Testimony of Treasury Secretary John Snow
Before the Senate Committee on Banking, Housing and Urban Affairs
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Chairman Shelby, Ranking Member Sarbanes, members of the Banking Committee, thank you for the opportunity to appear before you this morning to discuss Treasury's Report on International Economic and Exchange Rate Policies as well as related economic issues. The Report reviews developments in the United States and examines exchange rate policies in major countries across five regions - the Americas, Europe and Eurasia, Africa, the Middle East and South Asia, and East Asia. The Report documents the wide variety of exchange rate policies that are used around the world. A notable trend has been the move by many countries to adopt flexible exchange rates.

The Report concludes that no major trading partners of the United States meet the technical requirements set forth in the Omnibus Trade and Competitiveness Act of 1988. But let me be clear, the Bush Administration believes that the international trading system works best with free trade, the free flow of capital and with market-based exchange rates. An efficient system of trade and finance, with fair and enforced rules, is essential for the United States and all nations to maximize the benefits of trade and generate the highest levels of economic growth.

The Report finds that a number of countries continue to use pegged exchange rates and/or intervene in the foreign exchange market. It should be noted that a currency peg or intervention does not in and of itself satisfy the statutory test. Treasury has consulted with the IMF management and staff as required by the statute, and they concur with the findings of the Report.

The Bush Administration is aggressively encouraging our major trading partners to adopt policies that promote flexible market-based exchange rates combined with a clear price stability goal and a transparent system for adjusting the policy instruments. In my testimony today, I would like to discuss this work with you and the progress we are achieving.

Policies to Raise Economic Growth in the United States and the World

The Administration's international economic strategy aims for higher economic growth throughout the world. A stronger world economy is vital to sustaining U.S. economic growth and job creation. This is a reality of our increasingly interdependent world.

At the core of this strategy are the good economic policies we are implementing in the United States. But also at the core is our diplomatic work to encourage pro-growth and pro-stability policies in other countries. Good economic policies in other countries benefit the United States and the whole world. It is widely recognized throughout the world that free markets and market-determined prices are best able to allocate scarce resources to their most productive use. This is as true for domestic markets as it is for international markets. We strongly believe that the goals of raising growth and increasing stability can best be accomplished in an international financial system that relies on the principles of free trade, free capital flows, and market-based exchange rates among the major economies.

Free trade, in particular, improves the standard of living across countries. Thus, the Administration will continue to promote free trade through bilateral, regional, and global trade agreements. In this respect, the outcome at Cancun was a missed opportunity. The United States stands ready to work with others who seek liberalization. Our free trade initiatives, including the U.S. proposal to cut tariffs to zero for manufactures, will continue.

Implementing this broad international strategy is an ambitious endeavor, but it is an agenda that the Bush Administration is determined to pursue. Convincing others to contribute to further improvement in global growth prospects is a top priority for the President. In furtherance of this agenda I traveled to Europe, China and Japan this summer to deliver this very message. Growth was also the key focus of my discussions with Asian financial leaders in Thailand. Change has already begun among several major economies. For example, Germany is pursuing critical labor market, tax and pension reforms under its Agenda 2010, and France is also moving forward through its Agenda 2006.

With President Bush's leadership, the Administration has made reform and economic growth a priority goal throughout the world. In addition to my own travel, Commerce Secretary Don Evans, United States Trade Representative Robert Zoellick and other senior Administration officials all continue to press nations to put in place pro-growth policies that will result in higher rates of productivity and growth both here and abroad

The Administration has urged Japan to implement comprehensive reforms to bring about lasting recovery. These reforms involve ending deflation, strengthening the banking system, and undertaking structural reforms that promote flexibility. Indeed, the Bank of Japan has aggressively increased the money supply to counter deflation, and the Koizumi government has made important headway on improving the health of the banking system.

Treasury is actively engaged with the Japanese on monetary, fiscal and exchange rate policies both bilaterally and through meetings of the G7 finance ministers and central bank governors.

At the recent G-7 meeting in Dubai, we made progress, gaining agreement on a new "G-7 Agenda for Growth." Under this milestone agreement, G-7 countries have committed to concrete structural reform actions to increase productivity, spur growth, and create jobs. And for the first time they have agreed to a process for benchmarking and reporting on their performance.

Each country will identify its own policy plan under the Agenda. For example, the United States will work to lower health care costs, reduce frivolous lawsuits and streamline regulations and needless paperwork through the President's Six Point Plan to promote economic growth. Other G-7 countries will implement policies appropriate to their situations. Countries in the European Union will be looking at further ways to revitalize investment and create jobs. Japan has reiterated its commitment to reform.

The Agenda for Growth must be about action and results, not just plans and platitudes. When we met in Dubai, my G-7 colleagues agreed to be ambitious in embarking on reforms and pursuing growth. In coming months, we will be working to evaluate proposals and assess the results of our efforts. As the United States assumes chairmanship of the G-7 in 2004 that focus will be maintained.

The Administration is also engaging in other initiatives, both bilateral and multilateral, to advance growth and stability in emerging markets and developing countries. For example, Treasury is working with Brazil through a new "Group for Growth" to identify steps to expand economic potential; the Millennium Challenge Account targets assistance to countries that perform on pro-growth policies and delivering results for people; and in the international financial institutions, Treasury is advocating a sharper focus on measurable results, economic policy performance, and promoting private sector development.

Recent Economic Developments

The world economy has strengthened during the course of this year, and the United States is leading the way. Thanks to timely fiscal and monetary policy responses, economic growth in the United States is picking up now after the severe shocks of the terrorist attacks, corporate accounting scandals, and stock market decline of 2000. Growth accelerated to 3.3 percent in the second quarter, with fixed investment as well as personal consumption posting large gains. The President's Jobs and Growth plan, along with low interest rates, put the U.S. economy in an excellent position to achieve sustained, robust growth. The President's six-point plan to enhance growth and job creation will further boost our performance. We will not be satisfied until we see strong and sustained job growth.

Looking beyond the United States, global growth is also improving. There are signs of stronger growth in Japan, as well as in the United Kingdom, Canada and several emerging market countries. Much of Europe, however, is still falling short of a strong economic recovery. While we can be pleased with the progress made, growth in the major economies around the world, as a whole, has been too slow for too long.

The U.S. International Accounts

From my discussions with my counterparts in other countries, there is a great appreciation worldwide that the U.S. is a force for strong growth. This strong performance is also reflected in the pattern of our external trade and current account balances.

Developments in the current account are best understood in terms of developments in investment and saving. As a matter of accounting, the current account deficit is equal to the gap between national investment and national saving. Thus, when investment in the United States is higher than domestic saving, foreign investors make up the difference, and the United States has a current account deficit.

Our current account deficit in large part reflects the attractive investment environment and high growth of productivity in the United States. Increased saving in the United States along with stronger growth abroad will reduce the deficit in the current account.

Exchange Rate Policies

The Report shows that countries around the world continue to follow a variety of exchange rate policies ranging from a flexible exchange rate regime with no or little intervention to currency unions and full dollarization. While the choice of an exchange rate regime is up to each country, we have been encouraging countries to use flexible exchange rates. Flexible exchange rates ease the adjustment to changing economic conditions in the international financial system. Of course, a flexible exchange rate will not prevent the economic damage that is caused by a bad economic policy. For example, even with a flexible exchange rate, an inflationary monetary policy would lead to a weak, constantly depreciating currency with negative effects on economic growth. A good flexible exchange rate regime requires a monetary policy with a focus on the goal of price stability, and has a transparent procedure for setting the policy instruments.

We are encouraging the use of flexible exchange rates with our major trading partners, we recognize that, especially in the case of small open economies, there are benefits from a "hard" exchange rate peg, such as dollarization, joining a currency union, or using a credible currency board. Of course, just as in the case of flexible exchange rates, a "hard" peg will not prevent the economic damage caused by a bad economic policy.

The G7 statement from Dubai, which I mentioned earlier in the context of the "G-7 Agenda for Growth," also addresses exchange rate policy. Here is what that statement said:
"We reaffirm that exchange rates should reflect economic fundamentals. We continue to monitor exchange markets closely and cooperate as appropriate. In this context, we emphasize that more flexibility in exchange rates is desirable for major countries or economic areas to promote smooth and widespread adjustments in the international financial system based on market mechanisms."

All G7 Ministers and Central Bank Governors-including Alan Greenspan and myself-agreed with that statement. And let me be clear: the G-7 message is consistent with our strong dollar policy which I have consistently reiterated since my confirmation hearing. As I have said often, a country can not devalue itself into prosperity. A strong dollar is in the U.S. national interest. The G-7 message is also consistent with the Agenda for Growth, which is about a stronger world economy and flexibility.

Among the many currencies discussed in the Report, China's received special attention. China does not meet the technical requirements of the 1988 Trade Act -- the same finding for nearly ten years of past reports. China's global current account surplus has declined, and China has had a peg over a long time period during both upward and downward pressures on the currency. But it is clear that a flexible, market-based, exchange rate is appropriate for China. Given China's strong growth and substantial foreign exchange reserves, following on a series of economic reforms, China now has an opportunity to show leadership on the important global issue of exchange rate flexibility.

Greater exchange rate flexibility would allow China greater scope to maintain a low-inflation, pro-growth monetary policy. It would also enable China to enjoy the benefits, while helping mitigate the risks, of a more open capital account. And it would help improve the allocation of resources and the quality of financial intermediation in the Chinese economy. More broadly, a more flexible rate would help reduce macroeconomic imbalances.

A rules based system of trade and finance is essential for all nations to maximize the benefits of trade and generate the highest levels of economic growth. A pegged exchange rate is not appropriate for a major economy like China and should be changed.

For all these reasons, we are continuing our efforts to urge the Chinese to adopt a flexible exchange rate. I took this case to Beijing last month, emphasizing the need for exchange rate flexibility, along with reductions in barriers to trade and capital flows. And last weekend, following immediately on the heels of the President's meeting with President Hu, I met with the Chinese Finance Minister and Central Bank Governor in Mexico.

China's response to this engagement is encouraging:

- Earlier this month China's central bank governor said: "With the role of the market becoming increasingly important, the exchange rate of the RMB will be finally determined decisively by the market forces and have great flexibility."
- China's central bank is undertaking a number of capital market liberalization measures. In addition, Governor Zhou has endorsed a project in which the Chicago Mercantile Exchange and the Foreign Exchange Trade System & National Interbank Funding Center of China will develop a currency futures market in China.
- Vice Premier Huang Ju has accepted my invitation to come to Washington for an in-depth high-level discussion of these issues.
- A new technical cooperation agreement on financial issues related to exchange rates was announced by President Bush and President Hu. China's central bank governor and I will be responsible for implementing this program.

- The G-7 finance ministries and the Chinese finance ministry and central bank have begun talks on economic and financial market issues for the first time ever. Their first meeting was last month in Dubai.

We are encouraged by the steps the Chinese are taking, but we urge continued and speedy progress toward the goal of exchange rate flexibility. The Chinese are discussing exchange rate policy in international fora, and at home. China's leadership recently called for active advance of the reform in the financials system and exchange rate policy. The leadership also recognized that opening up of its capital market is seen by Beijing as an important step in moving to a flexible exchange rate. Further, the establishment of a strong regulator will help China's banking system see much needed improvement. Success will require daily engagement with the Chinese. For this reason, the Treasury Department is establishing an attaché presence in China.

As this example of China indicates, I recognize the need to address exchange rates as part of our overall international economic strategy. But, as the example of China also indicates, I believe that the course we are on of financial diplomacy is the right course and the most effective way to bring about change.

Conclusion

Strengthening the economic recovery in the United States is our key economic objective. I am very concerned about job creation in the United States. The President's Six Point Plan is designed to remove impediments to growth and job creation. We have undertaken an ambitious drive to remove rigidities and barriers wherever they exist and to thereby create a level playing field that promotes increased international trade. The G-7 Agenda for Growth is an important step forward. So, too, are the bilateral discussions we have had with many countries on economic and financial issues. We will continue to work hard to accomplish our objectives.

Thank you.