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Written Testimony before the Senate Foreign Relations Committee
"The G-20 and the New Global Economic Architecture"

Chairman Kerry, Ranking Member Lugar, members of the Senate Foreign Relations Committee, thank you for the opportunity to testify today on the role of the Group of 20 (G-20) in the global economy.

This Committee has long played a central role in strengthening America's leadership in the international financial system. This role is more important than ever at this moment when global cooperation is critical for promoting America's well being and our national interests.

In the wake of the most severe global recession in decades, strong American growth will require stronger growth in our trading partners. Moving from a global economy based on U.S. demand to one based on global demand is critical to our domestic efforts to reduce unemployment and increase the wages of middle-class Americans.

At the start of this year, the world confronted the very real risk of a great depression, global deflation, and financial collapse. Over the past year, President Obama has worked closely with G-20 partners to adopt a forceful response to the global financial crisis. U.S. leadership and action, coupled with historic G-20 cooperation and response, has put out the financial fire and restarted growth in private activity. We are now moving from a period of rescue and repair to one of recovery. As growth strengthens and financial headwinds diminish, we will begin the essential process of restoring balance to public finances and fully removing the broad backstop still in place for credit markets.

Cooperation through the G-20 will remain essential as we start to unwind extraordinary measures and put in place the broad framework to achieve a strong, sustainable, and balanced recovery, and implement profound financial reforms at home and abroad.

After the experiences of the Great Depression and World War II, the United States led in the creation of the international financial system that anchored prosperity and stability for more than 60 years. Today, that system must be reformed to address 21^{st} century challenges. The United States again faces an opportunity to help shape a system that ensures better economic potential for future generations in America and around the world. As this Committee recognized by organizing today's hearing, the United States will be more effective in achieving our economic goals and our strategic priorities and interests when we work in partnership.

Let me briefly describe how we are working with the G-20 to advance our central objectives: rebalancing the global economy to achieve stronger and more sustainable U.S. growth goals; promoting global financial stability; and forging multilateral solutions to threats such as food insecurity, fragile states, and climate change. To achieve all of these goals, we will need to reform the global financial architecture.

Rebalancing the Global Economy to Achieve Strong and Sustainable Growth

As stabilization and recovery take hold, our policy challenge will shift to catalyzing private demand and business investment. This will require continued policy support. We cannot make the mistake of putting on the brakes too early or withdrawing support prematurely. This is why our recovery programs were designed to provide support for growth over a two-year period, and that is why other governments around the world are committed to continue the recovery now underway, before the G-20 shifts to restraint. At the recent G-20 Ministerial meeting in St. Andrews, Scotland, Finance Ministers and Central Bank Governors were united on the central point that growth remains the dominant policy imperative across our countries.

But the financial crisis also showed clearly that previous global economic patterns were unsustainable. To establish a more global foundation for growth and avert future crises of this nature, we must rebalance global demand.

As U.S. consumers save more and spend less in the years ahead, and as our government embarks on a path of fiscal responsibility, emerging markets and economies with large and sustained surpluses will need to shift their growth towards domestic demand and reduce their reliance on exports. Governments around the world will need to accept this basic reality or we will all face slower growth.

Indeed, countries are already redirecting policies along these lines. In the United States, private saving has risen and the U.S. current account deficit has fallen from over 6-1/2 percent of GDP in late 2005 to about 3 percent of GDP at this time. We are seeing domestic demand play a stronger role in recoveries abroad and corresponding reductions in global imbalances elsewhere.

At the Pittsburgh Summit, President Obama secured a commitment by G-20 leaders to adopt a Framework for Strong, Sustainable, and Balanced Growth. In St. Andrews, G-20 Finance Ministers and Central Bank Governors set out a detailed process and timeframe for achieving this goal. We asked the International Monetary Fund (IMF) to assist us in a mutual assessment process by evaluating whether policies pursued by individual G-20 countries are consistent with a more sustainable and balanced trajectory for the global economy and, if needed, recommending how policies could be adjusted to improve the global outlook.

Why is this important? In the final analysis, it is up to each of our countries to deliver the policies needed to achieve strong, sustainable, and balanced growth throughout the world. The Administration will do its part and looks forward to working with Congress to put our fiscal policy on a sustainable footing when recovery is in place. But the fact that all of the G-20 countries signed up to this detailed process, recognizing that policy formulation in their countries will need to take broader global interests into account to avoid the booms and busts of the past, demonstrates the strong collective resolve to tackle global challenges with the same force that we brought to overcoming the crisis.

Let me assure you, however, that we are not laying the foundation for global rebalancing only in the context of the G-20. Even before the Pittsburgh Summit, we were working hard to achieve this goal through the Strategic and Economic Dialogue (S&ED) with China and in our ongoing bilateral discussions. I have had lengthy conversations with my European colleagues about this subject, and I was just in Tokyo for bilateral discussions with the new government ahead of attending the Asia Pacific Economic Cooperation (APEC) Ministerial in Singapore, where there was broad agreement on the need to balance growth.

Open trade and investment policies will be equally important to ensuring future U.S. economic growth, prosperity, and sustainability. Trade will be critical to creating U.S. jobs and ensuring economic dynamism and vibrancy. Importantly, G-20 countries have played an active role by pledging to keep markets open, not to erect protectionist barriers, and not to retreat into financial protectionism.

Together, Congress and the Administration have a critical role to play in showing the world that we are serious about critical financial reforms, strong trade and investment, and fiscal consolidation. These policy steps are essential to continuing the strong U.S. role in the global economic system, ensuring strong international confidence in U.S. economic fundamentals, and promoting our nation's interests. By taking action at home, we must communicate our resolve to ensure that the U.S. economy remains the strongest and most innovative in the world.

Together with the other measures we are taking, these steps will help foster a sustainable global growth path and a strong U.S. economy.

Promoting Global Financial Stability

Next, alongside the growth agenda, we must build a stronger global financial system to prevent and mitigate financial instability wherever it emanates in the international system.

In the wake of the crisis, policy makers and regulators from the United States and across the globe have mounted strenuous efforts to repair financial systems. A strong and welcome consensus exists among G-20 countries on a framework and objectives for building a more stable global financial system. We have agreed on a strategy to put in place stronger constraints on risk taking across the financial system, to bring appropriate oversight to key institutions, products and markets, such as the over-the-counter derivative markets, to reform the securities markets, and to provide the tools necessary to wind down firms that fail. All of this will make the financial system stronger and better able to withstand future pressures.

But as we saw during the financial crisis, in a world of global capital markets, even the strongest regulatory standards can be circumvented by lax oversight in other financial centers, triggering regulatory arbitrage and a race to the bottom in which everyone loses. Thus, the Obama Administration believes it is in the United States' interest to work with our G-20 partners and other countries to seek the adoption of high standards by all major economies.

That is why we expanded the Financial Stability Board (FSB) to include all of the G-20 countries.

That is why we are pursuing a vigorous agenda of regulatory reform internationally in parallel with our agenda at home. We are working with the G-20 to subject non-bank financial institutions, credit rating agencies, and hedge funds to greater scrutiny and advancing adherence to international standards across a number of other areas. We agreed at the Pittsburgh Summit along with the G-20 countries to build high-quality capital, mitigate pro-cyclicality in financial regulations, strengthen adherence to sound compensation practices in order to foster greater financial stability, improve the functioning of over-the-counter derivatives markets, and address cross-border resolutions and systemically important financial institutions.

The challenge each G-20 nation faces is now to implement this agenda. Here at home, we are working to enact sweeping reforms designed to protect consumers and investors and create a more stable, more resilient financial system. Working with Congress to pass legislation on comprehensive reform of our nation's financial system is one of my highest priorities.

Forging Multilateral Solutions to Global Threats

Let me now shift to the third priority: working with the G-20 to forge multilateral solutions to today's global threats. From Afghanistan and Pakistan to food security and climate change, the Obama Administration is committed to revitalizing the multilateral financial institutions to help tackle our toughest global challenges.

The G-20 has strongly supported the central role of the multilateral development banks (MDBs) in the fight against global poverty and as essential partners during this time of financial stress. They serve as the first responders for the global poor and provide a high return on U.S. development dollars. We estimate that for every dollar that the United States invests in the World Bank as paid in capital, $26 of aid are delivered.

As evidenced in Afghanistan, Pakistan and Iraq—environments that are as critical as they are challenging—the multilateral development institutions play critical roles in addressing some of our most pressing problems, often working side by side with our bilateral efforts, including Treasury's Office of Technical Assistance.

Recognizing that bilateral and multilateral aid work best when they work together, it is critical to focus more attention and resources in order to achieve greater results in the following areas:

Advancing Energy and Climate Security

The President has outlined comprehensive changes in how we use energy, focusing on policies to advance energy and climate security while promoting economic recovery efforts job creation, and driving clean energy manufacturing.

U.S. domestic action, however, can only be part of the solution to our energy security and climate change challenges. We must seek a global agreement with significant action by all major economies. As part of that agreement, developing countries will need financial support to reduce their emissions and create new markets for clean energy technologies, as well as to adapt to the unavoidable effects of climate change.

Climate finance therefore will need to be scaled up significantly but we must do so in a way that is efficient and leverages U.S. investments in the arena of climate.

Because of their central role in financing and assisting countries, we have argued within the G-20 that the MDBs are uniquely positioned to play an important role in helping to transition to a green global economy.

The World Bank will specifically have a central role in contributing to financing the transition to a green economy by assisting countries in integrating climate change concerns into their core strategies. In the context of a new climate agreement, we have argued that a new climate fund should be established at an existing international financial institution to deploy financial resources effectively. We expect such a fund to build on the experience of the Climate Investment Funds (CIF) at the World Bank, which this Administration has strongly supported.

While the G-20's work on climate is in its early phases, this fund can provide additional momentum to the U.N. negotiations in Copenhagen in December, as well as ensure that any agreement is implemented effectively.

At Pittsburgh, the G-20 Leaders committed to phase out inefficient fossil fuel subsidies over the medium term. This groundbreaking effort will encourage the conservation of energy, improve our energy security, and provide a down-payment on our commitment to reduce greenhouse gas emissions. We believe this step will encourage investment in clean energy sources, promote green growth, and free up resources to use for pressing social needs such as health, food security, and environmental protection. We will follow through on the commitment while also preventing an adverse effect on the poorest by providing them with targeted cash transfers and other appropriate forms of support.

Enhancing Food Security

Over the past year, the global financial crisis put millions more people at risk of chronic hunger and poverty. At the G-20 Summit in London, President Obama called for a new approach to food security that includes strategic coordination of assistance, investment in country-owned plans, a comprehensive approach to enhancing agricultural development, and the effective use of bilateral and multilateral institutions and facilities. In Pittsburgh, the President furthered this effort by securing agreement among G-20 Leaders to establish a multilateral food security trust fund at the World Bank to scale up agricultural assistance to low-income countries. To advance these efforts, I have been working with Secretary Clinton, Secretary Vilsack, my colleagues in the G-20, the World Bank, and others to advance new strategies for agricultural investments that leverage the resources and expertise of the multilateral organizations, and support accountable, country-led strategies.

Generating Growth in the Most Challenging Environments

As the United States works to stabilize the economies of vital countries, such as Iraq, Pakistan, and Afghanistan, the MDBs have a critical role to play in offering support. From assessing needs to mobilizing donor resources and providing substantial technical and financial support, the MDBs are important partners in places of strategic interest to the United States.

For example, Pakistan—one of the largest borrowers from the Asian Development Bank—will receive nearly $1.6 billion this year and another $1.4 billion next year to finance projects in the energy, transportation and agricultural sectors. Afghanistan, the largest recipient of grants from the Asian Development Bank, will receive half a billion dollars over 2009 and 2010. In Iraq, the World Bank is implementing programs worth $1 billion in education, roads, electricity, and water. These types of investments help governments meet fundamental human needs which, in turn, give citizens a stake in maintaining a stable political and economic environment.

Supporting Private Sector-led Growth, Infrastructure, and Financial Access

Additional means of strengthening the potential of the global economy include supporting private sector-led growth strategies and improving access to financial services for the poor. Through the G-20, we are seeking a renewed focus from the MDBs on promoting the business and market environments, including appropriate legal reforms needed for private enterprises of all sizes to thrive. These efforts will in turn strengthen the ability of the private sector in developing countries to foster opportunities for growth.

Improving access to financial services for the poor is also a critical component of this effort. Together with our G-20 partners, the United States has agreed to support the safe and sound spread of new modes for the delivery of financial services to the poor. Also, building on the example of micro finance, the United States and its G-20 partners have asked the MDBs to scale up the successful models of small- and medium-size enterprise financing.

Furthering the Reform Agenda

We are committed to working across the Obama Administration and particularly with the State Department and USAID to ensure coherence of this critical development agenda.

Achieving these objectives will require reform from the MDBs. To ensure the effectiveness of U.S. investments in development, we continue to press for institution-wide reforms. Our desired reform agenda includes greater progress on combating corruption; strengthening financial management; improving transparency, accountability, and governance; increasing the capacity to innovate and demonstrate results; dedicating a greater share of resources to the poorest; and seeking better coordination and division of labor among institutions.

Achieving these objectives may also require new resources. As this Committee is aware, all of the MDBs are undergoing, or have just concluded, capital reviews as part of a broader strategic repositioning. At a time when resources are at a premium here at home, the United States is carefully reviewing all options. Additionally, to underscore our commitment to poverty reduction, the U.S. will want to show leadership in MDB discussions on concessional financing for the poorest. We are conducting a thorough review of how best to equip these institutions for today's and tomorrow's challenges, and look forward to working with this Committee, as well as with our partners in the G-20, to reach agreement on a set of core priorities, reforms, and resources.

However, to be credible in these negotiations, we must fully honor our previous commitments, which currently surpass $1 billion. I hope this Committee will support our requests to pay down our arrears.

Reforming the International Financial Architecture

Reforming the international financial architecture will be critical for advancing these priorities and the cause of multilateralism. An essential element will be to strengthen international institutions and enhance cooperation, while continuing to preserve the strong leadership role of the United States in international forums.

As we continue to shape the G-20 to serve as the premier forum for global economic cooperation, we will also deepen and not diminish engagement though bilateral means such as the S&ED and through regional groupings such as APEC and the Summit of the Americas process.

As this Committee knows, the financial crisis clearly demonstrated the central role that the IMF plays in the global system as a crisis responder. Over the past year, the IMF has taken critical steps to strengthen its crisis response by improving the ways it provides needed resources to members – both emerging market and low-income countries – by streamlining conditionality in programs to focus on the most critical actions a country needs to take, and by increasing its capacity to provide precautionary support to help forestall crises, importantly through a new Flexible Credit Line.

I want to thank the Chairman, Ranking Member, and Members of this Committee for your critical support for the U.S. $100 billion investment in the IMF's NAB. Rapid Congressional passage of this legislation at a critical moment in the crisis enabled the United States to play a leadership role in expanding the IMF's supplemental resources through the NAB by $500 billion and restoring financial market confidence at a dark time. The commitment of G-20 members to contribute to the NAB has resulted in contributions from leading emerging economies for the first time.

Looking ahead, the IMF will have a critical role in supporting balanced growth and financial stability. I have already touched on the important assistance the IMF can provide in helping the G-20 countries with the mutual assessment of their economic policies. What we ask of the IMF, and frankly what is needed, is candid, transparent, and independent surveillance to support this process.

In order for the IMF to effectively carry out its post-crisis mandate and to continue to fulfill its role as a crisis responder, the IMF's governance structure needs to evolve to reflect the relative weights and changing dynamics of the world economy. This means giving greater representation to dynamic emerging market and developing countries that are now playing a greater role in the global economy and it also means preserving our strong leadership role in the Fund. Progress was made on this front earlier this decade and, earlier this year, Congress passed legislation to implement those necessary reforms. The G-20 took a critical step in Pittsburgh, committing to a shift in quota share of at least five percent to dynamic emerging market and developing countries. G-20 Leaders also reaffirmed their commitment to complete the process of reviewing quotas by January 2011.

Similarly, we secured agreement among the G-20 to support a shift of at least 3 percent of the World Bank's voting power to developing and transitioning countries. We expect an international agreement to be reached on this issue in the spring of 2010 at the annual meetings of the World Bank and the IMF. We look forward to working with this Committee as those reforms proceed.

Conclusion

Ten years ago, the Treasury Department took the lead in creating the G-20 Finance Ministers' and Central Bank Governors' process. We did so in recognition of the changing face of the global economic and financial system and the need to give dynamic emerging market economies a greater role in the system, especially in the wake of the Asia crisis. The G-20 finance process continued, on the whole successfully, during this period. It showed that our countries, despite representing a wide range of cultures, history, and developmental levels, could work together and had common interests in promoting the improved functionality of our economies. A decade later, based on this shared experience, the G-20 countries were well positioned to tackle the challenges of the crisis.

From rebalancing the global economy to preventing financial instability and addressing global threats, we must seek the engagement of partners to achieve our economic goals and objectives and serve our nation's interests. First and foremost, we are responsible for our own destiny and our job begins at home. But in today's interdependent world, no country is isolated from global events.

The turmoil of the past two years has been the worst the global economy has witnessed since the 1930s, and has put the international economic system to the most severe test it has faced since then. By shifting the forum in which we addressed the crisis from a small circle of advanced nations to a broader and more representative table of the world's major economies, we strengthened the foundation for success in taking cooperative action to pull the global financial sector back from the brink.

But the job of building an effective international economic system for the 21st century is far from finished. If the United States is to succeed in building a strong economy for future generations at home and abroad, we must continue to seek the support of our global partners in the G-20 and other forums. Just as the United States led in developing the institutions of today, so must we lead in developing the future foundation for a strong, resilient, and innovative global economy.

Thank you and I look forward to your questions.