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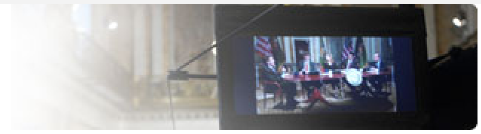

Remarks by Deputy Secretary Robert M. Kimmitt at the Virginia Military Institute

1/29/2008

A Department Transformed: Treasury's Role in National Security

Lexington, Va. – Thank you, Casey Brower, for your kind introduction, but moreover for forty years of support as a classmate and friend. And sincere thanks to the Virginia Military Institute for inviting me here to address both the Cadets and the wider VMI community.

– Thank you, Casey Brower, for your kind introduction, but moreover for forty years of support as a classmate and friend. And sincere thanks to the Virginia Military Institute for inviting me here to address both the Cadets and the wider VMI community.

It has been my honor to serve with VMI graduates in war and peace, in uniform and in civilian life. Your Superintendent, General Peay, was a fellow Field Artilleryman – indeed, he was my assignments officer when I returned from Vietnam. I envy you Cadets the years of service in front of you, whether in uniform or in the private sector. And, in addition to your faith and family, you can be sure of one constant source of support throughout your life – the classmates sitting around you today. In that connection, I would note that, in addition to General Brower, we are joined today by Colonel Red Taylor, both a West Point classmate and company-mate of mine.

I would like to talk to you today about the Department of the Treasury, one of our oldest and most respected federal institutions. When many of you think of the Treasury, I am sure you think about our most visible and well known functions: printing paper currency, minting coins, collecting taxes, issuing savings bonds, regulating national banks, and managing the economy. But especially since the tragic events of 9-11-2001, Treasury has gone well beyond these time-honored responsibilities and has begun to play an ever-greater role in protecting our national security. I want to make sure that this important audience knows about this transformed Treasury Department.

As I speak to you today, I am reminded of the counsel I received before going to Germany as Ambassador in 1991. My predecessor, Vernon Walters, passed along only one bit of advice: "Don't ever forget how important speeches are to the Germans. They like to give speeches, listen to speeches, and analyze speeches far more than is the case in the United States." He recounted a story of speaking once to a distinguished group like the one assembled here today. He spoke in his excellent German for 40 minutes and sat down, rather pleased with himself, only to have the host of the event stand and say, "Mr. Ambassador, thank you so much for your remarks. If you ever have time for a real speech, please come back to see us again." Well, if 40 minutes is when a "real speech" starts, my allotted 30 minutes only leaves me time today for "remarks," but I hope they will be remarks that give you new insights into your Treasury Department.

The U.S. Economy, Credit Markets, and Housing Markets

Before turning to Treasury's expanding role in national security affairs, I would like to say a few words about the state of the U.S. and global economies – an issue at the forefront of Treasury's agenda, and one that was a key topic of interest at the World Economic Forum in Davos, which I attended last week.

As the President said last evening in his State of the Union address, the U.S. economy is fundamentally healthy and is expected to continue to grow. A broad view of the economy shows that there are many signs of strength that will help keep it on a solid path. Real GDP growth was 4.9 percent in the third quarter of last year, supported by gains in consumer spending and business investment. Continued global economic growth is helping to boost U.S. exports, commercial construction is strong, and core inflation remains contained.

At the same time, growth looks to have slowed recently, and the U.S. economy is facing significant headwinds from housing, credit markets, and energy prices.

The correction we are currently experiencing in the housing market remains formidable, and was inevitable at some point after years of unsustainable home price appreciation. Housing has subtracted substantially from real GDP growth since the correction began in early

2006. Housing starts have fallen over 50 percent from their peak, and, nationwide, home prices are up just 2 percent over the past year. Some regions that experienced the highest house price appreciation are now seeing price declines.

Turmoil in credit and mortgage markets is also of concern. Fortunately, our financial institutions entered into this recent period with strong earnings and strong capital. They continue to be well-capitalized, and regulators are monitoring their status closely. These challenges will take time to resolve, and we are especially mindful of the risk that banks could reduce their lending to creditworthy borrowers.

Some of the incoming economic data are raising concerns about the health of our expansion, including reports that consumer spending is slowing. Also, while job creation in the United States continues, December saw a much more modest pace of growth. Although we saw the 52nd consecutive month of job increases, a U.S. record, the 18,000 jobs created in December were the smallest gain of that 52-month period.

Therefore, while I am confident about our long-term economic strength, there are short-term downside risks. For this reason, and at the direction of the President, the Administration is working closely with Congress to reach a bipartisan agreement to develop a short-term economic growth package that can be put in place as soon as possible to keep our economy growing and creating jobs this year.

After much hard work with House leadership, the Administration reached an agreement last Thursday on a package that is meant to be temporary, broad-based, and have an impact immediately. It includes measures to bolster business investment and consumer spending – both of which are critical to economic growth. The experience of the 2001 and 2003 tax cuts showed that providing tax relief to families stimulates the broader economy by boosting household spending. Furthermore, offering incentives to spur business investment will encourage businesses to expand and create new jobs. By quickly putting in place this short-term package, we can protect the strength of our economy as we weather the housing correction.

The Administration is also continuing to promote initiatives to minimize the impact of the housing market downturn on the economy. In the short term, we are focusing on the number of preventable foreclosures we can avoid. We must remember that the ultimate goal here is not the freezing of rates on as many mortgages as possible, but rather the prevention of foreclosures where we are able. This is how we will best measure success.

And we have made progress on two fronts. First, the HOPE NOW alliance, a private sector coalition of mortgage servicers, mortgage counselors, investors, and trade associations, has announced promising developments by stepping up the rate at which they are modifying subprime mortgages to stave off foreclosures. In fact, mortgage servicers modified subprime loans in the fourth quarter at a rate three times faster than in the third quarter. Second, the Administration's FHASecure program allows homeowners who have missed payments to refinance their mortgages. Of course, more needs to be done – including ensuring that we address the underlying causes to avoid a recurrence. We need to strengthen the oversight of the Government Sponsored Enterprises Fannie Mae and Freddie Mac, examine the role of credit rating agencies, and study issues such as the regulation of mortgage brokers.

The challenges before us are complex, and we are working hard to address the economy's short-term needs. But I want to reiterate that the U.S. economy is diverse and resilient. It has been remarkably robust in recent years and will be so again.

Evolution of Treasury

Even as we at Treasury work to address current economic challenges, a core Treasury responsibility since its founding, I cannot help but reflect on how the Treasury's role today has notably expanded from what it was during my first tour at the Department in the 1980s, when I served as Treasury General Counsel under Secretary James Baker and President Ronald Reagan.

During those years, the Treasury Department was only occasionally involved in high-level National Security Council meetings or the Administration's major policy discussions as they related to threats to our national security. Today, the growing interdependence of the global economy and our own economic interests around the world dictate a greater role for Treasury in national security issues.

At the outset, let me say that even after 30 years of working on national security issues at senior levels of the U.S. Government, I have never seen a definition of national security that is enduring and all encompassing, precisely because national security is a dynamic concept that adapts to changes in the world situation. National security meant one thing in the Cold War period from 1945-1991; quite another in the post-Cold War period from 1991-2001; and something very different again after September 11, 2001.

In my view, national security is defined best by its elements, which themselves will adapt over time. In short, national security is the summation of our foreign, defense, and international economic policies, all resting on a strong intelligence base. It is the growth in importance of the international economic policy component of national security that has been so striking over the past ten years.

As a result, Treasury now participates in 5-10 National Security Council meetings each month, as compared to maybe one a month when General Brower and I served together in the Reagan years. We contribute on the positive side of our agenda: that is, strengthening financial systems and contributing to the development of economies in difficult security environments such as those in Iraq and Afghanistan. We also have a punitive capability: using powerful new legal authorities to combat illicit financial activity perpetrated by countries such as Iran and North Korea.

Today I would like to discuss two specific areas that illustrate this evolution: Treasury's contribution to the development of the Iraqi economy; and our role in combating Iran's illicit conduct in support of terrorism and nuclear proliferation.

Iraq

Over the past five years, Treasury has played a major role in helping the Government of Iraq create a stable macroeconomic environment and build a solid foundation for economic growth. Of course, security remains the major challenge facing Iraq's young democracy. But economic progress contributes directly to the prospect of enhanced security and a better life for the Iraqi people.

An economy that is spiraling out of control – because of hyperinflation or plunging growth – undermines social cohesion and fosters civil unrest. This unrest plays directly into the hands of insurgents, who can exploit the Iraqi government's failure to provide economic security as a rationale for joining their efforts, thereby impeding or reversing the security gains that the Iraqi and U.S. military work so hard to achieve. As a result, the President and the National Security Council have looked to Treasury and other agencies to help promote the policies and provide the technical expertise necessary to support a stable and growing economy. Gains in achieving this goal have been significant and, in my view, underemphasized. Let me give you a few examples.

When Saddam Hussein was forced from power, Iraq's currency was becoming worthless, and counterfeiting was rampant. Consider how important a stable currency is to daily life – we need to know that the currency we hold will maintain its value. When people lose faith in their currency, as happened, for example, in Weimar Germany in the 1920s, the result is economic chaos. Moreover, they may try to replace their currency with more reliable substitutes, such as gold or foreign currencies, which only exacerbates the problem.

In 2004, Treasury helped the Government of Iraq develop a new currency. The introduction of the new Iraqi dinar required the printing of 2,300 tons of currency at facilities around the world, the shipment of this currency to Iraq via Boeing 747s, the circulation of this currency to 250 distribution points around the country, and the hand-to-hand exchange of the currency. About 2 billion banknotes have been successfully swapped, and the result has been a stable Iraqi dinar that is widely used by Iraqis.

High inflation was another major challenge – rapidly rising prices meant that more and more Iraqis found that their standards of living were dropping. Iraqi efforts in this area have resulted in another major success story: inflation has declined from 77 percent in mid-2006 to less than 5 percent by December 2007.

On the microeconomic level, we are seeing signs of progress, as well. For example, there has been a surge in registered businesses, which have jumped 500% post-Saddam, from 8,000 to over 40,000. We have also seen the advent of mobile technology, from almost zero to now 8 million cell phone subscribers, almost 1/3 of the Iraqi population. Similarly, there are now more than 260,000 internet subscribers, compared to an estimated 4,500 before the war.

The new government also inherited billions of dollars of Saddam-era government debt, many times more than Iraq could possibly repay. Imagine if you inherited credit card debt that was several times your annual salary. Without paying it off, you could not get new credit, and the debt would continue to build because of interest and penalties. In the case of Iraq, we helped the new government work out a deal with their creditors under which 80 percent of the debt was fully forgiven, and the remaining 20 percent paid off over several years. To date, 30 countries have concluded agreements providing debt forgiveness to Iraq worth $33 billion. As a result, Iraq is now on a much more financially sound footing, which in turn provides for a more attractive environment for international investors looking at opportunities in Iraq.

Treasury was also called upon to use its investigative expertise to lead the effort to identify and repatriate to the Iraqi people billions of dollars stolen by the Hussein regime. As a result of these efforts, we were able to identify and return more than $2 billion located in more than 500 bank accounts in 41 countries.

Treasury also continues to co-chair, with the Department of Defense, the Baghdad-based Iraq Threat Finance Cell (ITFC), whose mission is to enhance the collection, analysis, and dissemination of timely and relevant financial intelligence to combat the Iraqi insurgency. Since its establishment in late 2005, the ITFC has paid significant dividends to our war fighters. Senior U.S and Coalition military commanders have come to rely on the ITFC's analysis to help combat the Iraqi insurgency and disrupt terrorist, insurgent, and militia financial networks. For example, ITFC analysts and agents assist Coalition Forces in exploiting financial data captured on persons in raids in Iraq and identifying trends and patterns in insurgency financing.

To help build the confidence and support of the international community for the Iraqi economy, Treasury has also been involved in a major initiative called the International Compact with Iraq. I had the honor of serving as Presidential Envoy for this important initiative. Under the Compact, the Government of Iraq reached out to key partners in the international community to establish a collaborative process for developing policy commitments. These reform commitments will put the Iraqi economy on a path to self-sufficiency and sustainable growth, while also creating safeguards to protect the most vulnerable groups in its society. In return, the international community has continued to provide support in various forms, including debt relief, loans, grants, and technical assistance. The final Compact document was presented at a meeting in Sharm El Sheikh, Egypt, in May 2007 that was attended by over 70 countries and institutions and hosted by UN Secretary General Ban Ki Moon and Iraqi Prime Minister Maliki.

The Compact is important because it commits Iraq to a number of significant unifying principles, including the adoption of policies to ensure that all Iraqis benefit from the country's vast oil resources, important anti-corruption practices, and the protection of vulnerable citizens. All of these reforms will help achieve both economic and security objectives. Moreover, the Compact was unanimously endorsed by Iraqi Cabinet members from all of Iraq's communities – Shia, Sunni, and Kurds – establishing a clear consensus on the direction and strategy for realizing Iraq's economic potential.

Looking ahead, Treasury has several economic priorities in Iraq for the coming year, with budget execution a top priority. Slow budget execution – that is, failing to spend budgeted funds – means the Government of Iraq has been unable to provide essential services and capital investment in key sectors. As security has improved, however, Iraq's central government ministries and provincial governments have been able to increase their rates of spending on investment. As a result, the level of government investment in crucial infrastructure and services through September 2007 had already well exceeded the level for all of 2006. However, even more progress will be critical for building confidence in the Maliki government's ability to deliver essential services throughout the country.

Second, we want to help secure more debt relief for Iraq. Several major countries that made commitments to provide debt relief – such as Saudi Arabia and Russia – have yet to deliver. We want to make a final push to get this done by the end of 2008. This will enable Iraq to borrow money to finance its investments, something that is not currently possible.

Third, we are continuing to work with the Iraqis to implement crucial reforms outlined in the International Compact, such as bank restructuring, investment reform, and hydrocarbons legislation. These types of reforms are essential for making it easier for businesses – from small scale entrepreneurs to major international corporations – to invest in Iraq. This will create opportunities for job growth and give all Iraqis a stake in maintaining a secure environment.

Iran

Let me now turn to Treasury's role in U.S. policy toward Iran, where we have seen that, through a combination of targeted financial measures by governments and necessary vigilance and action by the private financial sector, we can put tremendous pressure on the support networks of illicit actors.

The Treasury Department has embarked on an initiative to alert the international community to the threat that Iran poses to the international financial system. Over the past year and a half, Secretary Hank Paulson, Under Secretary Stuart Levey, and I have met with our finance ministry and central bank counterparts from around the world to discuss the imperative of ensuring that the international financial system is not tainted or harmed by Iran's abuse. We have also engaged in unprecedented outreach to the international private sector, meeting with more than 40 banks around the world to share information and discuss the risks of doing business with Iran. And we have implemented targeted financial measures against Iranian banks, entities, and individuals engaged in illicit activities.

Diplomatic efforts have also resulted in two unanimous United Nations Security Council Resolutions targeting Iran's pursuit of nuclear capabilities and ballistic missiles. And last October, the world's premier standard-setting body on anti-money laundering and counter-terrorist financing – the Financial Action Task Force – issued a public statement confirming the extraordinary risks to the financial system that accompany doing business with Iran. Further, the Task Force issued an advisory identifying customers and transactions associated with Iran as representing a significant risk factor for financing the proliferation of weapons of mass destruction.

The private sector plays an essential role in this effort. By proactively going beyond their legal requirements to avoid risky business with money launderers, proliferators, and other illicit actors, the international banking sector is augmenting government-imposed measures to isolate these actors financially. Financial institutions do not want to risk their reputations by dealing with such customers, and they understand the dire consequences to their business should they engage in such activity.

We are beginning to see the isolating effect that financial pressure can have on the Iranian regime as the international community counters Iran's financial support for terrorism – a cause to which Iran dedicates hundreds of millions of dollars each year – and its pursuit of nuclear capabilities and ballistic missiles. We have been sharing information with government and private sector leaders about Iran's deceptive use of the financial system to try to hide its support for these dangerous activities from the law-abiding international community. Many financial institutions worldwide have recognized this risk and have dramatically scaled back or cut off altogether their dealings with Iran – in all currencies.

This financial pressure is amplified by the Iranian regime's economic mismanagement. President Ahmadinejad has failed to deliver on his promises to improve the lot of average Iranians, which is having real consequences:

- Unemployment and inflation rates are up: the regime claims their unemployment rate to be only 11%, whereas most independent experts estimate it to be double that.

- Inflation is on the rise: experts estimate the inflation rate to be close to 40% – well beyond the 16.8% suggested by the regime. Further, Ahmadinejad ordered the Central Bank to cut interest rates far below the inflation rate – an act of economic malpractice – and he fired his central bank governor for questioning this harmful decision.

- Corruption is widespread: the Iranian regime awards lucrative "no-bid" contracts to the Iranian Revolutionary Guard Corps, whose leadership has been sanctioned under UN resolutions.

- Iran's state-owned banks are finding themselves increasingly isolated, threatening the viability of their foreign-based branches and subsidiaries.

- The country's oil revenue reserve fund should be growing to benefit the future of the Iranian people instead of being spent down to mask the effects of the regime's misguided economic policies.

Iran is thus experiencing the consequences of its deceptive financial conduct and defiant policies. Iran's leaders are inflicting hardship on their people and steadily making their country an international pariah regime. Whether to continue down this path of isolation is a choice Iran must make.

Conclusion

These examples of our engagement on issues such as Iraq and Iran illustrate Treasury's evolving and expanding role in our government's national security strategy. Treasury has an important role to play by boosting growth and economic activity in key countries like Iraq, and ensuring that our financial systems are not only safe and sound, but also secure from exploitation by illicit actors like Iran. Our engagement also helps ensure we take a comprehensive view to the security challenges we face – that we examine them not only from a military and political perspective, but from an economic perspective as well.

Looking forward, I see a world in which economic issues will play an even more prominent role in our nation's security, and Treasury will continue to integrate its activities even closer with other national security agencies. To address our security challenges, we must take a broad-based approach that draws from the knowledge and expertise across all of government. As you Cadets step into your future lives of service, during which you will exploit the opportunities and confront the challenges of the 21st century, I encourage all of you to think in these broader terms as you serve and protect our great Nation. I can assure you that your Treasury Department, your transformed Treasury Department, is doing just that every day.

Thank you again for your kind invitation and may God bless you all and your families.