

# U.S. DEPARTMENT OF THE TREASURY

## Press Center



### Under Secretary David H. McCormick Remarks on Treasury's Changing Role in a Global Economy at the Center for International and Strategic Studies

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**Washington** - Today's global economic and financial system is characterized by increasingly interconnected financial markets and expanding cross-border capital flows. While bringing enormous benefits and efficiencies to the U.S. and global economies, this also makes our economy more vulnerable to risks or disruptions that exist or could arise in far off places around the globe. In today's environment, we are also uniquely challenged with protecting our national security by countering new threats from illicit finance and rebuilding fragile security environments which are of paramount concern.

Moreover, global public goods such as addressing climate change or rises in commodity prices have taken on important economic implications and growing urgency. Simply put, the challenges we presently face are more complex, more diverse, and more interdependent than those of the past. Not surprisingly, to be effective in this rapidly changing environment, the Treasury Department has had to make some dramatic changes in how we define our mission and how we are organized to achieve it. We have also had to develop new capabilities at home and abroad to address these challenges. Treasury's core mission has typically involved supporting the integrity and strength of financial markets and promoting U.S. and global economic growth and stability. In recent months, the traditional role of responding to crises and supporting global financial stability has been underscored by the rapid and comprehensive policy response that has been required during the current financial market turmoil.

But Treasury has also developed and deployed new capabilities in other critical areas to: (1) combat illicit finance, (2) ensure economic renewal and stability in post-conflict countries, (3) fight rising protectionism, and (4) support, and where appropriate, lead multilateral efforts to protect the environment in tandem with sustainable economic growth.

Today's Treasury is very different from the one that existed seven and a half years ago, or even two years ago when Secretary Paulson joined the Administration. While there is certainly much more to be done, we are well prepared to develop and execute U.S. economic policy in these dynamic times.

#### Financial Market Turmoil

At the center of Treasury's current efforts is maintaining the health and stability of the U.S. economy. The U.S. economy is facing significant headwinds – sharp reductions in the housing sector, turmoil in the capital markets, and rapidly rising energy prices. Though these challenges are serious, and we expect to be working through them for some time, the long-term prospects for the U.S. economy – and the underlying fundamentals on which it is based – remain sound. Policymakers in the United States and around the world are taking aggressive and targeted actions to stabilize financial markets, reduce the impact of markets on the U.S. economy, and protect against the same mistakes being repeated.

Our highest priority has been to address the challenges arising from market turmoil and the housing downturn, so as to reduce the impact on the rest of the economy. The Administration and Congress responded with a \$150 billion bipartisan stimulus package when it became clear that the market turmoil posed significant risks to the U.S. economy. Policymakers also launched a series of housing-market initiatives to help millions of Americans by preventing avoidable foreclosures.

Enhanced domestic regulatory coordination has been a key part of the response. In the United States, the President's Working Group on Financial Markets (PWG), chaired by Secretary Paulson, reviewed the causes of the recent turmoil and made recommendations to mitigate systemic risk, restore investor confidence, and facilitate stable economic growth. These recommendations are presently being implemented.

International regulatory coordination has also been a priority. Today's global markets require an international response to guard against uneven national responses and the risks of regulatory arbitrage. Therefore, we have worked closely with counterparts in major economies around the world to address the market instability consistently and comprehensively. The Financial Stability Forum (FSF), which brings together the supervisors, central banks, and finance ministries of major financial centers, has been critical to this effort. The FSF has released a number of recommendations that echo and complement efforts underway in the United States.

Beyond the near-term actions, there is also a need to ensure that all financial systems periodically reassess their effectiveness. Thus, well before the market turmoil began last summer, the Treasury began to consider how to modernize our outdated financial regulatory structure. The recently released *Blueprint for a Modernized Financial Regulatory Structure* proposes an objectives-based approach consisting of three regulators: a market stability regulator, a prudential regulator for institutions with federal guarantees, and a business conduct regulator with a focus on consumer protection.

We see this combination of initiatives already beginning to have a positive effect. As with other periods of market instability, this storm too shall pass. The United States will work through these challenges and emerge as it has in the past as a driver of growth and innovation for the global economy.

These efforts, while critical, should be no surprise. It is at the center of Treasury's long-standing mandate to ensure global financial stability. What some of you may not know about, however, are the other critical efforts underway over the past year that are reflective of Treasury's changing role in a globalized world.

### **Combating Illicit Finance**

A relatively new, but important area of Treasury involvement in national security is in combating illicit financial activity. To manage the threat to the international financial system, Treasury has built up its capabilities to target state sponsors of terror and prevent the proliferation of weapons of mass destruction (WMD). We have also coupled these domestic actions with coordinated multilateral efforts and actual engagement with the international financial community to increase the effectiveness of our work.

Within Treasury, the Administration created a new office--the Office of Terrorism and Financial Intelligence (TFI)--led by an Under Secretary and dedicated to targeting the financial networks supporting illicit actors, including narcotics traffickers and terrorist groups. This office was the beginning of a transformation within Treasury to play a more strategic role in combating terrorism. We have also created an in-house intelligence analysis office to bring the knowledge of the intelligence community to bear on the threat of illicit finance.

Iran is a case in point. We have seen that a combination of targeted financial measures can put real pressure on the regime and its continued pursuit of a nuclear capability and support for terrorist groups. Diplomatic efforts have resulted in three UN Security Council Resolutions targeting the entities and individuals that support Iran's attempts to develop WMDs. Treasury is working to implement these resolutions and prevent illicit conduct through targeted financial measures against Iranian banks, entities, and individuals engaged in these activities.

Treasury is also coordinating international efforts to alert the financial community to the threats of money laundering and terrorist financing. In February 2008, the world's premier standard-setting body on countering the financing of terrorism and the laundering of money -- the Financial Action Task Force (FATF) -- called on all governments to issue advisories to their financial institutions, warning them of the risks of dealing with Iran. All 32 member countries and jurisdictions have responded by issuing warnings about Iran, and on June 23 the European Union moved to designate and freeze the assets of Iran's largest state owned bank, Bank Melli.

The bottom line is that these efforts are making a difference. Earlier this year, Ali Larijani, who served as Iran's top nuclear negotiator, said, "These sanctions are a burden on the economy. Rising inflation, an unemployment rate that is not falling, and the high cost of living are all direct consequences of the sanctions." We have learned that sanctions, especially targeted ones, will always be more effective when done on a multilateral basis.

### **Post-Conflict Rebuilding**

Another facet of Treasury's greater role in national security can be seen in our work supporting the development of economies in difficult security environments. Through our experiences in war-torn countries in the Balkans, the Middle East, and Africa, the United States has learned that security and economic stability must go hand in hand if we are to achieve lasting peace. Treasury's role is to devise and implement strategies that avert financial crises and to promote policies that generate sustainable growth and job creation. To do this right, we have to put people in the field -- both financial attachés and technical advisors. In fact, we had some of the first civilians on the ground in Afghanistan and Iraq -- as well as in places like Kosovo, Bosnia, and Liberia.

These critical personnel assess the situation on the ground and help us respond with appropriate measures. Treasury has played a major role, for example, in helping the Government of Iraq create a more stable macroeconomic environment and build a solid foundation for economic growth. Following the fall of Saddam Hussein, our advisors alerted us that rampant counterfeiting could lead to a collapse in the value of currency, feeding inflation and civil unrest. Under the leadership of one of my predecessors, John Taylor, they then developed a comprehensive strategy for creating, printing and circulating a new currency to 250 distribution points around the country.

Currently, we are working with the military to help Iraq use its resources more effectively to ensure that essential services--like electricity--get to the people. Because these efforts are so important to preserving recent security gains, we are planning to more than double our existing presence in Iraq. This plan is closely coordinated with the military command, which will provide logistical and security support for new advisors. General Petraeus has told me personally that he views the deployment of these twelve additional Treasury advisors as a top priority.

We have also made similar contributions in Afghanistan, where our advisors helped the Afghan Ministry of Finance craft the first post-Taliban budget working with nothing more than an Excel spreadsheet. And our debt management experts have helped Afghanistan secure

over \$10 billion in international debt relief and build capacity to avoid falling back into unsustainable debt. Without progress in these areas, Afghanistan has little hope of achieving a lasting and economically viable peace. We know that by helping these countries govern effectively and achieve economic success, their citizens will develop a stake in political stability, eliminating the longer term need for boots on the ground.

### **Investment Policy**

A fourth area posing new challenges and new responsibilities for the Treasury is the growing risk of protectionism, particularly directed toward foreign investment, including investment from sovereign wealth funds, here in the United States. In the aftermath of 9/11, we have seen a backlash against foreign investment on national security grounds, with some voicing concerns about the potential for foreigners to gain control over key sectors or critical technologies within our borders.

Foreign control over U.S. businesses may, in some cases, raise genuine national security concerns. But we also know that foreign direct investment flows into the United States strengthen the U.S. economy by stimulating growth and creating jobs. U.S. affiliates of foreign multinationals employ over five million U.S. workers, or 4.5 percent of all private sector employment. Foreign-owned firms in the United States also pay on average 25 percent more than U.S. firms and help stimulate investment in research and development in high-technology areas that promote innovation and competitiveness. Thus, a significant component of our economic policy mission is safeguarding national security but in a manner that maintains and strengthens the U.S. economy through our longstanding commitment to an open investment policy.

Recent proposals in other countries for additional restraints on foreign investment raise some concerns in this regard. Investment reviews must be strictly limited to genuine national security concerns, not broader economic or national interests. In the United States, the interagency Committee on Foreign Investment (CFIUS), chaired by Secretary Paulson, reviews certain foreign investments in U.S. businesses to determine whether they raise any genuine national security concerns. The preponderance of transactions in the United States do not require a CFIUS review, and for cases that do, we are taking steps to clarify and streamline the process.

Foreign government-controlled investment, particularly from sovereign wealth funds (SWFs), has also garnered a great deal of attention recently. The rapid growth in number and size of SWFs does raise legitimate financial stability and investment policy questions that should be addressed through a measured, multilateral approach that maintains openness. Treasury has taken a number of steps to help accomplish this objective, including proposing and strongly supporting the IMF effort to develop voluntary best practices for SWFs and urging the OECD to identify inward investment policy best practices for countries that receive sovereign wealth investments. Both initiatives are well underway. The IMF expects to complete best practices by October 2008 -- covering areas such as fund objectives, institutional and governance arrangements, risk management and transparency. The OECD will issue investment policy principles later this year.

### **Energy and the Environment**

Finally, Treasury's work has ventured into energy and environmental policy, an area largely ignored by finance ministries up until now. This is a part of Treasury's portfolio where our interactions with the emerging economies are particularly important. Since 2002, developing countries have been responsible for about two-thirds of global GDP growth, and not surprisingly, the environmental implications of their exploding energy needs are daunting.

While this unprecedented expansion has brought economic opportunities and higher standards of living to these previously impoverished countries, it has also led to surging demand for energy in the power, transport, building, and industrial sectors. The International Energy Agency (IEA) estimates that last year China surpassed the U.S. as the largest global greenhouse gas emitter and the rate of emissions growth of developing countries will soon surpass those of developed countries. The need for sustainable economic growth, in a way that protects our planet, is one of the most pressing challenges facing our country.

Recognizing this fact, President Bush asked Secretary Paulson in September 2007 to take the lead in establishing a major multilateral initiative to create a new international clean technology fund to help developing countries harness the power of clean energy technologies to place themselves on a cleaner emissions growth trajectory. The Clean Technology Fund (CTF), which is to be housed at the World Bank, aims to reduce the growth of greenhouse gas emissions in developing countries by helping to finance the additional costs of deploying clean energy technologies over cheaper, dirtier alternatives. It will stimulate and leverage private sector investment in existing clean technologies, and it will promote international trust and cooperation on climate change, a prerequisite for a future climate change agreement.

Secretary Paulson has led U.S. efforts to build support for the development of this fund, in conjunction with the UK and Japan, the other founding partners. Earlier this month, the G-8 Finance Ministers issued a strong statement endorsing the Fund and calling on other countries to participate, and this week, G-8 countries collectively pledged over \$5 billion for CTF. This Fund is one important step that the United States can take along with the other developed countries to demonstrate leadership and to contribute constructively to broader international efforts to mitigate the effects of climate change.

Clearly, climate change will have lasting economic effects as will the policies that are developed to address it. Treasury must play a critical role in policy development and implementation. As a result, we have created a new senior position, and a dedicated team, specifically for providing leadership on both international and domestic economic policy issues related to the environment.

## **A Broader Reform Agenda**

Today I have focused on the U.S. Treasury's changing role in the global economy and ways that we have adapted to meet these new challenges. But we are not alone in needing to reform. There is also a pressing need to evolve among finance ministries, central banks, regulators, the International Monetary Fund (IMF), and the Multilateral Development Banks (MDBs) around the world. There are a few areas in particular deserving a brief mention.

First, coordination and cooperation on international economic policy can no longer be isolated to the G-7 countries alone. As dynamic emerging economies increase their share of and integration into the global economy, our existing dialogues such as the G-7 and G-8, the G-20, the Financial Stability Forum, and others must adapt to accommodate the increasingly important role played by these countries.

Likewise, the international financial institutions, such as the International Monetary Fund, must also reform in order to remain relevant. The IMF has taken an important first step to reform its governance structure to reflect the growing weight of dynamic emerging markets by reforming the quota and voice representation of its members. It needs to further evolve by strengthening its multilateral and bilateral surveillance capabilities, focusing on exercising firm exchange rate surveillance, encouraging openness to international investment, and supporting global financial market stability.

For the MDBs, this means considering how to effectively address their core missions to promote economic development and reduce poverty. They should also consider how to work more effectively within their comparative advantages vis-à-vis other donors and how to leverage their unique convening ability to help tackle global public goods such as climate change, HIV/AIDS, and escalating food prices in a coordinated way. We see, as an example, the World Bank under Bob Zoellick's leadership making important strides in this direction.

As the world has transformed around us, Treasury has had to rethink its role in the global economy and the ways we fulfill our mission. Even as many of our longer-term goals and priorities – such as ensuring stable growth and maintaining global financial stability – have not changed, the way we do business to achieve them has. The challenges I discussed today are just a few examples of the many we face.

In these rapidly changing times, economic policymakers around the world must continuously review and adapt how they are defining and conducting their missions. While our journey is far from complete, the U.S. Treasury Department has made important progress on this front.

Thank you for your attention.