Under Secretary for International Affairs Lael Brainard
Written Testimony before the Senate Committee on Banking, Housing, and Urban Affairs
Subcommittee on Security and International Trade and Finance

The G-20 and Global Economic and Financial Risks
October 20, 2011

Chairman Warner, Ranking Member Johanns, and distinguished members of the committee, thank you for the opportunity to discuss how we are working with our G-20 partners to advance America's economic interests.

There is no stronger economic imperative today than to strengthen our economic recovery, create jobs, fuel growth, and build a stronger fiscal and economic foundation for our children and grandchildren. That is the prism that shapes our engagement in the Group of 20 (G-20) and with our international partners more broadly.

Safeguarding and Strengthening the Recovery

At the Pittsburgh Summit in 2009, the G-20 adopted as its core mandate achieving strong, sustainable, and balanced global growth. In the G-20 and in our bilateral engagements, we press vigorously for substantive economic, financial, and exchange rate reforms that will help achieve stronger and more balanced global growth in order to strengthen economic opportunities and growth for American families and workers.

Our recovery in the U.S. remains fragile and all too vulnerable to disruption beyond our shores. Earlier this year, high oil prices and the tragic earthquake and tsunami in Japan led to a sharp economic slowdown. Consumer and business confidence was shaken in the summer in part because of the debt limit debate in the U.S. but increasingly because of the intensification of the European crisis.

Europe's financial crisis poses the most serious risk today to the global recovery. While the direct exposure of the United States' financial system to the most vulnerable countries in Europe is moderate, we have substantial trade and investment ties to Europe, and European financial stability matters greatly for consumer and investor confidence. That is why we have been working closely with our partners to support their efforts to resolve the crisis swiftly and resolutely.

Last week at the G-20 meetings in Paris, the Europeans committed to delivering a comprehensive plan to address their crisis by the Cannes Summit in early November. There are four key elements. First, Europe needs a more substantial financial firewall to ensure that governments can borrow at sustainable interest rates while they implement policies to bring down their debts and strengthen the foundations for growth. Second, European authorities are taking steps to ensure that their banks have sufficient liquidity and build capital cushions to maintain the full confidence of depositors and creditors, and to ensure that banks have access to a capital backstop where needed. Third, Europe is working to craft a sustainable program in Greece as it implements its fiscal and structural reforms. Finally, European leaders must tackle governance changes to address the root causes of the crisis, and ensure that every member state pursues sound economic and financial policies.

The United States must also do our part, and as the world's largest and most vibrant economy, we recognize that we have a global leadership role to play in strengthening the recovery. To promote near-term growth and job creation, the Obama Administration has put forward a series of proposals in the American Jobs Act that would put veterans, teachers, and construction workers back on the job while rebuilding and modernizing America's schools and neighborhoods, and put more money in the pockets of every American worker by cutting their payroll taxes in half.

President Obama has also proposed a framework to put our medium-term public finances on a stronger and more sustainable footing. The President's proposal to the Fiscal Commission would place the nation's debt-to-GDP ratio on a declining path no later than the middle of the decade through a balanced plan to reduce deficits by $4 trillion over 10 years when combined with the $1 trillion in savings enacted in the Budget Control Act of 2011.

Together, pro-growth policies in the near term and meaningful deficit-reduction in the medium term represent our best insurance policy to protect the U.S. economy from further risks from global markets. We must work together to safeguard America's economic resilience and strength from further stress.

Emerging markets must also do their part to strengthen global growth through rebalancing. With demand in the advanced economies likely to remain weak, it is essential for emerging economic powers, such as China, to play a bigger role in bolstering and sustaining global growth. These emerging markets with large current account surpluses have substantial capacity to pivot more rapidly to a pro-growth strategy led by domestic consumption.

At last week's G-20 meeting, the surplus emerging market countries such as China committed to accelerate the rebalancing of demand toward more domestic consumption and to move toward more market-determined exchange rates and achieve greater exchange rate flexibility to reflect economic fundamentals. By allowing its exchange rate to appreciate more rapidly in line with market forces, China could boost consumption, strengthen domestic demand, and help curb inflationary pressures. We have worked aggressively to pressure China in particular to move much faster in allowing the value of its currency to appreciate. We have seen some progress on this front, with appreciation of over 10 percent in real terms bilaterally since June 2010 and 38 percent since 2005, but more is needed.

We will continue to urge the IMF to use the considerable scope it already has to identify risks to the international monetary system – particularly external ones such as exchange rates – and ensure that IMF members are meeting their international obligations.

Strengthening the Global Financial Sector

The second focus of our work in the G-20 and the Financial Stability Board (FSB) has been leading a "race to the top," leveling up the playing field across major and emerging financial centers. In the wake of the financial crisis, and with the leadership of this Committee, the United States moved quickly with the passage of the Dodd-Frank Act to undertake financial reform. We have moved in lockstep on our international financial reform agenda, securing adoption of key conforming reform commitments in the FSB and G-20.

With financial markets that are globally integrated, we need financial reforms that are globally convergent. This is particularly important in areas with the greatest potential for small discrepancies in national regulations to create disproportionate dislocations in global markets that could negatively impact our economy and our firms. Accordingly, we have focused on three key areas: stronger global standards for bank capital and liquidity; heightened prudential standards and orderly resolution processes for large, complex financial institutions; and aligning global derivatives markets.

First, following international negotiations that were concluded in record time, G-20 Leaders endorsed new global capital standards in November 2010. These standards will raise the quality and quantity of capital so that banks can withstand losses of the magnitude seen in the crisis, strengthen liquidity standards, and limit leverage. Implementation of these reforms will proceed at a pace that reduces risks to the economic recovery and ensures a level playing field around the world.

Furthermore, we have successfully called on the Basel Committee to ensure that risk-weighted assets are measured similarly across the world. This is essential to maintain a level playing field and to ensure consistency across borders.

Second, for the largest, most complex firms, whose failure could cause the greatest damage to the economy, we are establishing a new international standard for resolution regimes, so that large cross-border firms can be resolved without the risk of severe disruption or taxpayer exposure to loss; more intensive and effective supervisory regimes; and a capital surcharge. The G-20 Leaders in Cannes will endorse this set of reforms for these global systemic financial institutions (G-SIFIs).

Third, G-20 Leaders adopted new principles for the first time to promote international convergence across derivatives markets, which are fully aligned with the Dodd-Frank Act. In the run-up to the financial crisis, few understood the magnitude of aggregate derivatives exposures in the system and the risks embedded in these exposures as derivatives, such as credit default swaps (CDS), were traded over the counter on a bilateral basis and without transparency. Moving derivatives trading onto exchanges and requiring trades to be centrally cleared increases transparency and reduces systemic risk. Central clearing will greatly reduce risk by requiring a central clearinghouse to guarantee the transaction and help market participants better monitor their risk. Mandatory trading on exchanges or trading platforms will improve price discovery and greatly enhance transparency, and reporting to trade repositories will shed light on what was once an opaque market. New work is beginning on our call to establish global standards for margins on un-cleared derivatives trades that will incentivize central clearing

We are working with our G-20 counterparts to synchronize the implementation of these derivatives principles, and the United States is providing leadership by meeting the end-2012 deadline for implementing new rules consistent with these commitments. When taken together, these reforms will provide policy makers and investors a clearer picture of the true exposures and interconnectedness among and across financial institutions.

The examples above highlight areas where international convergence is imperative to preserve global financial stability. In other areas, the international regulatory system has long recognized differences in the institutional structure of national financial systems, reflecting different laws and histories. For example, the Volcker Rule in the United States and the Independent Banking Commission recommendations in the UK, though taking different approaches, are taking more restrictive positions on the permitted activities of banks than are some other countries which still use the universal banking model.

Retaining U.S. Leadership in the International Financial Institutions

Across all of these economic priorities, sustained and strong American leadership through the international financial institutions helps to facilitate solutions, advance growth, and build a better future.

In 2009, the United States was instrumental in supporting an expansion in the emergency financing of the International Monetary Fund. Rapid Congressional passage of legislation enabling U.S. participation helped stabilize financial markets at home and around the world during the peak of the crisis, paving a pathway for renewed global confidence and growth. Our continued leadership role at the Fund provides us with outsized influence to shape the IMF's responses to economic challenges, such as the European crisis, which matter to American jobs and growth.

Our leadership at the multilateral development banks (MDBs) has likewise offered us immense leverage and influence to shape development around the world, and thereby strengthen our own security and economic growth, while advancing American principles and ideals.

Yet today our leadership at the international financial institutions could be at risk if Congress does not act to support our commitments to these institutions. For example, at the World Bank, we currently have a veto over changes to the Articles of Agreement, which govern Bank membership and leadership, among other issues. At the African Development Bank, we have our own board seat, and can influence regional development to ensure that there are strict environmental and procurement standards. Other nations, particularly China, are eager to take up our shares in these institutions if we do not meet our commitments.

We must continue to work together in a bipartisan manner to renew U.S. leadership at these institutions, just as at the end of the Cold War, when President Reagan advocated for the last general capital increase for the World Bank and a Democratic Congress approved it. These institutions provide immense leverage of our scarce resources, with every dollar the U.S. contributes to the MDBs generating $25 of investments.

It was through the power of our ideas and our values that we became leaders. With the emergence of new powers and new challenges, we will remain leaders by expressing that same commitment and vision through our evolving global partnerships in the 21st century. Our leadership in the international financial institutions, the G-20, and the FSB will be essential to securing the future we want for our children and for their children.

Our leadership in the G-20 helped to avert a much deeper recession after the crisis and to forge a common effort to strengthen the recovery and the financial system. The U.S. will continue to emphasize the critical role of the G-20 in developing a strong, collective response to overcome near-term vulnerabilities, and put in place the building blocks for more balanced and durable growth going forward.

We appreciate the leadership and support of this Committee on these key challenges, and we look forward to working with Congress as we engage with our international partners, and encourage robust policy responses to today's global challenges.