoring states like Iran and Sudan as well as other countries of security concern. I have also been asked to comment on the activities of foreign firms that are simultaneously partnering with state-sponsors of terror while holding U.S. government contracts, or are recipients of U.S. taxpayer "bail-out" funds. Despite the efforts of the U.S. Treasury Department and other government agencies to curtail financial flows (both overt and covert) to bad actors, these regimes continue to benefit from the lawful inflows of hard currency and external financing. Having focused on this intersection of issues for many years, I have several observations that I would like to share with this Committee.

First, it is useful to understand that the principal source of financial and economic support for Iran and certain other countries of concern are publicly-traded foreign companies. Most Americans hold at least some of these companies in their retirement accounts and other investment portfolios, contributing to the funding capabilities of these corporations in a private sector venue that has typically been outside the scope of government oversight in Washington. Chairman Sherman has certainly been a leader in addressing this concern. Without these firms, hydrocarbons would largely stay in the ground or locked in the sea-bed, heavy manufacturing would be difficult to impossible, electricity and communications would be more episodic and primitive, and the list goes on.

Second, as referenced by other witnesses, the International Monetary Fund relies on the U.S. government as its single largest contributor and for underwriting 37.1 billion in Special Drawing Rights, equal to about $58.2 billion. In an effort to better manage the spread of global financial turmoil, the U.S. has now pledged some $100 billion in additional funds for the IMF's "New Arrangements to Borrow." This summer, the IMF will also likely call for a general allocation of $250 billion in SDRs. Iran, Burma, Sudan, Syria and Zimbabwe, as members of the IMF, would see their SDR accounts at the IMF increased by tens of millions, or more, as a result – in the case of Iran, by reportedly more than $1.7 billion. These SDRs may be exchanged for hard currency. The direct cash infusions potentially provided by the IMF and other IFIs to these governments is a legitimate security concern, particularly as these funds are undisciplined and easily divertible (as opposed to project finance or trade transactions).

Third, a number of private companies that have been awarded U.S. federal contracts are also actively operating in, or otherwise connected to, countries of security concern. We have calculated that among the top 100 recipients of federal contract awards for FY 2009, roughly 20 have engaged in some kind of business activity within the borders of a state-sponsor of terrorism during the past three years.[1] Given the dearth of attention to conditioning the security-relevant activities of companies that receive federal contracts (by way of the General Services Administration's application process), such business operations will likely increase as economic activity recovers in emerging markets.

This connection between tax dollars and contract awards to corporations with ties to countries like Iran has been exacerbated by Washington's TARP (Troubled Asset Relief Program) and TALF (Term Asset-Backed Securities Loan Facility) outlays undertaken thus far. These programs involve an unprecedented sum of federal dollars available to the private sector and are offered with a similar lack of security-minded conditionality regarding the recipient's business activities overseas. For example, a prospective borrower interested in participating in TALF must do so through a primary dealer. A primary dealer is required to review an application along with the Federal Reserve Bank

[1] Some such activity is humanitarian in nature and/or has been recently halted by the company in question (ref: CSAG's *Global Security Risk Monitor* online database, June 3, 2009).

of New York and then determine if a prospective borrower is eligible. Nowhere in this process, however, is there any due diligence into the recipient's business activities in U.S.-sanctioned states. We understand that several recipients of such funds have such ties, as do certain primary dealers.

The range of direct and indirect infusions of cash into firms helping provide economic and financial support to terrorist-sponsoring regimes and human rights abusers is fundamental to some of the questions being addressed today.

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As part of my contribution to today's hearing, I wanted to emphasize some of the private sector arguments for companies to implement new security-minded due diligence procedures that bring a self-policing dimension to their activities in a way that mitigates the valid risks involved. The U.S. Government, and the U.S. Congress, can play a catalytic role in supporting corporate behavior modification. Indeed, these efforts need to transcend "name and shame" tactics and should comprise the mitigation of legitimate business risk.

For these reasons and others, some foreign firms have already demonstrated positive behavioral and procedural change. Companies involved in the sale of gasoline to Iran, which have come to the attention of Chairman Sherman and this Committee, have recently reconsidered their business relationship with Iran. Media sources reported on June 4 that Reliance Industries, for example, would halt shipments of gasoline to Iran in order to protect its access to the U.S. market. This wise corporate governance decision by Reliance may be replicated elsewhere. After all, there are hundreds of publicly-traded companies that maintain business operations and investments in vital Iranian industries as well as those of other countries of concern.

Based on research conducted by my firm, Conflict Securities Advisory Group, we understand there to be over 350 publicly-traded companies worldwide with active, non-humanitarian business ties to Iran. No doubt, many of these have a presence of some sort in the United States, whether via contracts with the U.S. government or operations in this country. This pattern is evident in several other countries of concern mentioned in the course of this hearing. Our research shows that some 200 publicly-traded companies have active ties to Sudan, about 180 have active ties to Syria, and, roughly 50 have operations in, or with, North Korea. On the whole, over 500 public firms have active ties to at least one state sponsor of terrorism.[2]

This research is available for the performance of due diligence into the business operations of public companies, many of which are held in portfolio by both individual and institutional investors that are increasingly intent on scrutinizing their investments for

[2] Data provided by CSAG's *Global Security Risk Monitor*

such security-related concerns. Accordingly, reliable data is no longer an impediment to action.

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What more can be done? I have several recommendations for this Committee.

(1) Strengthen corporate awareness and increase the overall profile of what the U.S. Securities and Exchange Commission (SEC) defines as "global security risk" (i.e., the risk to share value and corporate reputation stemming from business ties to U.S.-sanctioned states). This could be accelerated by mandating that federal contractors report on risk mitigation steps taken with regard to any ties to U.S.-sanctioned states in the course of their application process.

In addition to emphasizing the relevance of such business activity to federal procurement decisions, this process might, at minimum, urge the establishment of global security risk management programs, much like export controls already in force. The SEC determined as early as May 2001 that publicly-traded firms that have business operations in U.S.-sanctioned countries, such as Iran, are exposed to asymmetric global security risk, even though such activities are legal. Among the risks are: new U.S., U.N., or other official sanctions that could affect a company's operations; consequential negative publicity; law suits by victim's rights groups; and opposition-oriented shareholder activism, including divestment campaigns. This proven financial risk can be compounded by firms doing business in more than one terrorist-sponsoring state and/or in security-sensitive sectors of these economies.

(2) Instill a sense of "America risk", among foreign companies in particular, for those firms partnering with Iran and other terrorist-sponsoring states. Leveraging the SEC's Office of Global Security Risk and its special mandate would likely get the attention of those firms with a significant footprint in the United States.

(3) Highlight Iran's use of foreign correspondent banks that permit money transfers, issuance of letters of credit, interbank deposits and related financial activity with most, if not all, of its major trading partners, despite U.S. and/or U.N. financial sanctions in place against major Iranian banks (e.g., Sepah, Melli, Mellat, Saderat, etc.). In addition, attention should be given to investment funds such as that created by Tehran to support Iran's Pars Oil and Gas Company.

(4) Capitalize on existing private investment initiatives in the markets by mandating investment options for federal employees that take into account these concerns. As a result of the heightened risk factors outlined above, a number of fiduciaries have indicated a desire to exercise greater caution and due diligence with respect to investing in public companies with operations in the terrorist-sponsoring states.

(5) Support state-led initiatives such as Florida's recently executed law, which provides investment alternatives for state employees sensitive to security concerns.

(6) Strengthen the breadth and intensity of Treasury Under Secretary Stuart Levey's efforts to pressure foreign governments and companies to adhere to U.S. banking standards regarding anti-money laundering and terrorist finance activities. In addition, encourage the Obama Administration, for the first time, to enforce the Iran Sanctions Act.

(7) Augment IMF structural conditionality and controls for the Fund's directors as well as the government-run boards of other international financial institutions (IFIs). The IMF should be urged to embark on a study, much like that conducted in January 2008, of loan conditions focused on security-related risk considerations.[3] The Boards of the IFI's should likewise be briefed immediately on the security implications of the likely diversion of at least some of the funds they provide to these countries that ultimately help underwrite malevolent activities (e.g., terrorism, WMD development, etc.).

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Conclusion

State-sponsorship of terrorism takes many forms including training facilities, communications infrastructure, weapons and specialized equipment, political cover and much-needed funding. North Korea's increasing nuclear weapons stockpile, not to mention Iran's nuclear ambitions, could soon facilitate the ultimate security nightmare for our country -- terrorists equipped with weapons of mass destruction. That said, the Congress, particularly this Committee, is keenly aware that without the support of these authoritarian governments, terrorist groups are apt to shrivel like a virus without a host.

Accordingly, the time is past due to take a more serious inventory of financial measures that could be brought to bear to hobble these regimes and change their cost-benefit calculations, much as happened with Libya. Conditioning U.S. government procurement practices is within the purview of this Congress. Among the first steps should be:

(1) Requiring full disclosure of business ties of prospective foreign suppliers, and

(2) Inquiring whether such firms have implemented global security risk programs.

This latter condition could prove a strong incentive to modify corporate behavior in countries tied to state-sponsors of terror. Greater scrutiny of correspondent banking networks of Iranian and other targeted banks, as well as the external banking relationships of larger state-owned enterprises, would broaden the financial net

[3] IMF website (http://www.imf.org/external/pubs/ft/survey/so/2008/POL013A.htm)

considerably and result in higher transaction costs and outright disruptions of these vital "life-support" components.

Mr. Chairman, I am persuaded that the market-oriented measures referenced above could serve as the most potent non-military means available to the U.S. to curtail terror-sponsorship and WMD development and proliferation (including barring known proliferators from raising funds in the U.S. capital markets). Naturally, these measures would prove most effective with strong, cohesive multilateral support – support which has traditionally been in short supply. If such allied policy coordination is unachievable, or would diminish the effectiveness of these measures while searching for consensus, the U.S. would be well-advised to proceed unilaterally. The U.S. financial system remains a dominant force on the global landscape that few responsible foreign financial institutions and companies can live without.

Regrettably, requiring these hard choices on the part of primarily foreign companies and banks is now a necessity. Postponing this day of financial reckoning will make more likely a nuclear Iran and more capable and dangerous U.S. adversaries worldwide.

Thank you, Mr. Chairman.

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Mr. SHERMAN. Thank you, Mr. Robinson. I will recognize our vice chair for his questions, followed by our ranking member.

Mr. Scott?

Mr. SCOTT. Thank you very much. I guess I would like to follow up on, to get your response to a couple of queries that were put to me by the folks from China yesterday. One caller was concerned about the safety and soundness of our United States treasuries and he asked whether China should divest or risk losing out on its return. Of course, I ensured the caller that the Treasury is the most safe and sound investment one could hold and that there is absolutely no risk that we might not repay our debt, but I am worried that there will soon come a day when that isn't the case, at least there are people who are thinking that.

Then another caller from China asked whether United States had essentially been bought off by China, i.e., if the United States has become reluctant to focus on the considerable human rights abuses in China out of fear that they may stop supplying financing to us. That is the other wrinkle in this. This particular question in particular highlights in my mind the dangers of our economic situation we find ourselves in. Now, I in no way believe the United States has been bought off, nor do I feel that the caller was expressing a common perception around the world, but the issue is, the U.S., as it is perceived to become economically weak, to what degree will its leverage in holding people to a higher moral standard?

So I would like to kind of get your response to that, because I think that is really the fundamental question we have got here is, what is the measure of this risk that our financial situation in this country is holding to the world? I mean, here we have got folks in China who think China is still dealing with us because we will go light on their human rights concerns, and others are—Mr. Robinson, I particularly would be interested in your response on this.

Mr. ROBINSON. Well, Mr. Scott, my personal view is that we are, obviously, entering a somewhat perilous period. It is unprecedented in our history, and I think that, and I very much hope, that the administration understands the urgency of righting the ship. This is a very complex question, and I confess that it would be difficult to go into all of the moving parts, so to speak. I would say that for the foreseeable future, it is certainly the case that we would be servicing our debt without any kind of disruption. I think the remarks to your Chinese callers were spot on, but at the same time, I think all of us, behind closed doors, need to acknowledge that we are in new territory here, and like Kevin Kearns and others have mentioned today, there are a number of remedial steps that need to be taken urgently if the ship is to be righted. I would leave it with those more broad remarks, if I may.

Mr. SILVERS. Mr. Scott?

Mr. SCOTT. Yes, Mr. Silvers, Mr. Kearns?

Mr. SILVERS. There are, I think, at least two ways of looking at your question. The first is central to understanding both how we got here and how we have to get out of here, out of the structural nature of the crisis we are going through. At the heart of our economic crisis is a structural trade deficit, which has led the Chinese, rationally, to accumulate dollars and then lend those dollars back into global markets, depressing the global cost of credit in ways that ultimately didn't capture the risks involved in the provision of credit.

This is at the heart of the bubble and the collapse of that bubble. Those imbalances, that structural trade deficit we run with China, is not a sustainable phenomenon. As Paul Krugman once said about it, something like that that at some point has got to end, will end. It creates a situation where we and the Chinese are sort of in a state of mutually assured destruction. If they stop financing us, we stop buying from them. I think everyone understands this, and yet everyone also understands that it can't be sustained over time.

I believe that the focus of the Obama administration's stimulus program and budget on not just spending money for its own sake but to lay a foundation for a more productive economy, and the Obama administration's commitment to addressing manufacturing, the details of which have not been worked out, are directionally correct in terms of dealing with that problem. On the other hand, those impulses among many different policymakers to essentially try to return to the economic status quo of 2006 or 2007 risks a perpetuation of the dynamics you are concerned about to the breaking point.

There is a second and more short-term related problem here. There have been, as a result of the bubble, very substantial real losses associated with our financial system. Those real losses can be found in abandoned tract housing projects across large parts of our country. Who funds those real losses, who takes the hit, is deeply connected to the question of the sustainability of our financial relationship with the rest of the world. To the extent that we try, either explicitly or implicitly, hidden or above board, try to have the U.S. taxpayer absorb those losses in their entirety—there are trillions of dollars of these losses—rather than looking to, as much as we can, the people who took the risks, the investors in these institutions, to absorb those losses, if we do that and we at the same time borrow the money to do that, then we again run the risk of dramatically increasing the unsustainable dynamics you are concerned about, and this brings us back to, just as the first point tied us to trade, this point brings us back to fundamental choices about whether the public or the investors in Wall Street, essentially, are the people who are taking the hit for the mistakes that were made by financial institutions during the boom.

Mr. KEARNS. Just very briefly, may I, Mr. Chairman? Is that a yes or a no?

Mr. SHERMAN. 30 seconds.

Mr. KEARNS. Okay, 30 seconds. I can be more succinct than Mr. Silvers. There is a Chinese proverb that you can use, Mr. Scott. It is that trees don't grow to the sky. The export driven model that the rest of the world follows, that the IMF, the World Bank, all these international institutions have shoved down their throat, has made America the first and last market of resort. It is over, okay. We are broke. We can't absorb their goods. So we need a new model, and the sooner that the Congress and the administration work on inventing what that model is and the people in the private sector, the better.

Mr. SHERMAN. Thank you. The time of the gentleman has expired. We will go to Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman. I would like to ask Mr. Robinson a couple of questions, and one would be, what specifically can be done to tighten economic pressure right now on North Korea?

Mr. ROBINSON. I think that a lot of folks in Washington are casting about for that answer, Mr. Royce, and——

Mr. ROYCE. Well, we had the Banco Delta Asia approach in 2005. That——

Mr. ROBINSON. Which was shockingly effective. You know how that originated and how surprised Treasury itself was in the way that it electrocuted money transfers, letters of credit, interbank deposits. Something similar to that could be done by looking at the correspondent banking relations of all of the major North Korean financial institutions, as well as the banking relationships of their larger state-owned enterprises. Now, if these networks of banks, some of which are well known, were to likewise feel themselves put at risk in terms of accessing the U.S. financial system, as Under Secretary Levey has done vis-à-vis the Iranian banks in many cases, this would have a very powerful effect.

It would be a Banco Delta Asia times three or four-fold impact, I believe, and we should also be looking at interbank deposits, because folks don't necessarily appreciate that when banks deposit with one another, the money can be used or misused as a kind of reserve checking account that are renewed every 6 months and turned into a 5-year loan near the cost of funds. So, there are a number of technical aspects to this strategy that we could employ that would, in effect, scare off, not just Asian, but European and other banks worldwide, and other financial institutions, from doing this kind of life-support business with North Korea.

Mr. ROYCE. I am thinking about some of the reports on the U.N. Development Programme and how they helped fund North Korea.

Mr. ROBINSON. Well, we certainly want to include, obviously, the international financial institutions. We have heard the kind of record that is been cited vis-à-vis Iran and the World Bank.

Mr. ROYCE. Right.

Mr. ROBINSON. We can sure suspect that multilateral institutions need to understand that the free lunch for Pyongyang is over.

Mr. ROYCE. Is Chinese cooperation critical on this, or can we get that cooperation, in your opinion?

Mr. ROBINSON. I think we can but it is not going to necessarily come voluntarily. I think that we have to put those Chinese financial institutions that are insisting on providing life-support to the North Koreans on notice that it is going to be that activity or enjoy normal, unfettered access to the United States financial system, but it is not going to be both.

Mr. ROYCE. That may be an area that the chairman and I can cooperate on as we move forward, but you mention in your written testimony that there were 50 publicly traded companies doing business in or with North Korea. Could you give us an example of some of those companies? You don't have to do it now if you don't have it at hand. We will get it later, but——

Mr. ROBINSON. Well, I certainly can, and just to put that in perspective, there are 350 publicly traded firms doing business in Iran, 200 in Sudan, 180 in Syria, for a total, taken together with the North Korean example, over 500 public firms with active non-humanitarian ties in the terrorist-sponsoring states, and of course, I include North Korea among them notwithstanding the fact that it was erroneously taken off the list of terrorist sponsors.

Mr. ROYCE. One of the things that strikes me right now is with the attention, the focus, that we have on North Korea, we might be able to make an example of North Korea to the next guy, you might say. There is the old adage about warning shots in Russia and warning shots in the United States. A Russian told me he liked them here. In Russia they had them too but it was a warning to the next guy. The idea would be if we could get that kind of cohesion and get that kind of policy developed, we might be able to show what cooperation could do, and in this particular case, we might have enough unified support globally to—and Levey has shown, and he is still in his post, he has shown what can be done on this front. It is pretty impressive.

2.0.0.5, as you indicated, it was an amazing lesson, and when you can't pay your generals and you can't continue to manufacture your missiles, as one of the defectors who had worked in one of the missile plants told me, you know, he said we were trying to buy gyroscopes on the world market, and when you have got no hard currency because everything's been shut down, you can't do anything. The whole line went dead for months. And so now might be a time to try to get the reforms necessary in the regime by deploying that strategy.

Mr. ROBINSON. Well, we have done a pretty deep drill on North Korea and I would be pleased to assist with the kind of research that we have done in this connection. Just keep in mind that when you are dealing with serious financial sanctions, which we are now talking about,——

Mr. ROYCE. Right.

Mr. ROBINSON [continuing]. The chance for multilateral support incorporating the Chinese and Russians, for example, and the six parties that are playing in this game, is unlikely at best. Now, but——

Mr. ROYCE. I understand that, but——

Mr. ROBINSON. But, unilaterally, as you know from the Banco Delta Asia case, we are packing the gear unilaterally in this particular field.

Mr. ROYCE. Right, right. Let me go to Nancy Birdsall, if I have still got some time here. I wanted to ask Nancy about an issue.

What does the G–20 commitment to governance reform, in other words, allowing developing countries to have a greater voice in the IMF and other international financial institutions, actually mean, because it seems to me what it means is that the U.S. clout would obviously be diminished, and I guess my concern here, do we want to willingly diminish that influence in this regard, because many of the countries that we would be giving that power to aren't necessarily after the same objectives that you are after, Doctor.

I am just thinking about rule of law issues, trying to get independent courts set up in different countries. We have leveraged a lot to try to bring the rule of law, and that is resisted by a lot of governments of the developing world. Certainly, intellectual property is another issue, doing something about intellectual property rights. If you diminish our ability to leverage on the IMF and you empower, basically, those developing countries where you are trying to institute reforms, presuming for a minute that the values that we are trying to inculcate or develop are worthwhile, such as an independent court system, give me your take on that, Doctor.

Ms. BIRDSALL. Yes, I think the issue is the following: We need to bring countries like China into the club in a meaningful way, and in particular, into the clubs represented by the international financial institutions, the IMF and the World Bank. Why? First of all, by bringing them into the club, we are in a position to work with them and, in effect, push along their inclination increasingly to play a role of global stewardship along with us.

Mr. ROYCE. Doctor, I was involved in Africa as chairman of the Africa Subcommittee for 8 years, and I have to tell you, as we pushed and as Europe pushed engagement with Africa, the African Growth and Opportunity Act, conditioned upon the development of the rule of law, independent courts, the Chinese Government were sending the opposite message. They were telling African leaders, No, you don't want to go down that road. That is not in your interest, it certainly isn't in China's interest, where they were trying to sole-source—they weren't trying to open up markets and they certainly weren't trying to improve the betterment of sub-Saharan Africa, and I just have to share with you, I think your premise about bringing them into the club, they are in the WTO and they are trying to wreck the WTO, you know?

I mean, if they behaved in a responsible way on some of this, I think we could be sold, but I think their behavior convinces me that we are on exactly the wrong track if we bring them into the IMF and give them influence in the IMF when their goal is not the betterment of the developing world. It is taking resources from the developing world, subverting democratic process there, and pushing the idea of dictatorship, frankly, in African states. They have been very forceful about that.

Ms. BIRDSALL. Well, the current proposal is to increase their voting rights and their quota in the IMF from 3.5 percent, something like that, to 5 percent, so there is no way that the——

Mr. ROYCE. But collectively——

Mr. SHERMAN. The time of the gentleman has long since expired.

Mr. ROYCE. If you add all of this up, we lose influence there in a pretty big way, once you add all of the state actors up.

I am sorry, Chairman.

Mr. SHERMAN. A number of issues came up during the ranking member's questioning. First, as to North Korea being removed from the terrorist list, I introduced legislation immediately after the Congress was notified of that intention, to prohibit the administration from taking North Korea off the terrorist list. For a variety of reasons, that did not get a vote on the floor. Speaking of North Korea and the ranking member's question of what leverage we have, and Mr. Robinson, thank you for your excellent focus on their banking relationships, my fear is that any one of a thousand banks could act as a clearing agent for them, cash on the barrelhead, and that we need to focus, in addition to the banks, on their real, sole lifeline, irreplaceable lifeline, and that is China, and as long as China, which subsidizes the regime in North Korea, it will take all of your banking skill and then some to put any real pressure on that regime, and as long as China believes it can sell tennis shoes in the United States and subsidize the North Korean nuclear program at the same time, they will keep doing it.

One of the biggest fallacies is that because China holds our debt, they have power over us, and Americans are told, it is like your banker holding your mortgage. You better be nice to him. Well, imagine a world in which banks are prohibited permanently from foreclosing. Then the banker better be nice to you, and the fact is that in the world, the true power is those who control markets, and unfortunately, as a number of our witnesses have pointed out, the whole world has grown addicted to overselling into the U.S. market.

Now, Mr. Silvers, your Oversight Panel, I think, has pointed out that we need more regulation. That is a no-brainer, but the World Trade Organization Financial Services Agreement obligates the United States and other countries to refrain from placing limits on the size of financial institutions, to grant market access to all new financial products, as if we don't have enough derivatives out there, to not add new regulation in new areas, and these obligations are enforced through the WTO tribunals empowered to impose trade sanctions against countries, as if our trade relationship and trade deficit wasn't big enough.

Now, it is true that certain prudential measures are excluded from these WTO sanctions, but anything we did to protect consumers would not be, and the whole Doha Round is focused on further financial service deregulation. What steps should Congress take to make sure that our efforts at new regulation are not defeated? There is no way you can sell to Congress the idea that there shouldn't be regulation of Wall Street, so the way for the world economic elites to achieve their purpose is to disempower Congress, and one of the more clever ways to do that is through the WTO, a non-elected body that could impose trade sanctions against the United States if we dared to not follow their lead.

So, what do we do to make sure that Congress's efforts to get a handle on the need for new financial services regulation are not defeated by the World Trade Organization?

Mr. SILVERS. Mr. Chairman, a couple of thoughts about this. Initially, I am not as convinced as some are that some of what appear to be WTO limitations on Congress's power in this area are actually all that toothy, and I think that Congress has taken a number of steps since the enaction of various WTO non-tariff barrier provisions to effectively regulate aspects of our financial markets and corporate governance, and no one seems to have raised the WTO objection.

The basic structure of the, and I am not an expert on the WTO, but my understanding is that the basic structure of the way in which it remains possible to regulate national financial markets involves not just the language you cited, but also sort of extenuating national security circumstances, that sort of thing, in the WTO——

Mr. SHERMAN. Mr. Silvers, if I can interrupt, because I want to illustrate that the WTO is a truly toothless boogeyman used by—and this boogeyman is used to scare Congress.

Mr. SILVERS. Right.

Mr. SHERMAN. And that is, we could simply adopt the policy that if the WTO, if any country got trade sanctions against us, we immediately had double trade sanction against them. Now, if that double trade sanction was in violation of the WTO, they could take us to the WTO and get a triple trade sanction on us, so long as our statute said, that means we do a quadruple trade sanction on them, so we would make it clear that any country that disagreed with our financial regulation was free to end all trade with the United States, but otherwise should keep its mouth shut. That is how toothless the WTO is, except as a boogeyman to scare Congress into doing whatever the world economic elites want us to do.

Mr. SILVERS. And Mr. Chairman, I think that is precisely the point I was, perhaps in a more wordy way, trying to make, which is that I think it is a boogeyman, and I think that over time, both the Congress of the United States and legislative bodies in other WTO member states around the world have effectively both strengthened and weakened financial regulation, while subject to the WTO. I would point out, though, that clearly, my testimony states that it is the opinion of the National Director of Intelligence that the failures to effectively regulate our financial markets have contributed to the primary threat to this country's national security extant in the world today, in the opinion of the National Director of Intelligence.

So, to the extent that Congress agrees with the Congressional Oversight Panel that comprehensive re-regulation of our financial markets is necessary, there is clearly a national security purpose underlying it. Secondly, I would say that this boogeyman, frankly, goes to the need, both politically, but also substantively, to make sure that there is coordinated re-regulation of the financial markets globally, and this is why the global labor movement is so concerned that the G–20 language, in particular in respect to re-regulating shadow markets, which is where some of the most slippery actors here are and some of the greatest leverage exists in the world economy, that that language is not strong enough.

We need, and the Congress needs, to work very closely——

Mr. SHERMAN. Mr. Silvers, I am going to have to interrupt you, but one thing comes—I believe that we could create a report, I know Mr. Kearns would support this, that the hollowing out of our manufacturing sector is a grave threat to our national security, and I think that would have very strong validity in dealing with any action necessary to restore our national security, both in the financial and the manufacturing sector.

Turning to Mr. Kearns, according to a number of economists, including Simon Johnson, former Chief Economist of the IMF, the money that we are being asked to provide to the IMF, $109 billion together with a lot more money from other countries, is very likely to be used chiefly for bailing out European banks who have lost money, some $1.5 trillion, in Eastern Europe. Do you think that American taxpayers should provide the money, not to deal with the world's poor, but to bail out those banks that made $150 trillion in shaky loans to Eastern Europe?

Mr. KEARNS. I do not, Mr. Chairman.

Mr. SHERMAN. That is the easiest question I have asked.

Mr. KEARNS. The Europeans certainly, the European bankers certainly knew what they were doing vis-à-vis Eastern Europe, and you know, we have had a system for the, I mean, I entered the Foreign Service in 1977. I traveled in 80 countries. I looked at a lot of governmental systems, financial systems, etc., and I became convinced that there were many, many free-riding allies around the world who always depended upon the United States to take the leadership to transfer the technology, to license the co-production, to make the loans, to supply money to the institutions, and the sad fact is, as Mr. Scott pointed out, it took us until the first year of Ronald Reagan's administration for the national debt to hit $1 trillion, you know, and now I don't know what it is, $12-, $13-, $14 trillion.

We don't have the money anymore to do this. I don't think it is our——

Mr. SHERMAN. Let me squeeze in one more question.

Mr. KEARNS. Yes. I don't think it is our responsibility.

Mr. SHERMAN. And that is, I believe the IMF played a major role with the financial crisis in Asia. Is it not true that one of the effects of their intervention in the Asian financial crisis was to force those countries to have undervalued currencies, which they kept undervalued for many years? Haven't undervalued Asian currencies hurt the United States by causing a huge and persistent trade deficit with those Asian countries, and contributed to the loss of 4 million manufacturing jobs here in the United States?

Mr. KEARNS. Another softball, a grapefruit over home plate, Mr. Chairman. They have. China competitively devalued in 1993 and 1994. Those led to other devaluations in East Asia. Certainly many of the countries that China scooped business from with their devaluation were a lot more closely aligned with the United States and more friendly to our foreign policies and security policies, etc., so East Asian mercantilism is a massive and major problem, and the world is not going to get better, the financial crisis is not going to heal, until we do something about it.

Mr. SHERMAN. And Mr. Silvers, do you have a brief comment on that, or do you generally agree with Mr. Kearns?

Mr. SILVERS. Oh, I agree. I think, Mr. Chairman, you stated it accurately.

Mr. SHERMAN. With that, let me recognize the gentleman from Arkansas, and during this period, I am going to ask the vice chair to chair for the next 5 minutes.

Mr. BOOZMAN. Thank you, Mr. Chairman. I would like to, and we will start with Mr. Kearns, but I would really like to get the panel's input. You mentioned about re-energizing manufacturing and things, and I think we all agree with that. The reality, though, is that we are in a 70 percent consumption, you know, market right now. We are way top heavy on financial services. We need to export a lot more goods and services, and yet, with the global economy the way it is, that is very difficult to do.

If I remember right, I read an article by Ms. Barshefsky, the trade rep in the 90s, and she was talking about the fact that 17 nations, including the United States, had already started, you know, the "Buy America," the equivalent of that in their country, and that trade might be down as much as 10 percent. So, again, I would like to hear your all is kind of take as to where we are going in the future and, you know, what the deal is.

Mr. KEARNS. Well, I think—may I go first?

Mr. BOOZMAN. Yes.

Mr. KEARNS. If you take a look at the import penetration statistics of the U.S. market, they are really dramatic, and they are worsening. That is, foreign countries and foreign companies' share of major industries, major industrial categories, sectors in the U.S. economy. So I think the first thing that we have to do is not so much worry about exports, but worry about retaking those percentages in our home market. We have the world's vastest market. It is the market we know the best. We don't have state-to-state regulations that confuse us. So let us make sure that we are the ones making the products here that Americans want and need——

Mr. BOOZMAN. So would you exclude other products in an effort to do that?

Mr. KEARNS. Well, I would certainly, you know—there is the myth of the level playing field, and I went to Frankfurt as a commercial officer in 1977 in the Foreign Service, and so I have been doing this 32 years and I haven't found a level playing field yet, and it is impossible for U.S. companies to compete against foreign VATs, foreign subsidies, foreign dumping, IP theft, you know, and on and on and on, without strong government actions. So, if it were up to me, I would use Article XII of the GATT and I would declare a balance of payments emergency, and I would put in tariffs, I would put in a border-adjustable surcharge for currency manipulation.

I think the time for talking to these foreign nations and trying to get them to agree over some series of years to do what we want them to do is impossible. The previous administration talked to the Chinese about increasing domestic demand and following a different model, and they were stiffed every time a Treasury secretary went to China, so let us concentrate on our home market and take back a good percentage of that.

Mr. BOOZMAN. Ms. Birdsall?

Ms. BIRDSALL. Yeah, I would just like to disagree with the thrust of what Mr. Kearns is saying. I think the issue is that we need to have a mechanism to ensure enhanced demand abroad. We have to have stimulus, not just in this country, but around the world. The fact is that China has done a relatively large stimulus package in order to increase domestic demand. The fact is that China, it is increasingly subject to the worry about the overall global imbalance. It is trying to find ways, given its political constraints, which are problematic, admittedly, to move away from an export-driven mercantilist approach.

It is also true that the IMF was unable to discipline China on the foreign exchange side. It was equally unable to discipline the United States on its fiscal side, so we have a world in which it is absolutely critical that the U.S. retain its leadership in pushing for collective action that deals together with our allies and partners on these problems. If we start threatening here and there, you know, we are going to do this, we are going to get ourselves into a big problem.

We are the masters of the universe in terms of knowing how to exploit an open, global, a liberal trading environment, and one part of that package has to be provision of collective insurance through institutions like the IMF and the World Bank so that developing countries and the rising, emerging markets don't go the mercantilist way, don't try to self-insure by accumulating reserves and doing all the saving, so that we are having to do all the buying and borrowing.

We absolutely have to retain the leadership we have had for 50 or 60 years in creating a system of collective insurance and appropriate collective action, bring China into the global community on these financial issues. Thank you.

Mr. BOOZMAN. Mr. Miller?

Ambassador MILLER. Thank you very much. I also want to disagree strongly with Mr. Kearns. I think the kind of restrictive and protectionist measures that he is proposing would set back growth and productivity in the United States and around the world tremendously. He is talking about re-creating a trading and commercial and production system that we might have had in the past, but the jobs that we need here in the United States are the jobs of the future, the jobs in new sectors, the newly created jobs that will happen in an open environment.

So, I think it would just be very tragic indeed to start to build walls around the U.S. economy and say, you other countries stay out, because that is going, in the first instance, to hurt American consumers tremendously who are benefitting, the average family of four benefitting by about $10,000 each year due to the open trading environment in which we participate. So you are going to have that problem and then you are also going to have the problem for U.S. manufacturers who depend on the imports of intermediate goods in their own manufacturing processes, and if we put tariffs on those goods coming into the country, then our manufacturers aren't going to be able to produce the finished products in a competitive way and our productivity will go down, our wages will go down, it is going to be bad for Americans in every aspect.

Mr. SHERMAN. The time of the gentleman has expired. I now recognize the gentleman from Virginia.

Mr. CONNOLLY. I thank the chair, and I would like to ask a number of questions, if we could be concise in our answers to the extent that is possible.

Let me start with you, Dr. Birdsall, and I so much appreciated your citation of China, because actually, the stimulus in China seems to be working. By the way, Ben Bernanke, the Federal Reserve Bank chairman here in the United States, announced to us last week at a luncheon that he believes that the stimulus here is working, and he is not a wild-eyed liberal, the last time I checked. Should we be concerned at the cleavage between the United States and some of its close allies, Germany and France to wit, on the issue of economic stimulus at this time?

Ms. BIRDSALL. Yes, I think we should continue to press the Europeans to increase their stimulus packages. We also have to recognize, however, that they have more automatic stabilizers built into their system because of their different and stronger social safety net, and I believe in the next year, as unemployment increases, for example, in Germany, and it will, because it is been kind of, employment has been propped up up until now, but as this thing unfolds and unemployment increases, their effective stimulus spending will increase automatically because of the safety net on unemployment.

So, you know, it is a back and forth. There are some estimates that suggest that because of their automatic stabilizers, their stimulus has been, in effect, 2 percent of GDP already. I think it could be more, it should be more. I think it is a problem, and my understanding is, my assessment is that the Treasury and the administration have been pressing hard on that and will continue to do so.

Mr. CONNOLLY. Thank you. By the way, in that same conversation, Chairman Bernanke was asked about inflation, the stimulative bills and growing deficits, do they have an inflationary impact down the road? What he said was that in looking at projections over the next 10 years, the assumption is 2 percent or below inflation for the next decade, that there are no signs in the market right now of anyone being worried about inflation. Would you all concur? Mr. Silvers?

I don't mean to suggest he said there is nothing to worry about. He was looking at data that said, there are no indications of the market suddenly in year 4 or 5 getting panicky about inflation.

Mr. SILVERS. Right. I mean, I would hate—I am not qualified to second-guess the chairman of the Fed on this question. The only thing I would be concerned about is that long bond interest rates are rising, and perhaps Mr. Bernanke knows things about that that I don't. I am perfectly willing to submit that. I would just point out something in relation to your last question, if you will indulge me.

Mr. CONNOLLY. Of course.

Mr. SILVERS. The labor movements in Europe, in the Euro zone, I think share your view of the need for further stimulus spending on the part of Euro zone governments. That is a key element of my testimony today.

Mr. CONNOLLY. Okay. If I may move to another subject, and invite any of you to speak up, how important is the new arrangements to borrow, and how important is it for the United States to participate? Ambassador Miller, do you want to start?

Ambassador MILLER. Oh, well, I probably don't have the same view as Dr. Birdsall. I don't think it is very important at all. I think it is important for the U.S. to participate as an equal partner in these international institutions. They do good, on average, but they are not essential to the workings of the world economy, and the amounts of money that are given to other countries, are provided, loaned, actually, to other countries through these programs, are very small compared with the amounts of capital that are moving through the private sector through flows from trade, financing that through foreign direct investment in the United States, through the purchase of government securities of the United States by other countries, so these are really very modest amounts of resources that are being provided through these international organizations, so in the global scheme of things, it is not that important.

On the other hand, it is important for the U.S. to be a good international citizen, and that means that we do need to participate on an equitable basis with other countries of the world, and in the case of the IMF, which hasn't had an increase in its resources in a very long time, it may be that some sort of increase is in fact appropriate right now.

Mr. CONNOLLY. Dr. Birdsall?

Ms. BIRDSALL. Yeah, I think it is useful to remind everyone that the Europeans and the Japanese are also contributing $100 billion, that the Japanese contributed $100 billion earlier. It is very important to participate, both as a good global citizen and also because this is the moment when in many developing countries and emerging markets, the private flows aren't happening. There is capital withdrawals. There is, remittances are declining, trade flows are declining, so the whole point is for the international institutions to play a counter-cyclical role and to be there when the private money is insufficient, and to play the stimulus role that, within the domestic economies, additional deficit spending plays. Very important for our prosperity, our security, securing demand abroad, our exports, all of the other things that some of the other witnesses have applauded, in order to secure our place, our continued leadership as a trading partner and as a global citizen.

Mr. CONNOLLY. My time has expired, Mr. Chairman.

Mr. SHERMAN. Thank you. I now recognize the gentleman from Illinois, a strong advocate for U.S. manufacturing and small business.

Mr. MANZULLO. Thank you. I am late here because we were attending a press conference because of what one of our state-owned enterprises, General Motors, is doing to the dealers. I have been going over some of the testimony, and I think there are some structural issues with the IMF that need to be addressed. Is anybody here familiar with the G–20, the Global Plan for Recovery and Reform of 2 April of this year? I have got a copy here and as I read this, I am absolutely shocked, and I sit in shock and awe that money would go to an organization that could state such things as, "We start from the belief that prosperity is indivisible."

Well, forgive me for the United States wanting to be profitable. Apparently, everything we have to do in this world is to make sure that every Third World country, and every country, has the same prosperity that we do. I am a citizen of the United States and not of the world, and I think we have to take that into consideration in dealing with international bodies, that part of being an American is that we want to prosper and we owe no apology for that.

But as you get into this agreement, especially paragraph 15, where it talks about taking the Financial Stability Forum, giving that teeth, turning that into the Financial Stability Board, to give it, among other powers, to endorse and implement the FSF's tough new principles on pay and compensation and to support sustainable compensation schemes and the corporate social responsibility of all firms. Mr. Kearns?

Mr. KEARNS. Yes, sir.

Mr. MANZULLO. Does that shock you?

Mr. KEARNS. Well, Mr. Manzullo, you and I have done business on manufacturing for a number of years now, so——

Mr. MANZULLO. Right. Nothing shocks you anymore.

Mr. KEARNS. I have said before you came in several times——

Mr. MANZULLO. And I have voted for every free trade agreement, but we still agree on maintaining the manufacturing base in this country.

Mr. KEARNS. Yeah, well, I think we have come to an end, and I think that there is no, you know, there is no easy solution. Prosperity can't be shared. The notion that we can pass some stimulus bills and talk our friends and allies and some non-allies into stimulating their economies and everything is going to come out fine, after we have been on this, you know, consume, borrow, spend, binge for the last 10 years, is irresponsible, and——

Mr. MANZULLO. Does anybody else want to comment on that? Ambassador Miller, then Dr. Birdsall?

Ambassador MILLER. Thank you very much. I think the important issue here is to remember that we don't operate in a zero sum game in the international economy. Doing something that is good for the United States doesn't mean automatically that we are doing something bad for another country.

Mr. MANZULLO. That is correct.

Ambassador MILLER. Of course, in all circumstances, we need to do what is absolutely best for the United States, but in most cases, the vast majority of cases, that is going to mean doing things that are also good for other countries, not in the first instance, but as a result of doing things that are good for ourselves, so this really is a case where we can have win-win solutions for everyone in the world if——

Mr. MANZULLO. But what about these words?

Ambassador MILLER. Well, I think the words are problematic, certainly the words corporate social responsibility and the talk about compensation and corporate pay compensation. That is very problematic, but that is also a rhetorical flourish, I think, on the part of the leaders there. What we are talking about is a consultative forum in this case, and if it started indeed to go beyond words, I would be extraordinarily concerned, but——

Mr. MANZULLO. Yeah, but wars start with words. Policies start with words.

Dr. Birdsall?

Ms. BIRDSALL. I just participate in the statements of Ambassador Miller, on both counts. It is a consultative forum. I think it was probably done to satisfy the Europeans in order to have greater strength on some other——

Mr. MANZULLO. But the European Central Bank has come out against funding more money to the IMF.

Ms. BIRDSALL. The main thing that I would say is, on this issue of prosperity is indivisible, that my sense is that the idea is that that is a both, or more importantly, a statement of fact, a positive as opposed to a normative statement, with which I would agree, that we are better off here when others are better off there.

Mr. MANZULLO. But that is not what it says. I mean, what Ambassador Miller just says, that when the United States prospers, then the world prospers. Maybe not in the first round, but somewhere down the line because of the creation of wealth, of the utilization of foreign materials, the import of foreign materials, for example, into manufactured products here in the United States, but what bothers me is that we are supposed to sit back, write all kinds of check to the IMF, and when you see what the leaders of the Group of 20, and this was signed by the Group of 20—Spain signed it individually. I mean, they have been in their own world for years, but we can deal with international bodies responsibly, but what I don't like is when the socialists tweak the language, then they turn to America for the check.

That bothers me more than anything, and also what bothers me is the fact that in one of the statements, I think that you made, Dr. Birdsall, is the fact that, on page 9, "Monitor but don't micromanage further IMF reforms. Further and deeper governance reforms are needed at the IMF, but I worry that the tendency for Congress to dictate what the IMF can and cannot do undermines the U.S. role in global institutional decision-making and ultimately weakens the effectiveness of the IMF."

The one who writes the check, and we write most of it, I believe, should have the opportunity to dictate the rules under which that check is spent.

Ms. BIRDSALL. May I respond briefly?

Mr. MANZULLO. Of course, absolutely.

Mr. SHERMAN. Let Dr. Birdsall respond and then the time of the gentleman has expired. Go ahead, briefly.

Ms. BIRDSALL. I think we are talking about a package, to be concrete, which will cost the American taxpayer, at the most, $5 billion, which will trigger—our contribution will leverage $500 billion to ensure that there is prosperity, to increase the likelihood that there will not be catastrophic economic losses elsewhere which would bounce back like a fire to hurt us. So, that is the way I think of it. It is $5 billion. Let me point out that in the context, for example, of the IMF and the World Bank, U.S. contributions, except for these special things that the IMF are virtually, they are not there, except for this sort of special package, the NAB, and at the World Bank we are no longer the largest single contributor to the soft money window.

So, we are losing our leadership. We are losing our leverage. We are losing our influence. We are losing our ability to take the normative positions that I think all of you support, because we are not making the financial contributions that we should.

Mr. MANZULLO. Thank you.

Mr. SHERMAN. Thank you. I just want to correct the record factually. The most we could lose to the IMF is $109 billion. There is a small risk that we will lose something, and the CBO has in effect said there is like a 5 percent risk of us losing the whole $109 billion, not a risk to only $5 billion. I would also point out that the leverage depends upon whether other countries do what their leaders said they would do, which may or may not occur in light of the action that Mr. Manzullo points out was taken by the European bank.

With that I yield to the woman from California.

Ms. WATSON. Thank you so much, Mr. Chairman. I will just throw this out, maybe one of you would like to respond. Please do so. Both the World Trade Organization and the World Bank have been monitoring trade restrictions proposed and adopted since the beginning of the financial crisis. However, they have come to different conclusions concerning the number of anti-dumping cases in 2008, with the World Trade Organization finding that there has been no dramatic increase and the World Bank finding that the number surged in 2008.

Has any effort been made to resolve the differences between the two reports, and anyone who might have information, can you respond, please? Okay, Dr. Birdsall?

Ms. BIRDSALL. I don't know the answer to your question whether there has been any effort to reconcile the two, but I think that it is probably important to recognize that it is healthy to have this robustness and some redundancy in these assessments by the international institutions in which the U.S. is a member, and it is probably useful to assume that the greater estimates that the World Bank has put out are an important warning signal that we are on the brink, potentially, of a trade war, and the U.S. needs to take leadership in ensuring that that doesn't happen.

Ms. WATSON. Let me address this one to Mr. Robinson. Do you believe that these full payments to foreign banks such as Société Générale and the Deutsche Bank and Barclays were a proper use of Federal funds AIG received, and do you believe that not paying these counterparties at a rate of 100 percent would have posed a systematic risk to the global economy, and is there a more appropriate mechanism for providing needed capital to foreign AIG counterparties?

Mr. ROBINSON. I would associate myself with the chairman's remarks in that respect, in the sense that the irony of the AIG banks being made whole 100 cents to the dollar is scandalous at some level, that is for sure, and it seems to me that that was not indicated or required. There is certainly, in the case of Société Générale and others, and we do have a list of those banks that have been, obviously, recipients of U.S. Government or taxpayer largesse, that as I may have mentioned in my testimony, there is a dearth of due diligence on the security-minded or security-related side of that equation as well. Again, some of these banks have international activities, including partnering with Tehran and a number of other terrorist-sponsoring states, that almost certainly was never looked at when the due diligence was performed as to these recipients, and we have never really had a security-minded conditionality in global finance for this country until over the last couple of years, and this was surfaced by still just a handful of folks in the United States, the chairman among them, who are intent on trying to get a better handle, not only on where our money is going and how it is being used, but some sense of fair play, which this does not represent, given the risk that these investors knowingly took in going into AIG.

It is, as I say, you know, in my humble opinion, scandalous that they would be made whole in the way they have when you compare it to those bondholders, for example, in Chrysler. I think that was the illustration that the chairman used. So, I have problems with this particular issue, and I also believe that, I hope that we will more systematically, when we are doing due diligence in the broadest sense of the term, we will finally, at long last, include our national security as a plank or standard operating procedure, if you will, for that kind of due diligence.

Ms. WATSON. Mr. Chairman, a colloquy with you, I have about 5 more seconds.

Mr. SHERMAN. Oh, absolutely.

Ms. WATSON. Okay. Is it possible that we could hold a hearing, then, to see where these dollars go and taking in the security aspect? I think we need to pin that down. We don't want to repay these banks and they are supporting the proliferation of arms in Iran or wherever, and I think we need to zero right in and see if we can start a trail and find out just where. Can you respond, please?

Mr. SHERMAN. Well, I think we have, in this committee, focused on what happens to United States money, both private and public sector, and how that affects our efforts against terrorism and nonproliferation, and in my opening statement I focused on how we put money into AIG and they then immediately, I mean, it was seconds, wired many billions of dollars to a French bank that is actively engaged in banking with Iran.

Ms. WATSON. If we could zero right in and just hold a hearing to really trace and then see what we need to do in order to secure these funds—one of the things I understand that is being considered with North Korea is cutting off the funding that would circumvent and, you know, go to North Korea, that is feeding their nuclear proliferations. So, I think we need to do a little more, and I was hoping that maybe we would have a hearing to trail, trace.

Mr. SHERMAN. We have focused on that a bit in this hearing. I look forward to covering it in other hearings, and I am relying on the witnesses to let us know whether they have the pithy information. It is not enough for us to have a hearing because we have got very interesting questions. We have to have some reason to think that you folks can come up with interesting answers. So, I see Mr. Robinson nodding his head, and we will certainly check to see whether we can put together a panel that will focus exactly on——

Ms. WATSON. I yield back.

Mr. SHERMAN. Yes. I am going to do a short second round here, basically because Mr. Robinson hasn't gotten enough questions, but before I do, I want to once again paraphrase the Congressional Research Service when they stated, the most effective way that Congress can influence U.S. policies toward international financial institutions is by attaching enforceable conditions to new funding agreements, and it strikes me that if we pass a bill providing $109 billion to the IMF with not a single enforceable condition, then we are not in the business of influencing U.S. policy toward multinational financial institutions, which begs the question, why do taxpayers have to pay money to keep the lights on in this room?

I would think that if Congress doesn't want to be influencing U.S. policy toward multinational financial institutions, the whole idea of having this committee, this subcommittee, etc., is called into question. Now, Mr. Robinson, for 13 years, we have had on the books, well, it is been on the books for longer, but for 13 years, no administration has identified a single company that has invested over $20 million in the Iran oil sector.

As you know, the Iran Sanctions Act requires that the administration name and identify such companies, and then either impose sanctions or waive those sanctions with an explanation as to why they are being waived. The convenient approach taken by the last two administrations, and this administration may still be reviewing the policy, but it is at least continued for the last 136 days or so, is to simply never see such a triggering transaction.

Could you identify for us just a couple of the clearest investments in the Iran oil sector of more than $20 million of the type directly described by the Iran Sanctions Act? And I realize I am hitting you with a specific here. My guess is that you can answer now, if you can't, I will ask you to answer for the record, but go on.

Mr. ROBINSON. I have some recollection of such companies. If you go back in time to what was then the Iran-Libya Sanctions Act, and the waiver program, which became a kind of program, an automatic waiver, commenced, as you might recall, with, I believe it was Total, the French oil giant, and Gazprom of Russia. They have remained active in Iran and in some cases other terrorist-sponsoring states. If you look at Sinopec, which is traded on the New York Stock Exchange, as I recall, they have about a $100 billion deal in Iran that certainly qualifies for over the $20 million mark of the legislation.

If you look at Royal Dutch Shell and, I believe, BP—I am starting to run out of off-the-cuff examples, but I would underscore that there are a number of very prominent firms that are technically in violation of the Iran Sanctions Act today, and as that bill has been expanded somewhat to move beyond the oil and gas sector to some of the downstream operations, this number of companies will increase.

Mr. SHERMAN. I believe most of those are legislative proposals that were opposed and blocked in the Senate by the former administration. So let us not count our legislative achievements before they are signed into law.

Mr. ROBINSON. Needless to say, I think it is moving in that direction, and again, the signal that is being sent internationally is clear, which is that you can invest in Iran's strategic energy sector with impunity and there is not an executive branch on either side of the aisle who has been willing to step up to sanctions enforcement.

Mr. SHERMAN. Or to even—as you point out, there was—first of all, it was once the Iran-Libya Sanctions Act, we enforced it against Libya, we had some international support in similar sanctions on Libya, and it worked so well, Libya gave up its nuclear program, and we took them out of the act. So, the act was remarkably successful when applied. It is now the Iran Sanctions Act. You describe a period of time more than 13 years ago when administrations would at least identify the company making the investment, name and shame, and they would at least follow the law, even though the law allows them to limit their sanction to naming and shaming and to waive all other sanctions, and what we have experienced for the last 13 years is an executive branch that deliberately violates American law for the purpose of protecting Iran's business partners, which shows you that the values of the world economic elite sometimes take precedence over not only American values, but even American law.

I will ask you to furnish for the record, not the biggest investments over the last 13 years, but those that are most clearly provable, because sometimes there is an announced investment in Iran that may or may not reach the point where it constitutes an investment as defined by the law. So the issue here is not what is the biggest, flashiest announcement, but what is the most provable investment of over $20 million, and I would ask you to furnish at least one example during the last few years of the Clinton administration and at least two examples during the Bush administration, and perhaps you can furnish one or two examples of things that are continuing, because something can be an investment during the Bush administration but also be an investment during the Obama administration as well, and when I refer to the Bush administration, I mean the second Bush administration, not going back to the 80s.

I have got so many questions here, but we have gone long. I don't know whether my colleague from California has any additional questions.

Ms. WATSON. No. Thank you.

Mr. SHERMAN. I think we have, consistent with the President's declaration that America does not torture, we should let our witnesses go. Thank you very much.

[Whereupon, at 3:13 p.m., the subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

SUBCOMMITTEE HEARING NOTICE
Committee on Foreign Affairs
Subcommittee on Terrorism, Nonproliferation and Trade
U.S. House of Representatives
Washington, D.C. 20515-0128

Brad J. Sherman (D-CA), Chairman

June 3, 2009

TO: MEMBERS OF THE COMMITTEE ON FOREIGN AFFAIRS

You are respectfully requested to attend an OPEN hearing of the Subcommittee on Terrorism, Nonproliferation and Trade, to be held in **Room 2172 of the Rayburn House Office Building:**

DATE:	Wednesday, June 10, 2009
TIME:	1:00 p.m.
SUBJECT:	Foreign Policy Implications of U.S. Efforts to Address the International Financial Crisis: TARP, TALF and the G-20 Plan
WITNESSES:	Nancy Birdsall, Ph.D. President Center for Global Development Mr. Kevin L. Kearns President United States Business and Industry Council Mr. Roger Robinson, Jr. President and Chief Executive Officer Conflict Securities Advisory Group (*Former Senior Director of International Economic Affairs at the National Security Council*) Damon Silvers, Esq. Associate General Counsel American Federation of Labor and Congress of Industrial Organizations (*Deputy Chair of the Congressional Oversight Panel*)

The Honorable Terry Miller
Director
Center for International Trade and Economics
The Heritage Foundation
(*Former Ambassador to the United Nations Economic and Social Council*)

By Direction of the Chairman

The Committee on Foreign Affairs seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202/225-5021 at least four business days in advance of the event, whenever practicable. Questions with regard to special accommodations in general (including availability of Committee materials in alternative formats and assistive listening devices) may be directed to the Committee.

COMMITTEE ON FOREIGN AFFAIRS

MINUTES OF SUBCOMMITTEE ON *TNT* MEETING

Day *Wednesday* Date *06/10/09* Room *2172*

Starting Time *1:06 p.m.* Ending Time *3:14 p.m.*

Recesses ☐ (_____ to _____)

Presiding Member(s) *Mr. Sherman*

CHECK ALL OF THE FOLLOWING THAT APPLY:

Open Session ☑
Executive (closed) Session ☐
Televised ☑

Electronically Recorded (taped) ☐
Stenographic Record ☑

TITLE OF HEARING or BILLS FOR MARKUP: *(Include bill number(s) and title(s) of legislation.)*

Foreign Policy Implications of U.S. Efforts to Address the International Financial Crisis: TARP, TALF and the G-20 Plan

SUBCOMMITTEE MEMBERS PRESENT:

Mr. Sherman, Mr. Scott, Mr. Connolly, Ms. Watson, Mr. Royce, Mr. Manzullo, Mr. Boozman

NON-SUBCOMMITTEE MEMBERS PRESENT: *(Mark with an * if they are not Members of HIRC.)*

None

HEARING WITNESSES: Same as meeting notice attached? Yes ☑ No ☐
(If "no", please list below and include title, agency, department, or organization.)

STATEMENTS FOR THE RECORD: *(List any statements submitted for the record.)*

Statements of the Witnesses

ACTIONS TAKEN DURING THE MARKUP: *(Attach copies of legislation and amendments.)*

RECORDED VOTES TAKEN (FOR MARKUP): *(Attach final vote tally sheet listing each member.)*

Subject	Yeas	Nays	Present	Not Voting

TIME SCHEDULED TO RECONVENE ______
or
TIME ADJOURNED *3:14 p.m.*

Subcommittee Staff Director

COMMITTEE ON FOREIGN AFFAIRS
SUBCOMMITTEE ON TERRORISM, NONPROLIFERATION AND TRADE
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

Donald A. Manzullo (IL-16)
Opening Statement

July 9, 2009

Mr. Chairman, thank you for calling this important hearing to examine the Export Administration Act (EAA). Congress must pass an updated EAA that is relevant to the both the needs and threats of the 21st century, and we can't begin soon enough. Fundamental reforms to our nation's export control system are necessary for both our national security and our global competitiveness, and I truly believe we are facing a rare opportunity to accomplish measurable progress in export control reform.

As you well know, the EAA has not been updated since the end of the Cold War despite several attempts by Congress. New threats to our national security have emerged over the past 15 years while, unfortunately, our primary control regime for dual-use items has remained focused on protecting technology transfers to the defunct Soviet empire. The U.S. government must establish an export control policy based on clearly defined national security and foreign policy priorities that also recognizes the realities of a global supply chain and encourages legitimate trade. It is clear that overly broad controls are actually detrimental to U.S. national security interests as well as our overall global competitiveness.

When we talk about dual-use items adversely affected by export controls, I can think of no better – or more timely – example than thermal imaging cameras. We all know that night vision equipment is vital to America's operations in Iraq and Afghanistan and is a key component to our defense superiority. There are also growing commercial applications for thermal imaging cameras, from checking the structural integrity of railroad tunnels to screening people for infectious diseases. But global market share for U.S. thermal imaging companies has fallen significantly in the last few years because of overly broad and restrictive controls.

These technologies and products are readily available in other countries that do not unnecessarily restrict the sale of these products, and the end result has been the loss of technological "know how" and leadership of U.S. companies to foreign competitors. The continued loss of U.S. leadership in producing these technologies could irreparably damage the U.S. defense industrial base and pose a permanent threat to our national security if we are forced to rely upon foreign governments for our most basic defense technologies and supplies.

Last September, BIS initiated a review – at the request of one of department's Technical Advisory Committees – of the export controls on certain thermal imaging cameras and assessed their foreign availability. Recognizing this growing foreign availability, BIS issued a final rule just last month that revises the export licensing requirements for certain thermal imaging cameras. While imposing license requirements on exports that incorporate certain thermal imaging cameras, the new regulations removed Commerce Control List (CCL)-based export and re-export license requirements for 36 destinations – mostly European countries – for certain thermal imaging cameras, with a couple of caveats.

I hope they will take similar steps in the near future on machine tools. One company that I represent in the 16th District of Illinois is losing sales right now to foreign competitors that don't have to struggle with system like ours.

The authorities under the EAA officially lapsed **eight** years ago during the last major attempt to pass export control reform. Since then, any attempts to reauthorize and modernize the system have failed because of entrenched views held by one stakeholder or another. Congress, the Administration, and industry all seem to agree, though, that the current system does not adequately meet U.S. foreign policy, national security, and economic objectives.

Recent efforts to reauthorize the basic EAA statute without any underlying reforms other than enhanced penalties have not gone far enough to address the realities of business in the 21st century. The proposal by Senate Banking Committee Chairman Chris Dodd last year, for example, concentrated on the need for higher penalties and greater enforcement authority without addressing other much-needed reforms. I support expanded enforcement authorities to the Commerce Department's Bureau of Industry & Security (BIS), but these higher fines and penalties can only be part of the solution. I am concerned that moving a narrow EAA reauthorization bill will satisfy just one faction of the stakeholders interested in this issue; thus providing little incentive for them to negotiate other critical changes needed to update our export control regime. I believe that key elements of reform include:

- Removing all references to the Cold War, making the new export control system better able to respond to new threats to our national security – terrorism and the proliferation of weapons of mass destruction.

- Accounting for globalization by recognizing the increased role of civilian technology for military applications; and

- Making the Wassenaar arrangement a more effective multilateral export control regime by providing incentives in the form of defense technology sharing, re-export policies, and intra-company transfers if member countries develop a more strict export control regime, perhaps starting with the United Kingdom, Australia, and Canada.

If we can't find consensus on these concerns, a simple short-term extension like the one that passed the House in the 107th Congress, would be an appropriate template for a stopgap EAA reauthorization bill that would allow time for the stakeholders to come to an agreement on a comprehensive EAA rewrite. If we go this route, I will strongly recommend the creation of a commission – a public/private partnership – that will thoroughly analyze U.S. export control laws in the context of a more globalized society and deliver to Congress an EAA proposal that particularly accounts for foreign availability.

I would urge the committee to reject any EAA reauthorizations similar to the version introduced in the 109th Congress (H.R. 4572). Some of those penalty provisions could cause significant problems for small manufacturers who may make minor paperwork mistakes simply because they do not have the time to read the Federal Register every day. Many small businesses do not have the resources for an export control compliance department, and a $500,000 penalty could put them out of business.

The *Export Controls Improvement Act* – which I introduced last year with this subcommittee's Chairman, my friend Brad Sherman, and Adam Smith of Oregon – would address several of these concerns by expanding enforcement authorities for BIS and also mandating updates to the computerized Automated Export System (AES). This bill, which we will be reintroducing shortly, would strengthen our current trade controls by requiring the federal government to modernize AES, making the filing process for shipments abroad more thorough and significantly reducing unintentional illegal exports. The bill also creates an accountability system for export intermediaries and enhances prosecution of exporters who attempt to circumvent electronic blocks.

I'd like to take a moment to recognize the work of the Commerce Department for aggressively pursuing export control reform within their existing framework. I appreciate their attempts to illuminate and address issues of "design out," emerging technologies, deemed exports and intracompany transfers – among others – and hope to continue working alongside the administration as we fundamentally reform the export control system's statutes.

I greatly appreciate the opportunity to share my views and concerns today, and I look forward to working with my colleagues on the committee in crafting a good EAA reauthorization bill. Thank you again, Mr. Chairman, for convening a hearing on this vitally important topic.