THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM AND IMF REFORM

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BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

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THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM AND IMF REFORM

TUESDAY, MAY 22, 2001

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC.

The committee met, pursuant to call, in room 2128, Rayburn House Office Building, Hon. Michael G. Oxley, [chairman of the committee], presiding.

Present: Chairman Oxley; Representatives Leach, Roukema, Bereuter, Bachus, F. Lucas of Oklahoma, Kelly, Paul, Weldon, Ose, Biggert, Shays, Miller, Capito, Ferguson, Tiberi, LaFalce, Waters, Sanders, C. Maloney of New York, Bentsen, J. Maloney of Connecticut, Hooley, Carson, Sherman, Meeks, Lee, Inslee, Schakowsky, Moore, Jones, Capuano, Hinojosa, K. Lucas of Kentucky, Shows, Crowley, Israel, and Ross.

Chairman OXLEY. This hearing of the Committee on Financial Services will come to order. Pursuant to the Chair's prior announcement, I will recognize myself for 5 minutes for an opening statement, as well as the Ranking Minority Member, and the Chair and the Ranking Minority Member of the Subcommittee on International Monetary Policy and Trade for 3 minutes each. All Members' opening statements will be made a part of the record, and it is so ordered.

Today, the committee is meeting to hear from the Secretary of the Treasury, Mr. Paul H. O'Neill, on the state of the international economy. This hearing is mandated by the fiscal year 1999 Foreign Operations appropriations bill. That law provided for an $18 billion increase in U.S. funding to the International Monetary Fund. To ensure that the IMF would effectively use these funds, Congress included as a requirement, authored by Representative Mike Castle and a Member of our committee, that the Treasury Department report annually on IMF reforms and testify to this committee on the state of the international financial system.

Earlier this year the committee heard from Federal Reserve Board Chairman Alan Greenspan, about the conduct of monetary policy and the state of the domestic economy. Given the interdependence of the U.S. with the rest of the world, economic growth in the United States is greatly affected by disturbances or crises in the international economy. For instance, the recent 30 percent drop in the Turkish lira caused Ohio-based Procter & Gamble to blame the Turkish economic crisis for a decline in earnings projections for the second half of 2001.

Accordingly, the committee welcomes this opportunity to oversee U.S. international economic policy. An important way the U.S. has influenced the direction of the international economy is through its participation in international financial institutions, principally the IMF and the World Bank. These two institutions, as well as the General Agreement on Tariffs and Trade, were the result of the Bretton Woods Conference in 1944 and comprised the Western world's response to the Great Depression and World War II.

The IMF's traditional focus has been on exchange rates and balance of payments and how they effect trade and the stability and growth of global economy. The World Bank has traditionally focused on providing loans to assist countries in developing their basic infrastructures. As the international economy has evolved, so too have the institution's programs, with the IMF now also providing longer term loans for "development" purposes and the World Bank providing short-term structural adjustment loans.

Most commentators agree that the Bretton Woods institutions were successful in reconstructing post-World War II Europe and Japan, assisting in the economic development of a number of less developed economies and avoiding international economic depressions. What there is not agreement on is their success in providing development in poorer countries and combating economic crises in a more interdependent world.

The last half of the 1990s was marked by recurrent financial crises and a recognition that the economic situation in some of the world's poorest countries has gotten worse, not better, despite billions of dollars in development loans. As a consequence, both the international financial system and the multilateral lending institutions have been the subject of widespread calls for reform.

In that regard the IMF legislation also had a provision, authored by International Monetary Policy and Trade Subcommittee Chairman Doug Bereuter, calling for the establishment of an advisory commission to review the need to reform the World Bank, IMF and other multilateral organizations. This so-called Meltzer Commission issued its report last year and will no doubt be the subject of review by this committee today and in the future as it conducts its oversight of the international financial institutions under its jurisdiction.

In addition to U.S. participation in international financial institutions, I am sure the committee will want to hear the Secretary's thoughts on how the U.S. should respond to some of the economic problems in other countries and in other regions of the world. Japan's economic stagnation, Turkey's and Argentina's currency woes, EU's interest rate policy and foreign exchange policy may all be subjects on which the committee will seek guidance from the Secretary today.

In closing, this hearing gives this new committee with its enhanced jurisdiction over the financial services sector a chance to hear from a new Administration on how best to use these international organizations to encourage trade and economic growth. From my own perspective, I am supportive of international efforts to improve trade and economic cooperation among countries. While some would prefer to take a more isolationist stance and withdraw U.S. participation and leadership from these institutions, such a stance is neither desirable nor conceivable in the 21st Century. A much more constructive route is to focus on how to best reform and use these institutions to increase economic prosperity for the United States and our trading partners.

With that, I welcome you to your first appearance before the committee, Mr. Secretary, and I look forward to your testimony.

I am now pleased to yield to the Ranking Member, the gentleman from New York, Mr. LaFalce.

[The prepared statement of Hon. Michael G. Oxley can be found on page 38 in the appendix.]

Mr. LAFALCE. Thank you very much, Mr. Chairman.

Secretary O'Neill, I want to welcome you to your inaugural appearance before our committee. Oversight of the United States interests in the international financial architecture is without doubt one of the important functions of our committee. So I think it is appropriate that this topic is the occasion for your first appearance.

Reform of the international financial institutions is a continual and complex task. For our part this committee and Congress have provided specific guidelines of reform over the past 3 years, and it is critical that we achieve good communication between our committee and the Treasury Department in order to ensure that these guidelines lead to good policy reforms. I hope today's hearing is only an initial step in what will be a continuous and cooperative effort.

I would like to raise a conceptual issue that I believe is nonetheless critical to the reform effort, and that is identifying the proper mission of the IMF, the development banks, and especially the World Bank, and I am troubled by the impression that may be left by some of your remarks, correctly or incorrectly, regarding the nature of World Bank activities. There has already been some confusion and some reading of the tea leaves regarding your recent statement on this topic, and I look forward to clarifying your views here today.

As some have interpreted your comments, distributional concerns should not be a part of the Bank's mission and the exclusive guiding principle for bank activities should be the promotion or productivity in per capita income growth. If that impression is accurate, I would be troubled. All should recognize that productivity is central to the long-term success of all economies, rich or poor. And I note that you rightly point to education as a critical productivity enhancing investment which the bank should be supporting.

Indeed, in the Reagan era I authored the bill creating the White House Conference on Productivity, chaired by one of your predecessors, William Simon. The working chairman was Bill Seidman, the chief White House liaison was Roger Porter. So my concern is not with emphasizing productivity, but my concern is with any attempted exclusivity of this focus.

Those of us who follow the history of the World Bank recognize a pattern of policy shifts over the years between so-called growth policies and policies that emphasize poverty reduction. I think the McNamara era firmly established the moral imperative of poverty reduction at the bank. This was followed by a period coinciding with the Reagan years which ushered in a much more focused, some say exclusive focus on growth policies, however badly designed. But starting with the tenure of President Bush, the senior, and continuing through the end of the Clinton Administration, I believe the Bank has sought a path toward what could ultimately be an appropriate combination of growth and poverty reduction policies.

We are not there yet, but I do believe that reform efforts already under way at the Bank may well succeed in stimulating long-term growth in developing countries while also providing desperately needed immediate relief from poverty. Both are necessary, but the latter is critical, in my view. Growth policies constitute a good long-term anti-poverty strategy, but they are insufficient for meeting the needs of those trapped at the bottom of the income ladder in the interim, and the interim could last for generations. The so-called long term can often amount to decades or even lifetimes, and the bottom of the income ladder often means less than a dollar a day.

So it is unacceptable to suggest that the World Bank should ignore conditions of desperate poverty while exclusively pursuing growth policies, the benefits of which may trickle down to the poor, but only after many, many years.

There are a number of other issues that I am extremely concerned about that I can't discuss in great length, but in 1988 I included a provision in the omnibus trade bill which called for Treasury to make 6-month reports on the exchange rates and have a policy with respect to exchange rates, which is enshrined in law, and I worked this out with David Mulford. And we are entering trade agreements all the time with little regard to the effect of exchange rates and it is difficult to enter into a trade agreement with a country for free trade when it might be 1-to-1 and all of the sudden within a month it is not 1-to-1, it is 1-to-3 or 1-to-100.

So we need much more attention on exchange rates, and note the Treasury has to give us a report every 6 months. The report preceding the Mexican debacle of 1994 did not even mention potential problems with the peso. So it has got to be a good report though, too. And so much is going on today around the world, Argentina and Turkey. I would like a glimpse of your views as to what is going on there and what we might be able to do.

Thank you very much.

Chairman OXLEY. The gentleman's time has expired.

The Chair is now pleased to recognize the Chairman of the Subcommittee on International Monetary Policy and Trade, the gentleman from Nebraska, Mr. Bereuter.

Mr. BEREUTER. Thank you, Mr. Chairman. Since my remarks are lengthy, I would ask unanimous consent to summarize and just make a point or two.

Chairman OXLEY. Without objection.

Mr. BEREUTER. Thank you, Mr. Chairman, and, Secretary O'Neill, welcome to the committee. As my colleagues know, we look forward to a productive working relationship with you and your key assistants, Assistant Secretaries or Under Secretaries, when you get them in line that is. And I would tell you that our subcommittee's agenda includes some work on authorization for the Export-Import Bank, the Asian Development Fund, something called the IFED, and then we will move into trying to knock down some of the trade barriers to the export of our financial services from the various types of institutions. But after that I think the most challenging, politically and intellectually challenging task before us is a fundamental reexamination of the international institutions architecture.

The IMF in particular is controversial, especially charged now, in light of the fact that it is an element in the anti-globalization demonstrations and effort around the world. I would like to offer just a couple of comments about the IMF specifically.

I believe that the IMF and the Treasury Department under the Clinton Administration was unwilling to admit some of its errors and misjudgments. During the Asian financial crisis the IMF, with strong encouragement from key members of the Clinton Administration, employed what I think were counterproductive policies in both Thailand and South Korea, inappropriately treating them as the usual fiscal basket cases at the beginning even though their fiscal situation was sound. Perhaps any Administration would have made that judgment, but it was a very different case, and I think we need to learn from these errors.

In addition, there were also loans to Russia, which might be better labeled as Yeltsin loans, and which will be shown over time, I think, to be one of the biggest blunders of the late 20th Century.

However, at the same time we in Congress, I think, need to candidly admit that if we didn't have an IMF or an institution somewhat like it we would have to create one.

The second area, as the Chairman already mentioned, I have a particular interest in the recommendations, majority and dissenting views of the Meltzer Commission, which resulted from language I first offered. That commission—and I would like to have your comments, your views on it today and later from the department.

Looking at the majority and the dissenting views, they recommended that the IMF withdraw from questionable long-term concessional loans and focus instead on the extension of more manageable short-term, 4- to 8-month, credit areas. Moreover, the Commission recommended that the IMF should lend only to countries that meet certain prequalification criteria.

I appreciate the independent judgment of the dissenting members of the Commission who contend that limiting the IMF to a set of prequalification criteria would preclude certain countries which are central to macroeconomic global financial stability from receiving assistance. For example, if this prequalification criteria would have been applied to the 1997 Asian financial crisis, global contagion may have been far worse.

They have devoted most of their attention to the IMF and secondarily to the World Bank and not too much to the regional banks. But with respect to the World Bank, they propose that the World Bank shift from highly concessional loans to a system of performance-based grants to the poorest countries in the world that lack reasonable access to funds in the capital market. Furthermore, the Commission recommended that the World Bank defer to the regional multilateral institutions for lending activity in Asia and in Latin America.

I think the Congress should do a fundamental reexamination of their recommendations and the dissenting views, and I intend to in our subcommittee, with the assistance of both sides of the aisle, engage in that kind of activity as a major part of the subcommittee's activities for this Congress, and I look forward to your input, your recommendations in all respects.

[The prepared statement of Hon. Doug Bereuter can be found on page 41 in the appendix.]

Chairman OXLEY. The gentleman's time has expired.

The Chair is pleased to recognize the Ranking Member, the gentleman from Vermont, Mr. Sanders.

Mr. SANDERS. Thank you very much, Mr. Chairman.

Welcome, Secretary O'Neill, thanks for being with us. Since its beginning 55 years ago, the IMF has grown to become the most powerful financial institution in the world, with effective control over the economies of some 50 developing nations. But there is a growing sense among many people, including myself, that the IMF is not doing the job it was established to do and that it has taken on new jobs that it is not able to do.

In Asia, for example, the IMF not only failed to warn of the financial crisis, it was largely responsible for creating the crisis in the first place. It did so by forcing countries to remove restrictions on capital flows and then made matters worse by requiring governments to raise interest rates and slash budgets, turning a financial crisis to a full-blown economic depression in Asia, with reverberations throughout the world.

At the same time, the new roles that the IMF has taken on for itself have led to dismal failures. The IMF's debt reduction program for the world's most heavily indebted poor countries, for example, has led to deeper poverty and continual debt for the poorest people of this world. In many of these countries, where HIV/AIDS, hunger and unemployment are rampant, it is common for governments to spend far more on debt service than on urgent human needs, such as health and education.

In addition, by requiring poor countries to export their way out of financial and economic trouble, the IMF has forced American workers to compete against rising imports of low wage products. The IMF's misguided policies in recent decades are largely responsible for the lack of per capita economic growth in Latin America, plummeting per capita income in Africa, skyrocketing trade deficits in the United States, and a decline in real wages for American workers.

Mr. Secretary, I hope you will agree with me that the IMF is an institution in desperate need of some structural adjustment of its own. For example, number one, the IMF and other international financial institutions should open themselves to public scrutiny and oversight. Where is C-SPAN when we need it? Major decisions, often impacting the lives of hundreds of millions of people, the most vulnerable people in this planet, are taken behind closed doors. In fact, the Congress, to be honest with you, doesn't even know the role that our representative in the IMF is playing.

Number two, the IMF should make lenders pick up the tab for their losses in financial crises. If you want to invest in Asia, that is fine, but if you lose money there, don't ask the taxpayers of this country to bail you out. Our conservative friends call this moral hazard. I call it corporate welfare.

Three, the IMF should stop prescribing "one size fits all" austerity conditions that often lead to economic stagnation and poverty. Instead, the IMF should allow countries to pursue alternative policies to create stability without austerity; in other words, sustainable economic development.

Fourth, the IMF should stop pretending to be a development institution. Its misguided development attempts have resulted in rising debt and deepening poverty for the poorest countries in the world. Developing countries need real transfers of resources and technology, direct investment and development aid, not austerity policies and more debt.

And last, but not least, the IMF and the World Bank should cancel—and I hope that you will think about this and perhaps agree with us—should cancel and not just reduce the debt that they have created among the impoverished countries of the world. The IMF's current debt reduction program, according to the recent report by the U.S. General Accounting Office, is keeping poor countries hopelessly in debt and the IMF forever in charge.

Mr. Secretary, I hope you will join me in calling for these reforms, and I hope that you will join Members of Congress from various political philosophies in working to make these reforms a reality. I thank you for joining us today.

Chairman OXLEY. The gentleman's time has expired, and we will now turn to the Secretary for his statement.

Mr. Secretary, welcome to the Financial Services Committee for your first appearance before our committee and hopefully, not the last. Thank you.

STATEMENT OF HON. PAUL H. O'NEILL, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Mr. O'NEILL. Well, thank you, Mr. Chairman, Mr. LaFalce, the distinguished Members of this committee. It is a great pleasure to have this opportunity to be with you today to talk on these important subjects. Since there are so many of us and the time is already moving on, with your permission, Mr. Chairman, I will simply put my prepared statement into the record.

Chairman OXLEY. Without objection.

Mr. O'NEILL. Thank you, sir. And maybe just make a few observations and then engage you in the things that you are most interested in talking about.

I believe the institutions we are here to discuss today have been, and are, and need to be important to the world. Having said that, I also believe that reform is both desirable and necessary, in the sense that I think we should expect a great deal from these institutions and from what they accomplish, and I think it is not too difficult to find, both in the experience and the analysis that has been done of these institutions, shortfalls in what one would describe as an ideal performance. So it is clear to me that changes are desirable and need to be made.

It would be nice if we could stop the world so that we could do it all at once. I frankly don't think that is possible. As evidence, I would suggest to you that from January 20 we have been necessarily engaged with these institutions on matters of the moment, if you will, with Argentina and Turkey. It is simply not possible to say we are going to have a complete transformation of the way these organizations work and implement changes on the fly. This is not to say that we can't begin to reform and begin to have an opinion about directional changes, but perhaps that will come out in our dialogue in the next couple of hours.

I think these institutions developed over a considerable period of time and there is an expectation of practice and procedure in the world. I think, if we simply drew a line and said from this day forward these things will not rule, the relationships any more, that we would find we would not like the consequence of, in effect, shutting off the lights on policy the way it has been and insisting it change tomorrow in a sharp and distinct way. So I think for sure we need reform, and we need change, and we need to do it in a way that gives people around the world a clear indication that we are intent on changing the rules of engagement, if you will. But we need to be deliberate and certain in the changes that we do want to make. Of course, what we suggest to these institutions, I think we need to understand, is a voice among several. In most of these institutions we hold a significant position, but not an absolute controlling position. At the same time, I think those of us in the Administration do understand that what we say to these institutions we say on behalf of the American people. So it is very important that this not be an independent view; that is to say, not a view independent of the view of the Congress and the will that you work through legislation.

But I do think working together we can help the rest of the world to attain a living standard at least directionally consistent with what we have been able to achieve in this country and in a fairly near term. Mr. Chairman, with that, I would be delighted to begin responding to questions.

[The prepared statement of Hon. Paul O'Neill can be found on page 56 in the appendix.]

Chairman OXLEY. Thank you, Mr. Secretary. And let me begin. First of all, thank you for your remarks and for the prepared statement that I reviewed in regard to the proposal of reforms on the international front.

Mr. Secretary, I was interested to read this past Sunday an op-ed piece in *The Washington Post* in which you were criticized for remarks made regarding the World Bank anti-poverty programs and the OECD initiatives concerning international tax and banking safe havens. I thought it was a rather, shall we say, in your face kind of an op-ed piece and I thought perhaps since you were testifying today, it would be an appropriate time for you to perhaps reflect on that op-ed piece, assuming you have seen it or certainly your staff has seen it. I will give you an opportunity to respond.

Mr. O'NEILL. Well, thank you very much. Indeed I did see it. I suppose from graduate school days I have been a consumer of four or five newspapers every day. Now that I am here I find I don't enjoy them quite as much as I used to. I did see this column, and frankly, I was surprised that if Mr. Hoagland was going to write what he did, he didn't bother to call me to find out if what he was criticizing me for was fair game or not. With regard to the issue that he raised about the statement that I have issued about the so-called tax haven process with the OECD, in fact, in a nutshell—I would be happy to supply this for the record as well—what I have said is this, and I believe it is a correct policy for the United States: we are intent and, in fact, we have a legislative mandate at the Treasury to ensure that all people who fall under the tax laws of the United States fully and faithfully pay their obligations under the tax laws of the United States. In that regard, we have before my time been associated with the OECD in working to develop an arrangement so that our country and reciprocal countries can provide information to each other to assure that information on individuals that fall subject to the tax laws of any of the reciprocal countries can be made available with probable cause. I reaffirmed and reasserted as strongly as I know how to in the English language that we were committed to that principle and we were committed to working with the OECD to accomplish that purpose with the countries of the world, not just the members of the OECD.

[The information referred to can be found on page 60 in the appendix.]

At the same time, I was getting lots of letters from respected Members of Congress from both the House and Senate, suggesting to me that the OECD was not only helping with this initiative to help us fully enforce our tax laws, but that the OECD project was wandering off the path and getting involved in so-called tax harmonization and trying to interfere in the tax structure judgment of sovereign nations. I went out of my way again to say as clearly as I know how to do in the English language that we did not wish to be associated with any such process.

Those are the two principal issues in the debate in which I tried try to clarify the U.S. position in writing my opinion and making it available to the public. Mr. Hoagland, I think, perhaps without having read what I wrote, chose to characterize my intervention as somehow creating a difficulty for U.S. foreign policy because I was now advocating dirty money.

Perhaps all of you who have lived in the public eye, most of you for a very long time, are accustomed to this. I am not so much accustomed to it. Perhaps I will become accustomed to it.

On the issue of what it is I have said about the World Bank, and again I think Mr. Hoagland suggested that I was personally attacking Jim Wolfensohn, I must tell you this column appeared on Sunday and I really found it quite humorous to be at dinner at Jim Wolfensohn's house on Sunday night so we could have a laugh about it together. It is true that I have said that I think the IMF and the MDBs and the World Bank need to reform. These are not things that I say in the closet or to a selective audience. I have said it on the public record over and over again, as recently as at Jim's house on Sunday night when there was a distinguished group gathered to talk about the reasons why these institutions exist, which is the existence of 4.8 billion people who live in the world with living standards that I think we are all horrified by. And I said as directly as I know how in that company that I do believe we need to raise our standards and expectations of what these institutions deliver. That was not said in a way to be personally critical of Jim Wolfensohn and the things he has been trying to accomplish. Quite to the contrary, I think all of the good things that have been accomplished should be credited. On all of the shortfalls, we should work together, not in a mean-spirited way to find fault with the institutions, because I begin with the presumption that we all want to do good and it is useful to learn from our mistakes.

I must say there is an awful lot of room to learn, because if you look at what we have accomplished in terms of raising the standards of living around the world in the last 50 years, we have a very long way to go. Despite the fact that we have spent hundreds of billions of dollars or provided hundreds of billions of dollars, there is woefully little to show for it, at least as I would measure the productivity that one could expect to see from well-deployed money.

So again, I guess I am not too surprised to find people writing things without what one would consider to be the necessary information, but I take it as part of the badge of having the honor to do public service again.

Chairman OXLEY. The gentleman from New York, Mr. LaFalce.

Mr. LAFALCE. Thank you very much, Mr. Chairman.

Mr. Secretary, I want to emphasize something that I just didn't emphasize enough before at that point. I do want to work with you in a very cooperative manner, in a very bipartisan manner. I look forward to that and I think I can speak for, if not all, virtually all of the Democrats on this committee, too, and we look forward to getting together with you in the near future to start that process.

Let me just focus in on two areas: First, exchange rates and then; second, the roles of IMF and the World Bank with respect to two issues in particular, debt relief and AIDS. But first exchange rates.

You were the President of Alcoa Aluminum, and if you entered into a long-term contract with Mexico, would you have taken payment for a 30- or 40- or 50-year period in pesos without regard to the possible devaluation of the Mexican peso? How would you have accounted for that, and how would you, please, account for a free trade agreement, whether it is with Canada or with Mexico or Israel or Jordan or free trade agreement with the Americas? How would you account for the potential volatility of exchange rates, because our trade agreements historically have not done that?

Mr. O'NEILL. Well, you are right. This is a subject that first as President of International Paper and then as CEO of Alcoa for 13 years.

Mr. LAFALCE. I didn't mention International Paper, because they closed the plant in my congressional district, Mr. O'Neill.

Mr. O'NEILL. I noticed that.

Mr. LAFALCE. That is J. Stanford Smith.

Mr. O'NEILL. That is right. I noticed that Tonawanda was part of your district, and I was happy to say that Tonawanda was closed before I got there. It was not on my watch. But as you know, there are other great International Paper facilities in the State of New York.

In any event, how does one deal with this in the private sector? First of all, you do not make what I would call unbalanced contracts, actual relationships across country boundaries, because you are aware of the uncertainties and complexities that can develop over time. But you are quite right to put the time dimension on the question you did. Because in the kinds of businesses that I have been in, when you go into a country and either buy operating plants or build operating plants, those are decisions for 50, maybe even 100, years. So first of all, you do not go in unless you have a fairly high level of confidence that something like the rule of law that we know here and enforceable contracts and an ability to keep corruption out of your immediate activities exist. So there are some preconditions that intelligent people make before they put assets on the ground.

Mr. LAFALCE. If that was the case, we never would have gone to Mexico, because Vincente Fox campaigned on the imperative of cleaning up the endemic corruption.

Mr. O'NEILL. I was careful to say within the framework of the work that you do as an individual company. I am one who believes you can pretty well secure for yourself an ability to work in a corridor of Western values if you insist on it. And I think I can demonstrate to you I was able to do that in Brazil and in Mexico and in Korea and a lot of other——

Mr. LAFALCE. How would you deal with the exchange rate problems and how do we deal with that in our trade agreements?

Mr. O'NEILL. I guess I think it is not possible to protect, nor probably is it desirable to protect, all of our individual companies and factors of production against shifts in the way the world is configured and the risk associated with changing government structures and rulers and presidents and parliament and Congress and all the rest of that.

Mr. LAFALCE. Should your trade agreements have some escape hatches?

Mr. O'NEILL. I do not think it is possible to create a safe corridor for capital that says no matter what you do we are going to ensure you that sovereign governments, in general, follow fair exchange rate practices. So no, I don't think that you can be protected by your government against exchange rate risk. But there are market devices that exist out there that those of us in the private sector use every day, in effect to make sure that for production purposes we work in the currency of the country so that whatever happens our production cost, in effect, remains protected against the rest of the world. Then the other thing you look at if you are good at making money in the worldwide operations, you look at the basic physical competitiveness of what you do, so that no matter what happens in the world you have an anchor that gives you a better position than anyone else in the world, and then you would use derivative contracts to protect your foreign exchange risk.

Mr. LAFALCE. With all due respect, Mr. Secretary, I find that unfortunately quite deficient, because I have too much experience with trade flows being dependent primarily upon currency fluctuations. You look at the trade we have with Canada and if we are dealing at 88 cents to the dollar, that is one thing. If we are dealing at 65 cents to the dollar, it is something else. Businesses close and people lose jobs and if you enter into an agreement on a certain set of assumptions, and that is a certain relationship between the two currencies, and then there is a 50 percent change or a 5000 percent change, the most basic fundamental element of the bargain has changed so drastically that you never would have entered into that bargain. And I just don't think we can enter into trade agreements without considering that question. And nobody, Democrat or Republican, has come to grips with that issue. And I don't find your response thus far adequate.

Chairman OXLEY. The gentleman's time has expired. The Secretary may respond.

Mr. O'NEILL. As I said to you, I was the Chairman of Alcoa for 13 years and at International Paper for 10. During this time I ran a company that lived in a world where the yen varied between 270 and 80 and mine was always the most profitable company in the world, without regard to exchange rate fluctuations between the yen. If you would like to talk about European countries, yes, it creates pain on a short-term basis if your financial management is not good at providing derivatives to cover exchange rate risks, but it is a fairly short phenomenon. If you know what you are doing, you can make money in a very substantial way in a world that is fraught with uncertainty and the uncertainty of sovereigns changing and currency rates changing, because sovereigns make big mistakes about the financial structure of their own country.

Chairman OXLEY. The gentleman's time has expired.

The gentleman from Iowa, Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. Your written testimony very thoughtfully focuses on IMF reform and I think quite properly it underscores the effort to promote in three words, productivity, transparency and prevention. In that context, particularly of the first and the third, productivity and prevention, it is arguable that the greatest issue in the world today, particularly the developing world, is disease prevention. Here it is relevant to note that the so-called Meltzer Report called for greater attention to the AIDS problem. It also called for a greater grant, as contrasted with lending, component of the international financial institutions.

Consistent with this reform approach, this Congress, led by this committee in the last Congress, passed authorizing legislation for the establishment of an AIDS trust fund and in the last 6 months there has been an awful lot of international discussions on the subject. In any regard, the legislation that emanated from this committee, which is the law of the land, directed the Secretary of the Treasury to negotiate the establishment of such funds to be housed at the World Bank. Could you update this committee on the status of those negotiations?

Mr. O'NEILL. Well, as I am sure you know, a week or so ago the President announced the intention to provide $200 million as a beginning for a trust fund arrangement. We are still working out the details of exactly how this should be housed and administered, and the details are not quite finished.

Mr. LEACH. I appreciate that. I would only stress that the World Bank has more experience than many understand, and it has a mechanism of a 5-to-1 leveraging circumstance, of which the one is the United States. It seems to hold an awful lot of potential for an early timeframe addressing the trust funds issue. And I would only urge, as we have privately discussed, the Treasury put its oar in as strongly as it can. And I am pleased with the President's announcement. We all hope for more, but I hope this is a first step in that direction.

Thank you.

Chairman OXLEY. Does the gentleman yield back?

Mr. LEACH. Yes, I do.

Chairman OXLEY. The gentleman yields back.

The gentleman from Vermont—he is temporarily gone.

Mrs. Maloney.

Mrs. MALONEY. Welcome, Mr. Secretary. In 1998, the world faced an Asian contagion so potentially massive that our leaders in this country feared that our domestic markets could be destabilized if it spread. Before this committee Secretary Summers said the contagion would put American savings at risk, because of what it would have meant for the broad pattern of financial markets if it had not been contained. Obviously, with the explosive growth of investing in this country through mutual funds and retirement plans, such a situation could impact tens of million of small U.S. investors.

Given the possibility that we could face another situation like that in the future, I have a question about how the Administration—the policy that you would put forth. Would your Administration actively work with our international partners to fend off such a crisis or would you stand on the sidelines and leave countries to fend for themselves? In such a situation do you support only IMF lending to countries that prequalify for loans under the conditions developed by the Meltzer Commission?

Mr. O'NEILL. Thank you very much.

Let me begin by saying I think in the world that we lived in then, and even the one that we live in today, that contagion is an issue that should concern us. At the time that Secretary Summers spoke to you I suppose I would have said to you what he did, but I frankly do not believe that we should accept the notion of contagion as something that God intended for us to have. In fact, I think the idea of contagion is one that we should work very hard to develop mechanisms to defeat.

In this sense, if you look today at, let's say, some locations or nation-states that have had financial problems that have been in the news—everyone knows something about Turkey and Argentina and Indonesia. If you look at those three places, and you look at their geographic relationship to each other, and you look at their international trade with each other, I submit that you would be very hard-pressed to make a case that they were in any way related to each other. Yet we have this fashionable notion that if something happens to the financial condition of one, that it could be difficult for other countries, like the three that I mention and a host of others. It seems to me we should not accept this proposition that somehow a weakening financial condition in one difficult place is accepted as a basis for money to race around the world and be withdrawn from other markets on the basis of an experience in one country.

Now, I don't think it is so easy to solve the problem of potential contagion. But associated with recognition of the possibility of contagion has come what I would say is too frequent intervention, because, in fact, we have convinced ourselves we did not have a choice; that is to say, if we did not act, that the consequences would be multiplied like dominoes falling over. That may have been correct, but by making money available on that theory, I think we do promote the idea that the Meltzer Commission report found not a good one, that somehow we have got to intervene everywhere on the spur of the moment in order to protect ourselves against the consequences of someone falling. I think, as we work, that we can limit country problems to individual countries, and that we will, with that, have a much stronger ability to do preidentification of places that are getting into financial difficulty and, therefore, be able to intervene on a precautionary basis rather than standing back and waiting for things to come apart.

So, yes, I think we need to be worried about contagion. I think in the most desirable of worlds we need to be identifying, unraveling financial conditions and working through the international financial institutions before there is a real problem. And in that regard I think we need to become increasingly insistent about the fundamental conditions for association with these institutions which are, as I said earlier, insisting on at least directional activity toward the rule of law and enforceable contracts and an accelerated effort to reduce corruption.

Chairman OXLEY. The gentlelady's time has expired.

The Chair now recognizes the gentleman from Nebraska, Mr. Bereuter.

Mr. BEREUTER. Thank you, Mr. Chairman. I wonder if you would comments on two things, Mr. Secretary. First of all, it seems to me we have an international problem of one or a few people having huge amounts of money which they can move around the world immediately or in very, very short order and that they can manipulate the currency market and the stock markets with devastating effect, that then the IMF is then asked to come in and pick up the pieces and it has a contagion effect beyond that.

I remember leading a small delegation in the office of Donald Tsong, who has a very powerful position of Finance Officer for Hong Kong. He was badly shaken. He had just in his view taken on this group of pirates what were attempting to break the peg between the Hong Kong dollar and the U.S. dollar and he was successful because he intervened in the stock market, which was contrary to every ideological bone in his body, but he was sitting on $80 to $100 billion reserves at the time. A country with small reserves couldn't handle that situation.

I wonder what you think we need to do to adjust to this reality that exists today. Does, for example, the Bank for International Settlements have a role? What do we do?

The second question relates to the Asian financial crisis and how the IMF responded to Thailand, but particularly also the Republic of Korea. There it seems to me a major contributing factor was simply bad banking practices, a whole array of things, lack of transparency, crony capitalism, and I am wondering if you think the IMF did an adequate job of warning about those problems and those warnings were simply ignored and not given much attention or if, in fact, the IMF is up to this task, if it should be allocated in some sort of different fashion, because I think the consequences were severe and they eventually gave those countries fiscal problems that they didn't otherwise have.

I welcome any kind of comments, or perhaps you need more time to reflect on this. But any initial comments or proposals to follow up on will be appreciated.

Mr. O'NEILL. I think we will give you something for the record in addition to what I will say. I think the IMF is up to doing the role that it should be doing, which in a way would scale back some of the breadth of what it is doing now and what it has in the recent past been trying to do, by becoming much more focused. So I think the resources can be there to do a job that is doable.

With regard to renegade money, what I would call renegade money, I would say something else. I think we need to be especially vigilant of what I would call the presence of substantial amounts of hot money in places that have financial weakness. What I mean by that is money that is not invested in the hard, economy on the ground, because if it is invested in physical assets, it is not so easy to pull up a smelter or paper mill by its roots and run off with it whenever you wish.

So I think there are some indicators of danger that one can see. I think the other thing we need to do is partly related to what I said about the dangers of contagion. If we can create a satisfactory way for dealing with the issues of contagion, then we can do a good job of preidentification of places that have difficulties. Let's say that the IMF would recommend to a country these are things that you need to do in order not to become a crisis country and a country chose to ignore that advice, to solve the contagion problems we could teach them very valuable lessons by letting so-called hot money take a bath. I think in places where capital rates of return are, let's say, 25 or 30 percent a year, you know that there is a reason for rates to be so much higher than the cost of capital and that reason is risk. I think the nasty part of what we have done in bailing out some of these countries is that we have, in effect, let people get away without paying the risk premium that was implied in the rate of return that they were able to get. We need to figure out a way that when somebody, in effect, bets the farm on a 25 percent interest rate environment, if the circumstances suggest they should lose it all, they should lose it all.

Chairman OXLEY. The gentleman's time has expired.

The gentleman from Vermont, Mr. Sanders.

Mr. SANDERS. Thank you very much, Mr. Chair.

As you know, Mr. Secretary, we don't have a lot of time and I apologize for that. I would like to ask you three questions if I could.

Number one, I and many Members of Congress and the public are concerned about the issue of transparency. And while I can appreciate that in rare circumstances every organization in this world needs secrecy, the fact of the matter is that the IMF is cloaked in secrecy. Can you assure the committee that you will do what you can to open up the IMF so that the citizens of this country and the world, in fact, can get a better understanding of what that institution does? That is question number one.

Question number two deals with what some call moral hazard, some call corporate welfare. You are aware that the IMF essentially bailed out many large banks who made unwise investments in Asia. People all over this country are outraged. When they make bad investments, the United States Government and the IMF do not bail them out. Will you be prepared to stand up in a very strong way to say to the banks and financial institutions if you want to invest poorly, go ahead, but we are not going to bail you out?

My third question is will you urge the IMF to not just reduce the debts of the most impoverished countries of the world, but, in fact, to cancel them? As you know, our country and other industrial countries have said that the IMF has not. According to a recent report by the GAO, the IMF policies are keeping poor countries hopelessly in debt. The question is will you urge the IMF to cancel, not just reduce debts?

Those are my three questions, Mr. O'Neill.

Mr. O'NEILL. Thank you.

On the first issue of transparency of the IMF, what I would like to do is meet with you, or have my staff meet with your staff, and understand exactly what it is you would like to have for the benefit of the public that you do not now find available. To the degree that we can agree that such information ought to be available to the public so they can understand what these institutions are doing with our money.

Mr. SANDERS. Thank you. We will take you up on that, and we will give you a ring. Thank you.

Mr. O'NEILL. To the issue of corporate welfare, what I was saying earlier to the previous question, was that I want to develop a way so that people who take a risk of earning 25 percent actually have an opportunity both to realize that 25 percent and to lose everything if that is what the circumstances of country suggest. I am certainly not for bailing out investors when they made a free will decision and it turned out to be wrong. I don't think that should be the business of government.

Mr. SANDERS. Good, glad to hear that.

Mr. O'NEILL. On the third issue of debt forgiveness I would say two things. First of all, I don't know of a single case, and I don't pretend to be 100 percent sure of the history of these institutions, but I doubt if there is a single case where a country was forced to take money from these institutions. That means that these loans that are now being the subject of forgiveness are something that was agreed between the granting institutions and the countries. So I think the idea that somehow the IMF and the World Bank and the MDBs somehow intentionally put countries into a financial tailspin, I don't know the evidence of that.

Mr. SANDERS. Mr. O'Neill, you are aware that in some cases the IMF lent money to dictators and really unscrupulous people who made debts in a very undemocratic way without input from their people, and now the poor people of these countries are stuck with these debts that the IMF should not have negotiated with dictators and corrupt people. I would just mention that.

Mr. O'NEILL. Let me say again what I said about rooting out corruption. If you are a real investor, you don't knowingly go where corruption is because it raises the risk premium for your capital. So I am not one who wants to make a case that we should be—

or that our intermediaries, which I consider these institutions to be—should be knowingly making money in the face of corruption.

Mr. SANDERS. You are aware that that has happened, right?

Mr. O'NEILL. It is certainly true in retrospect, as one looks at the fact that there have been people that absconded with the money. There is no doubt about that. I have said on public record, I may as well say it again here, sending the money that was sent to Russia was beyond belief, but it was sent by the previous Administration and actually at the insistance of the previous Administration through the IMF to Russia. I am not in favor of doing that kind of thing.

Now, should we forgive money at a faster rate? I think we should see how this debt forgiveness program is doing. But given the opportunity, I would say this to you as well, as I begin to examine these programs and activities in more detail, I ask myself the question, what does all this look like from the point of view of the president of a recipient country? Then I look at what we have been doing with the so-called HIPC relief and we are saying to the sovereigns who receive principal and interest relief you must do this with the proceeds, it makes me wonder very much if we have really given careful consideration to what it is like to have a responsibility for running the country rather than being at the end of a direction line where there is no coordination among the different trusts that are being put on people. So, while in some sense one might say as we give relief through the HIPC activity and we reduce or eliminate principal payments or interest payments, there is something very attractive about more investment in education. But from the financial point of view, it may be the worst thing in the world to insist that a sovereign now take on new debt obligation as though it were suddenly financially secure, when maybe the best use of relief from principal and interest is simply to put the country on a sound enough financial basis so that it may some day have hopes of being financially solvent.

Chairman OXLEY. The gentleman's time has expired.

The Chair will announce that there are two votes on the floor of the House, Mr. Secretary. There are about 3½ minutes left on the first vote. The hearing will stand in recess.

[Recess.]

Chairman OXLEY. The hearing will come to order.

I now recognize the gentleman from Alabama, Mr. Bachus.

Mr. BACHUS. Thank you.

Secretary O'Neill, last week you testified before the IMF/World Bank about the banking crisis in Japan, and you pointed to what we did here during the 1980s, that we wrote off the debt, we punished the wrongdoers, and we made a fresh start.

Mr. O'NEILL. Right.

Mr. BACHUS. I agree with you that is an appropriate thing to do on many occasions.

I would ask you to look at that analogy with the highly indebted poor countries. I think you have correctly said that in many cases going forward, we ought to use grants as opposed to loans. In fact, in the past I would submit to you that we should have used grants instead of loans. Because we didn't, we have created a horrendous situation in these countries.

I am not going to cross-examine you about this, because I am sure you are aware that millions of people are dying in these countries because funds are being used to repay debt that could be used for health care, education, sanitation and infrastructure.

I would ask you this: I am aware that President Bush in his second debate said and acknowledged that debt forgiveness is appropriate at times. Are you aware, number one, that the rich countries of the world have agreed to forgive the bilateral debt, but that we still have the IMF and the World Bank, and they say they are not in a position to forgive much of the multilateral debt?

First of all, I would say are you aware of that, that we have a contrast between the rich countries forgiving debt, yet the multilaterals not taking that same step?

Mr. O'NEILL. Well, I think it is true that we have some inconsistency even among what rich countries have decided to do. But for sure there is a difference, say, between the beginning initiative with the HIPC—and I would characterize it as that, a beginning initiative—and what some countries have done in a bilateral way, yes.

Mr. BACHUS. Are you also aware of some of the successes that we are hearing from Zambia and other countries? There are countries we are hearing of success, the number of children enrolled in schools and beginning to turn some of these epidemic conditions around as a result of the debt relief that has been granted?

Mr. O'NEILL. Indeed, I have looked at individual country reports and examined what has happened to life expectancy figures and attendance of children at school and the presence or absence of safe water and sanitation conditions and the other things we associate with economic progress or well-being of human beings. But as I said in my testimony, I think where you find there is real progress, the standard of living is going up as measured by the average earning power in the economy. I guess one of the things that I am interested in seeing if we can develop as we go along is, in fact, a very direct measure of what is happening to the average income of individuals and families in all of these developing places around the world, so that maybe we begin with that statistic at the top of everything we look at, because it is probably the best summary figure that tells us whether or not life is really improving in these places.

I suspect you probably have traveled as much or more than I have around the world. It is really difficult to believe the conditions that exist in some countries, and, in fact, to see places that lived under colonialism for a period of time that have actually receded far behind where they were when the rule of colonialism was lifted, and to wonder how we cannot only resolve to change these outcomes, but to accomplish a substantial change in direction and level of standard of living everywhere in the world.

Mr. BACHUS. I would also submit to you in regard to income levels that we are having children go to school for the first time, and I think there is a lag time, but I think once you start educating children, there may be a few years before the income rises, but I think we would all agree in this room that education is essential to improving living standards, and in many of these countries they simply lack those schools.

Chairman OXLEY. The gentleman's time has expired.

Mr. BACHUS. Let me simply say this: I would hope that the Treasury would analyze the pros and cons of the proposals to go further with debt relief and provide 100 percent debt forgiveness for these countries. I would ask you, if you have already done so, to supply some of the information to us. If not, I would hope you would consider such an analysis.

[The information requested can be found on page 62 in the appendix.]

Chairman OXLEY. The gentleman from Texas, Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman.

Mr. Secretary, let me say, reading through your testimony, I don't have any particular problems with what you say on its face, but I think when you dig a little deeper, I think it becomes much more complicated. I used to think I was sort of becoming somewhat of a rational expectationist, but now I think now irrational behavior is a more realistic economic model, particularly when it comes to international markets.

Even in your testimony, I think you have some conflicts in how things have really played out, but I want to give you the benefit of the doubt, because you are new to the job, and you are going to have to ride through these things as it is. But I do want to get your viewpoints on a couple of these things. Your core objectives I agree with, but then you talk about later on page 3 that conditionality is sometimes a problem, and you reference Indonesia.

We have had debates on this panel, left-right, right-right, left-left and in the center, on questions of conditionality and whether or not the Fund and the Bank and Treasury and the G-7 were too harsh on countries. But I think there come times when you want to promote sound monetary, fiscal exchange policy that it requires some pretty tough conditions that have to be imposed. I would concur that Indonesia has not worked, whereas South Korea has worked fairly well, and Thailand has worked fairly well.

I would also agree with your comments regarding issues of moral hazard, and I am all for letting investors lose their money. What they do with their own money is their own business, as long as it is legal. But we also have to recognize, I think, that you have questions of capital flows in emerging economies and the impact that that has. I doubt you would agree with, and I hope you don't agree with the idea, of having some sort of capital flows regulation or capital flows tax. Malaysia, as you know, tried that, and it ended up being a failed experiment.

The I would like you to comment on those, but the three questions I have for you are this: Your Administration has said that you don't want to pursue the same policies that were pursued in the past in dealing with bailouts. I am curious of how you view Turkey different, and perhaps Argentina—maybe you don't want to comment on that—but, how you view Turkey different from what South Korea and Thailand were.

Second of all, we had a hearing last week regarding the HIPC countries, and the GAO reported that it would take 15 years of 6 percent annual real growth for the HIPC countries, the majority of the HIPC countries, to grow out of the concessional lending program. You talk about the idea of lending to pay debt payments, which I think is a disastrous policy. What is the Administration's long-term view on trying to address that, or are we going to just continue to paper over? This goes back many Administrations.

Finally, what are your views or the Administration's views on the issues of dollarization and monetary control boards?

Mr. O'NEILL. OK, good. I don't think you asked me a question about conditionality. You were just commenting on what I said in my testimony. But I do want to make a point about conditionality, if you don't mind.

You know, I believe it is fundamental and it is a question of management principle, if you will. If you have conditionality in any arrangement that you might have, in a private contract or understanding or in relationships between these international financial institutions and a country, if you have three conditions, and you have people to oversee three conditions, and you have measures that you can use to know whether or not the conditions are being met, I would suggest to you you are much more likely to actually accomplish what you want than if you have 300 conditions and they are very murky and immeasurable. It is in that sense—and I understand I am drawing polar extremes to make the case—that I see a need for these institutions to be very careful in the number of conditions that they put under the umbrella of conditionality, and include as a general rule only those that are measurable and, therefore, enforceable and necessary to the broader goal of improving the living condition of a people in the affected country.

Now, on the question of do we handle Turkey differently than Secretary Rubin or Secretary Summers might have done, I honestly don't know. What I can tell you is that what we did in this particular case was to be very clear that we thought the intervention institutions of choice should be the IMF and the World Bank, and that these are the institutions that at least in theory we have held out as the right way for the world to deal with financial crises, problems, and we ought not to become engaged in bilateral assistance on top of or in lieu of appropriate intervention by the IMF and the World Bank.

The other thing I think maybe one can say is different from some of what has gone before is to be very strong in our suggestions to the institutions that they should expect the political leadership of Turkey to take a forthright, on the record, very clear position of ownership of the changes that were going to be made as a condition for the receipt of assistance, which they agreed to do.

It has been, I think, too frequently the case that the institutions have dealt with supposedly empowered finance ministers and maybe with the appearance of the political leadership of the country owning the agreement, but without the reality of that ownership. We were really quite strong in suggesting to the IMF and the World Bank that they should ensure and insist on the ownership by the political leadership of changes that needed to be made, and then—in the case of Turkey for the 15 issues that they decided they were going to tackle—that they, in fact, take legislative action where it was needed before money began to flow.

If you read the newspapers of record in the last few weeks, you will see they have begun to do things that most would have said were not possible. So, I suppose you were here and you can decide for yourself better than I whether these are, in fact, different in kind from what Secretaries Rubin and Summers might have done. They are certainly different from my impression of what has been done in the past as a general rule.

Chairman OXLEY. The gentleman's time has expired. Let me indicate the gentleman is almost 3 minutes over. We will have to move on.

Mr. BENTSEN. If the Secretary could answer the others for the record, I would appreciate that.

Mr. O'NEILL. I would be happy to do that. Thank you.

[The information requested can be found on page 64 in the appendix.]

Chairman OXLEY. Without objection.

The gentleman from Texas, Dr. Paul.

Dr. PAUL. Thank you, Mr. Chairman, and welcome, Mr. Secretary.

Mr. O'NEILL. Thank you.

Dr. PAUL. I appreciated most of all your comments in your statement about transparency and accountability, considering that to be very important, because you say it is essential. Of course, I would like also to have transparency and accountability in another arm of the U.S. Government in dealing with international financial systems, and that happens to be with the Exchange Stabilization Fund. The IMF was set up with funds from the Exchange Stabilization Fund in 1934, and in recent years it has seen to it that Mexico got $20 billion from the Exchange Stabilization Fund and $22.6 billion went to Russia.

This is all off budget, it is not appropriated, and there is a question of constitutionality here on whether or not the Treasury Department should be involved in this type of financing at all.

But as far as the taxpayers' exposure goes, it is greater, I believe, with the Exchange Stabilization Fund than it is with the funding that we give to the IMF.

Recently there were some minutes released from a discussion with the Federal Reserve that occurred in 1995 dealing with the Mexico City bailout, and in this discussion they recognized that the Exchange Stabilization Fund could be involved in gold swaps, and this was recognized as being legal.

The question also came up whether or not there were any other agreements made, other than the one that was currently pending with Mexico, and the answer to that was yes, indeed, we had a swap arrangement with the Bundesbank.

My question to start with is: did that swap arrangement deal with a gold swap, and does it continue to exist? I would like that answered in light of the fact that up until August of the year 2000, the status report on the U.S. Treasury gold always reported that gold at the West Point Reserves, the amount was 1,710 tons, was called gold bullion reserves. In September that label changed, and it changed to custodial gold. During that same period of time, the Bundesbank also had a reduction of gold that they held by 1,700 tons.

I would like to know what is the connection between these two events, and what does this all mean? Do we have gold swaps with Germany, and could we have a little bit of transparency so I can better understand this process?

Mr. O'NEILL. Well, I will tell you, I would not probably be in a position to answer any of these questions except for the fact that on Sunday night when I was working through my briefcase, I found a report that it is my duty to transmit to the Congress providing the information on the most recent examination of the Exchange Stabilization Fund. Indeed, this was a fund set up in the Roosevelt Administration in 1934 for the express purpose of protecting the American financial system from the vagaries of the rest of the world's finance systems. Just as you say, it is empowered to operate in gold and in currencies, and there is a substantial latitude as to how this arrangement can work.

My memory is that last year there was one transaction. It was a fairly small transaction involving an agreed intervention vis-a-vis the yen. It was the only transaction last year. I can assure you, and we will make sure you get a copy of this report, that I found the report really quite complete in its documentation of what was done in the past year.

I don't know the 1995 circumstance. In fact, the funds in the Exchange Stabilization Fund are marks and yen, and, if I can say it this way, attributed dollars. But the U.S. Government does still have gold reserves, and just by coincidence, Chairman Greenspan and I were talking about those reserves this morning. It turns out, by his best recollection—I didn't check, because I assumed that his recollection is always right—but, he was noting this morning that the U.S. holdings of gold are some $80 billion, which I observed is just about the same as Bill Gates' net worth, for whatever that is worth.

In any event, we will get you a copy of the Exchange Stabilization Fund report, and if there are additional details you would like to have, I would work with you to see if we can't get them for you.

[The information requested can be found on page 65 in the appendix.]

Dr. PAUL. If I could follow up on this, thank you very much.

Chairman OXLEY. The gentleman's time has expired.

The gentlelady from California, Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman.

Hello, Mr. Secretary. Let me follow up on a question Congressman Leach asked you with regard to the World Bank AIDS Trust Fund and my conversation to you about this.

Last year, of course, we passed the World Bank AIDS Trust Fund. It was signed into law, and it was the responsibility of the Treasury to coordinate the efforts and to negotiate this Trust Fund. To date this Trust Fund has not been negotiated. One of the reasons we are very anxious about this is, of course, AIDS is killing many, many people around the world. Since the passage of the World Bank AIDS Trust Fund, we have estimated over 1 million people have died in Africa alone.

What I want to ask you is what is going on in terms of the negotiations? You indicated that the details were not quite finished. Last week, or the week before last, the President announced his commitment, $200 million to an international trust fund, but we don't know which trust fund he is talking about. This Congress worked very hard, very diligently to negotiate the principles and authorities and all of the details for the World Bank AIDS Trust Fund, and to date nothing has happened.

So I would like to hear more from you with regard to the Trust Fund, which is the law, and what are you doing in terms of enacting that law, or are you trying to get around it by doing something new?

Mr. O'NEILL. I honestly can't speak to the question of why the previous Administration didn't do anything about this.

Ms. LEE. The previous Administration transferred $20 million only. It should have been $150 million. We were very disappointed at that dismal amount of money that was transferred.

Mr. O'NEILL. Actually, it is my impression they didn't move anything. But in the budget we put together in January and into February, we did decide we were going to move $20 million to get started with this Fund and to make good on the legislation, just as you say. It has been subsequent to that that the President indicated we are going to now put $200 million into a fund. There is still work going on at the OMB as to exactly what vehicle should be used.

Ms. LEE. Why is there a question about which vehicle?

Mr. O'NEILL. Well, there are substantive discussions. Kofi Annan has suggested that the U.N. has a special capability for running this kind of activity. So there is a look to see what are the merits of the different devices one could use to make sure that this money does the highest value job that is possible in putting money where it accomplishes the most.

Ms. LEE. Mr. Secretary, these funds should not be mutually exclusive. We passed one fund last year which should be enacted immediately. The Secretary General of the United Nations is also talking about a fund which hopefully will be enacted immediately. But the nature of the pandemic is so enormous that we need both funds. My concern is, once again, Treasury being in the lead to negotiate the fund that was enacted into law, what is the problem with complying with the law at this point?

Mr. O'NEILL. We are getting it done. I think it is not true that the Congress appropriated the amount of money authorized.

Ms. LEE. No, we didn't appropriate it. We authorized it.

Mr. O'NEILL. Right. So we are working on the structure that is required to respond to this legislation, and we should have it done fairly soon.

Ms. LEE. It was my understanding also that in the legislation we wrote a provision that you would report back by April 30th on actually the status of those negotiations.

Mr. O'NEILL. Do we have a report?

The staff says the report is completed. We should get you a copy today.

[The report requested can be found on page 93 in the appendix.]

Ms. LEE. Today. Thank you.

Let me just ask one more question with regard to this $200 million. Do you know what accounts the President is intending to take its $200 million from in terms of the Trust Fund which he announced his support for?

Mr. O'NEILL. We talked about this at the National Security Council. The Department of Health and Human Services is going to be the source of $100 million, and the State Department will be the source of another $100 million.

Ms. LEE. Mr. Secretary, I would encourage you and urge you, in fact, to not take money from funds that are needed in terms of infectious disease control, in terms of U.S. peacekeeping, in terms of any kind of initiatives that don't need to be robbed. I mean, we have a surplus in this country, and $200 million is nothing in terms of new money. So I would just encourage you, whatever fund that is going in, make a pitch for new money, and also enact the World Bank AIDS Trust Fund immediately. The pandemic is such that we need as much money and as many resources as possible through as many vehicles as possible.

Thank you very much.

Chairman OXLEY. The gentleman from Connecticut, Mr. Shays.

Mr. SHAYS. Mr. Secretary, it is wonderful to have you here. I want to thank you for your openness. I hope that over time you don't become so jaded that you aren't as open as you have been. I think in the long run it pays off.

Mr. O'NEILL. Thank you.

Mr. SHAYS. I know you have so many different responsibilities and so many different areas, but I do want to just focus on debt to the IMF and Africa. I realize it is a small part of all the things you focus on, but I have a tremendous amount of regret as a Member of Congress that Congress didn't get more involved in Africa years ago, and I didn't get more involved.

When Secretary of State George Shultz testified before Jesse Helms' committee last year, he said, "People need to live in reality. There have been a lot of loans made to desperately poor countries that are never going to get repaid, and a lot of them have been extended by the IMF and the World Bank, and it seems to me these organizations should realize that reality and write them off just as if you were running a private bank."

So my question to you, Mr. Secretary, is shouldn't we stop the IMF and World Bank from making new loans just so they can pay off their old loans?

Mr. O'NEILL. Well, as I said in my testimony, I believe this: I do not believe that we should confuse the recipients or ourselves or our people by calling something a loan when we really intend for it to be a grant, which is to say we have no hope that the principal and the interest are ever going to be paid. That is a grant. Frankly, to me, it is not an acceptable way to do business, to confuse those terms. That is not to say that from time to time you won't be disappointed about performance on a loan, but when you look at the amount of money that we are talking about forgiving, it is a huge amount of money. If I remember the numbers right, if we went to 80 countries——

Mr. SHAYS. We are talking primarily about 35 countries.

Mr. O'NEILL. Let's talk about 35. As I understand, my recollection is that full forgiveness is $43 billion. My staff tells me my memory is good.

Mr. SHAYS. We are not talking about Sudan and Somalia.

Mr. O'NEILL. I am talking about the 35 countries that I am sure you are, the ones that are subject to debt forgiveness, $43 billion. It is very hard to make a case that anyone could make $43 billion worth of mistakes. So for sure we need to work on letting this money go. The process that has been put in place is working away.

One thing, I think this is right, is that as we become more direct in what we are doing with loans and grants, that we not make new loans when it is fairly certain they won't ever be paid back either, so that we put our policy where our heart is and our programs where our heart is and face the reality when we are giving the money away that we are really giving it away.

Mr. SHAYS. What tells you, though, that many of these African nations are going to be continuing to grow their economy? We are seeing the AIDS epidemic savage certain areas of various countries, where the kids have no teachers, they are all dead, their middle class is just dying off in large numbers, five million orphans. I just don't see what the IMF sees as the ability of these countries to pay back debt. So I would love to know what you see. What hope do you see in Africa for their ability to pay these debts?

Mr. O'NEILL. Well, I think you have to do this one country at a time. There are different degrees of capability to pay back new loans if all the old ones are forgiven and the interest is forgiven on the old ones. I was saying earlier I think we should not look at these countries through the lens of the IMF as though the IMF existed alone in the world. Intelligent risk-takers would look at these questions from the point of view of the leadership of the receiving country, and then they would look at the financial condition of the receiving country and understand what degree of risk or security there was with regard to the fiscal situation in the country. Then they would not just look at the IMF, they would look at the IMF and look at the U.N. and all of the sources, both public and private, of funds flowing into a country, and they would not necessarily follow what we have decided to dictate apparently to the IMF that they must say to countries: when you get principal and interest relief, you must spend the money on these new purposes, which we know better than you what you need to do.

I think no one could argue that some of the things we are suggesting aren't desirable, but they certainly don't have anything to do with fiscal responsibility or the prospect of ever helping a country get on a good footing so that it can be responsible for itself.

Mr. SHAYS. Fifteen seconds just to respond and say my concern is the IMF doesn't want to acknowledge that they made bad loans, that they then reinforced those bad loans by giving more loans to pay off the bad loans, and we have been doing it for years and years and years. That is my concern.

Chairman OXLEY. The gentlelady from California, Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman, for holding the hearing, and I thank the Secretary for being present here today.

Mr. Secretary, I sent you a letter February 16th that basically urged you to support complete debt cancellation for the world's poorest countries during the February meeting of the G-7 finance ministers in Palermo. That letter was signed by 73 Members of Congress, both Republican and Democratic Members. Unfortunately, until yesterday I had not heard from anybody. I did get a brief response yesterday, but I am sure that both you and I should have the opportunity to understand a little bit better where you stand on debt cancellation.

I would like to just ask, I guess there has been a lot of conversation here today about debt relief. I don't know if you know what happened last Congress. The Appropriations Committee reported out $69 million in debt relief. We went to the floor cold with an amendment. We ended up with $225 million for debt relief from the U.S. When that ended up in the conference committee, the conference reported out $435 million for complete bilateral debt relief.

Now, this was a result of a lot of hard work by a lot of good people, religious organizations, non-Government organizations, all under the banner of Jubilee 2000. We worked very hard to get us to live up to what was a commitment to deal with this issue of debt relief.

We don't want to stop here. We want to continue to make a push for full debt cancellation, but, of course, we know that the United States would play a most important role. I mean, we are the 800-pound gorilla at the IMF and the World Bank.

Where do you stand on complete debt cancellation for these poor countries? Your letter back to me and the other 17 members really does not discuss that. Could you help me to understand?

Mr. O'NEILL. You know, I have said on the public record, and I am sorry if you didn't think my letter really reaches your question, that I think we should proceed with the program we have in place, I think we ought to proceed with the process that has been put in place.

I think if we are really going to entertain the possibility of writing off everything, we need to face up to how many billions of dollars that is. Before we adopt the policy, we need to put it to ourselves whether we are ready to appropriate the money that is required for, let's say, our 25 percent of all of the IMF debt forgiveness, whether we are prepared to ask the American people to appropriate it at this time. As long as we are at it, we should go beyond the IMF and the World Bank and the MDBs and look at all the bilateral loans that exist out there and see how we differentiate all the loan arrangements that we have, either directly or indirectly, through the Federal Government, and see what our taste is for doing this and on what basis we would do it.

Ms. WATERS. Well, let me just share with you some information that I have. I am told that to provide complete debt cancellation to these 22 impoverished countries would cost only $287 million per year for the IMF and $215 million per year for the World Bank. To extend complete cancellation to all heavily indebted poor countries would cost an additional $81 million for the IMF and $138 million for the World Bank.

Considering this is a modest amount, considering the fact that Congress appropriated $435 million for debt relief last year alone, where are you getting your billions information from? Would you give me your figures again?

Mr. O'NEILL. $43 billion for the 35 countries. I think the difference is that your numbers suggest that we are going to write off the principal and interest over the life of the loan instead of—if you are really interested in writing loans off, you write it off. You don't continue to carry it on the books as though somehow it only failed to be repaid 1 year at a time. Perhaps that is the difference. From a financial point of view, if you have got a bad loan, it is all bad. It is not bad 10 percent. If it is a 10-year loan, it is not bad 10 percent this year and 10 percent next year, and 10 percent, and so forth, every year until you get through 10 years. It is no good today, and it is not ever going to be any good. That is what we are talking about.

I think the difference is a difference between an idea, which I frankly never heard of before, of amortizing a bad debt rather then recognizing it as all bad at once. It is a new concept to me, I must say.

Chairman OXLEY. The gentlelady's time has expired.

The gentleman from Florida, Dr. Weldon.

Dr. WELDON. Thank you, Mr. Chairman.

Just to follow up on the lady's question, were you implying that you think it would be appropriate if the IMF and World Bank are going to write off these loans, that the Congress appropriate the money to make the loans good, that that is necessary?

Mr. O'NEILL. Well, in this world where we are probably in all stages of loan maturation, what I was basically saying is that while we don't often think of ourselves as having a balance sheet, we have, in effect, said to the American people, we participated in a process where we used your taxpayers' money to create a loan fund or to guarantee a loan fund, and the money was then given to these countries, and by all accounts many of these loans are not serviceable, they are not ever going to be paid back, the principal is not going to be paid back, the interest is not going to be paid back.

So probably I should grant you the point that we wouldn't in most of these cases have to actually appropriate the money, but it is an appropriation of the American people's money. But if we basically say we have an asset we don't have, and we write it off to the tune of $43 billion, at least as a private citizen, I would be pretty interested if my Government held out to me they have an asset that they have decided they really don't have. I would like to know what the balance sheet looks like, as well as the income statement.

Dr. WELDON. Sure, and I certainly support you on that. I have read your statement, and I support particularly focusing these organizations more appropriately in areas where I think they have really been more effective in terms of promoting international financial stability and stable currencies. But I just wanted you to clarify that for me. You are not necessarily suggesting that for the IMF and World Bank to properly write these off, we would have to make an appropriation. They can do that, but we would have to be notified that the balance sheet has contracted substantially.

Mr. O'NEILL. There is a secondary consequence. If you believe, as I do, that these institutions should stay in business, and we suddenly decide to write off all of these loans and the prospective interest payments, it very much changes the loan position of these institutions.

Dr. WELDON. Absolutely. I understand that.

Mr. O'NEILL. In fact, one would have to begin appropriating very substantial amounts of money over time in order for these institutions to even maintain their current level of activity. So I think even the way we keep, frankly, kind of funny books in this country, we would eventually be in a position where we would have to tell the American people we are going to have to appropriate substantial amounts of new money in order for the institutions to maintain their level of activity.

Dr. WELDON. Thank you for clarifying that for me.

I wanted to just quickly get back to an issue that you alluded to in your response to Mr. Oxley's question. You were referring to tax policy, international tax policy, OECD.

Mr. O'NEILL. Right.

Dr. WELDON. I assumed you were alluding to in parts of your response to the Clinton Administration rule regarding U.S. institutions reporting the names and other identifying information on non-resident aliens.

I was curious, has the Treasury—I know we are still in the comment period on that. I have had some concerns about that rule being broadly applied in terms of precipitating capital flight. As I understand it, it is estimated—and I realize it is hard to get a gauge on something like this, but it is estimated it could be as much as $1 trillion of foreign investment in U.S. financial institutions.

Have you at the Treasury looked at the implications of capital flight, in other words, money going elsewhere, should that rule be fully implemented?

Mr. O'NEILL. We are looking at it. As you say, it is in process, and we are sensitive to the issue of not creating a disadvantage for investors who choose to be in the United States. But I think we also feel a keen responsibility to enforce the law, to enforce the tax law and other laws of the United States. So it is a constant process of examining how one can accomplish multiple purposes without running into oneself. It is not always so easy.

Dr. WELDON. I read your guest editorial in the *Washington Times* that dealt with this issue. You referred to the American investor who goes to the Cayman Islands to escape U.S. capital gains tax. Would you agree that a preferable approach to that is to lower the U.S. capital gains tax as opposed to pursuing these people through administrative and legal actions?

Mr. O'NEILL. Well, you know, I am on the record as saying I would like to get rid of a whole lot of attributes of our current tax system. Hopefully, as soon as we are done enacting the tax bill that is in front of the Congress now and make good on the President's pledge that we are finally going to fix Social Security, we can turn our attention to a simplification that goes far beyond the question of capital gains and straightening out a tax system.

One thing I have found—it is something in a way even when I was outside the Government I have been working on, because I am interested in and long have been interested in issues of public policy—you can be sure if you go to almost any audience I have ever appeared before in the last 20 years and suggest to them you know some way and you have some intent of reducing the 9,500 pages of our Tax Code to, say, 95 pages, people will get up on their chairs and stomp their feet. I have yet to find anyone who likes the Tax Code the way it is, and not just for the question of perverse implications of the way capital gains are applied, but for all of the reasons that offend people and make it more difficult for them to relate to their Government, which we keep piling on.

So I would love to see us make major changes to our tax code.

Chairman OXLEY. The gentleman's time has expired.

The gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

Just in brief, in response to some of the questions I heard Congresswoman Waters and Congressman Sanders indicate, we talk about debt relief with reference to Africa, but it is a known fact that when we gave much of that money to dictatorships and to other rogue governments, to me it is similar to what we have in some of our urban cities today, something called predatory lending, where you lend money out to folks that are not able to pay it back, you know, but for other reasons, and then they have to pay it back, so then you take back their house and they put everything in it. So that should be considered when we are looking at the question of debt relief, debt forgiveness, as far as to many of the nations in Africa.

But let me go to my question. I just wanted to put that out. In last year's foreign operations conference report, there was language to eliminate the World Bank and IMF-promoted user fees. I am sure you are aware the language requires the U.S. to oppose any World Bank, IMF or regional development bank loan or debt relief agreement that includes user fees or other charges for primary education or primary health care.

In the Administration's fiscal year 2002 budget, they support striking that language. I want to know, what is your position? Are you in favor of removing this language?

Mr. O'NEILL. We are trying to simplify the language. We are certainly in full accord with the idea that these restrictions and the intent of the words is appropriate. We are just trying to do some simplification.

If I may comment on your earlier question, because it has indeed come up a few times before about this issue of lending to so-called dictatorships, you know, there is a fact case that I think is analogous, and it is an engagement I have had with the Russian Finance Minister in the 4 months I have been here now.

When I first met him in Palermo, the media was reporting that the Russians were thinking about defaulting on their so-called Paris Club debt. The reason they were going to, at least what he said to me in Palermo, was, well, you know, we would like to pay it, but our Duma, that is to say their legislature, wouldn't appropriate the money. It caused me to say to him, you know, it is really an interesting thing. When you make a contractual relationship with a sovereign state, at least one would like to believe that you have made a real contractual relationship in the way that we think about enforceable contracts. So I frankly don't give a damn about some part of your government that doesn't want to pay their fair owings to the rest of the world. That is your problem. Otherwise, if we can't have an understanding of what the rule of law is, I don't know how we can deal—I don't know how any institution, the IMF or the World Bank, can proceed on a basis that if they make a loan and the people who were there who made the agreement turn out to be rogues, we forgive the whole country because the rogues took it all.

It is awfully hard for me to understand how to extend this principal that if the top guys are bad, we forgive the whole country. It is a very difficult doctrine to me. Not to say I am not sympathetic to actually wanting to prosecute the devil out of people who absconded with the resources of the people they were charged to lead; I have lots of sympathy with that. But I worry about the extension of a doctrine that says, well, the people got ripped off by their leaders; we will keep sending money, because maybe the new leaders will be better than the old ones.

Mr. MEEKS. Except until some of those situations, some of those leaders we put there to practice our doctrine, we knew they were bad, we gave them the money so they could do what they were doing for the protection at that time against the Russians in the cold war. So we knew they were bad, we knew they were raping the country, but we didn't care, because we had a different goal or different reason for giving the money. Now that it is over and we are talking about democracy, and the cold war has ended and we are talking about promoting democracy elsewhere, and now we have countries where they have legitimate leaders and elections and a democratized system, but they can't go anyplace because of the debt that was placed on them in the past, they can't educate their people, they can't provide primary health care, so therefore they are not able to go, so they are smothered. But there is some responsibility, I think, on us and the IMF and the World Bank to recognize those factors so we can help promote democracy, as we say.

Chairman OXLEY. The gentleman's time has expired.

The gentleman from California, Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

Mr. Secretary, I want to thank you. Having read your statement here, I thought you did a remarkable job. I would like to actually cite it as a case example for saying a whole bunch with a few words.

Mr. O'NEILL. Thank you.

Mr. OSE. I wanted to say I appreciated your respect for my time, and I will try not to waste yours.

Mr. O'NEILL. Thank you.

Mr. OSE. In your remarks as written, you made a couple of points here which you have reiterated with Congressman Meeks about the certainty of the judicial systems in the countries into which the IMF lends money and the ability to recover; the fact that the multinational development banks ought to spend their resources in areas where they have expertise, which I thought was a remarkable breath of fresh air; and using results-based performance indicators to actually measure what it is we are getting for our money.

I want to strike specifically at that last point. I know where you come from in private business, and I have not been near as successful as you, but I do aspire. In a typical lender-borrower situation, the lender has the control of releasing any money under a loan. In other words, you can't get it until you have satisfied that lender. The purpose of that is to ensure the borrower's performance to the terms and conditions of the loan.

In many cases, unfortunately, it is apparent that, as it relates to IMF or World Bank or maybe some of the international development banks, after the fact that the loan funds that had been extended were not used as they were originally agreed upon. In other words, the conditions and terms were violated, and that those funds were then diverted to other uses. The thing I keep coming back to is how do you prevent the diversion?

My question is, are you satisfied by the controls that the IMF presently uses to ensure that loan funds are used for the intended purposes, and, if not, do you have any specific suggestions that could be implemented to improve the accountability over how those loan funds are used?

Mr. O'NEILL. I think this is an area where we can expect, maybe even demand, improvement. If you use as an example the case of what happened in the money that went to Russia, it is almost as though there were not even the simplest of conventions, for example, second signature requirement, as you suggest, to release funds.

But, of course, I am sure you understand from the line of your question these are complex matters, and it is not as easy as having a second signature, say, in the example where maybe an individual is buying a house and you can go and look and see if the structure is being actually built. Oftentimes these monies are going into a world of fungible money where it is difficult to tell what is happening to the overall resources of a country in the financial system, where, say, you are dumping $5 billion, because there are many, many tens of billions of dollars in question that are flowing in and out every day.

But it is possible, I think, to establish certain ratios and levels, maintenance of levels of balances that one could then be quite certain that monies flowing from the IMF and the World Bank didn't simply disappear into the world of fungible money, where the money from the people of the world got taken away by badly inclined leaders or people who know how to manipulate financial things.

So, yes, I think it is possible to do better, and as we work with the IMF and the World Bank, this is an area that we will develop in more detail with them.

Mr. OSE. Mr. Chairman, I don't recall, are you going to allow questions subsequent to the closing of the hearing? Are you going to leave the record open?

Chairman OXLEY. Yes.

Mr. OSE. If I might, I would be happy to submit it in writing, and then you can have the appropriate person make specific recommendations.

Mr. O'NEILL. Great. We will do that.

Mr. OSE. Thank you, Mr. Chairman.

Chairman OXLEY. The gentlelady from Ohio.

Mrs. JONES. Thank you, Mr. Chairman.

Good afternoon, Mr. Secretary. I guess I am the last one. But I want to go back over a few questions that you answered for some of my colleagues.

In response to Congressman Gregory Meeks' inquiry with regard to some of the Sub-Saharan countries and debt relief, I don't want to paraphrase what you said, but, anyway, you remember what your response was about—strike that. Let me start over and say, do you recognize that in many of the African countries where we entered into agreements with them, that none of the leadership or anyone in any logical descending order—like our Congress goes from the 105th to the 106th, 107th, that kind of setup doesn't exist in those countries? You recognize that, don't you?

Mr. O'NEILL. I do.

Mrs. JONES. So, therefore, it is my opinion, one lowly Member of a 435-Member body, that that is something that ought to be taken into consideration when you consider whether those loans ought to be forgiven or not. Specifically we do it in our country all the time, bankruptcy, people are out from under the debt. Somebody pays it off, and that group goes and creates another business, and maybe that business is successful. In many of these countries, there is the opportunity—for example, many of them are a diamond in the rough, and they are real diamonds. For us to not take that into consideration with regard to forgiveness of debt, in my opinion, is illogical. I don't want to say it is irresponsible, but illogical.

Would you agree with me on that?

Mr. O'NEILL. I think we need to look at these individual country situations one at a time, and I really do think it would be valuable to the Congress to roll up the implications of debt forgiveness across—both principal and interest forgiveness—across all of these arrangements that have existed sometimes for 50 years with 18 or 25 different intervention programs, and also look at the experience we are having with the 22 countries that are now running through the established process to begin getting debt forgiveness, and then bring these facts together and talk about what the policy of our country ought to be not just with regard to the IMF or the World Bank, but with regard to bilateral loan arrangements.

Mrs. JONES. Maybe multilateral as well.

Mr. O'NEILL. And the multilateral development banks. For sure I think we should open the scope of this question and bring some more facts to the table and see how we should proceed.

I think you should have no doubt that I think what we have begun to do with the HIPC initiative is well-advised and directionally correct. It is really a matter of how fast we should move and what the scope of our activity should be.

Then I want to say again, because I think this is really an important point, we need to stop thinking about these countries from the point of view of individual program interventions. The idea of saying to a sovereign country that, because the IMF has forgiven or the World Bank has forgiven principal and interest on a loan, that that should then give us the automatic right to force them into yet more borrowing—even in the private sector—because we have these wonderful intentions about improving their education system or their health system. This is a bridge too far in terms of our understanding of what it means to run a country, as distinguished from sending grants or loans to a country.

Mrs. JONES. I just want to extend it to say, then, so if you don't want us to determine what the country should do with the dollars, are you saying, then, that the countries ought to have the ability to say this is what I would like to do and then receive the dollars? Or are you saying just leave them out there floating somewhere?

Mr. O'NEILL. No, no, no. I am saying, as I said earlier, that I think we should have much more limited understanding of what we mean by conditionality, and as we do conditionality, because indeed it will come from individual institutions and streams of money, that we need to do conditionality in the context of a complete country, not as though a program carried with it the right of establishing ever-larger notions of conditionality, which I think are sometimes inconsistent with each other and unenforceable in any event.

Mrs. JONES. I would like to echo my colleagues' concern about the AIDS issue and the dollars being allocated to assist these countries, because it may come to a situation where there is a grandmother raising 55 children, which makes no sense when we could come in and help out the countries.

Chairman OXLEY. The gentleman from Texas has been very patient, and I recognize the gentleman for 5 minutes. Then we will close down.

Mr. BENTSEN. Thank you, Mr. Chairman.

Fascinating testimony, Mr. Secretary. Just a couple of points.

First, I do want to go back a little bit to the question of conditionality with respect to IMF loans or bailouts or whatever we might call them. I would recommend that you go back and look at the South Korea package, because I was in South Korea as that was going through, and I remember sitting—I was with the prior Chairman, and we sat down with Kim Dae-Jung right before he was sworn into office, and he was having to face the fact that for the first time the Koreans were going to have to pass legislation to allow layoffs by private corporations and look at the idea of establishing an unemployment compensation program, and the markets were looking at how they could engage in more transparency, all things that we thought were good for them as a form of conditionality, and I still believe that today.

So I think you can draw a lot of comparisons to Turkey and what you are doing there.

I guess the point I would make is that I am not sure that things were done all that poorly, given the situation at the time; that we did what we had to do, given what the impact might be. I think you are on the right track, quite frankly, with Turkey, but I don't think there is a lot of difference.

I want to go to the conditionality with respect to HIPC, because this is sort of what I was getting at, and I think the GAO report, which I am sure your staff has looked at, is quite telling.

When we first started the HIPC legislation a couple of years ago, I was one of the ones that raised the idea we ought to treat this almost like a bankruptcy and ought to write down the debt, and we also ought to say that countries that participate in this stay away from the window, even if it is the soft loan window, for a period of time.

Now, that is going to require a policy on our part, as well as our partners through the Fund and the Bank, to be willing to step up to the plate, because obviously these countries can't survive without some capital infusion.

What you are saying is appealing, although I hope that the Administration—and I realize you all are just getting in and you are trying to figure this out, that this is the direction that you want to go in, because I do think it is a mistake, and it really is just a short-term bridge that we are giving them to say, we are going to wipe your debt off, but you are going to have to come back and borrow again, and we are going to be in the same problem 5 years from now, because it is highly unlikely that any of these countries or any country is going to achieve that level of real growth over that period of time to get out of there, particularly a lesser developed country. So I hope that is the case.

Finally, I am curious what the Administration's viewpoint is with respect to packages like with Turkey and others. If you go back, there was a lot of criticism of Mexico, a lot of criticism of South Korea, of Thailand and other Asian countries that conditions included contractionary economic policies in the fiscal area. But I am curious what the viewpoint of the Administration is as to how you would otherwise build confidence for currency when your goal is to try and stabilize the currency and exchange rates.

Mr. O'NEILL. Well, first of all, you know, my own experience with this and observation of what we have done in the last 50 years with the very best of intentions is if we don't have, we ought to have a lot of humility about how much we actually know and understand about the straight path to improving the standard of living in the world and reducing the level of poverty that exists in the world, because we have spent, I suppose—around the world we have probably spent, not just in the U.S., but with everyone—$1 trillion, and I would say we have precious little to show for it.

When you look at where we have taken some fairly strong interventions, I think even with the best of intentions, to help to accelerate the standard of living and economic growth in countries, the results have been pretty pale tea. So I think we are well advised to be pretty humble about what we know and how well we are able to deploy it.

I remember reading, I think, in maybe 1959 or 1961 Walt Rostow's "Five Stages of Economic Growth," and it wasn't very revealing, it wasn't very helpful, and there is still nothing much better than what Walt Rostow wrote more than 40 years ago. So I think we have a long way to go to actually understand how to do all of this.

Having said that, I do think that we can improve the likely outcomes by insisting on the things that we know are necessary. This is repetitive, but I don't think you can find a place where good growth and reduction in poverty and improvement in the standard of living exists where there are not a rule of law and enforceable contracts and at least directionally a reduction in the level of corruption. Those things we know are necessary.

Someone said earlier, and I would stipulate this point, that without education there is probably no hope at all. In that regard, you know, I said when I was at the Asian Development Bank meeting a couple of weeks ago, I think what the President has said about "no child left behind" ought to be the mantra for all of us when it also comes to questions of our position on international advancement.

Education needs to be a primary focus. But, again, I think it is really critical that we not look at nation-states, even from the most genuine, sincere concern about absence of education, and act as though the rest of the country didn't exist, because it does. If they are ever going to have hope of financial success, there are some things they need to do. I think it is really quite telling that Russia had tax rates that were very high, expropriation-level tax rates, and they were collecting almost no money. When they reduced their tax to a 14 percent straightforward flat tax, they tripled their revenue.

So there are some things that we do know that are therapeutic in moving a nation toward a more governable position. Again, we need to balance our humility and insist on the fundamentals that we are pretty sure about.

Chairman OXLEY. The gentleman's time has expired.

Mr. Secretary, thank you again for your testimony. I share the opinion of the gentleman from Texas, it is most fascinating.

Without objection, the record for this hearing will remain open for 30 days to permit Members to submit questions in writing to the Secretary and have his responses placed in the record.

The hearing is now adjourned.

[Whereupon, at 4:40 p.m., the hearing was adjourned.]

A P P E N D I X

May 22, 2001

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

"State of the International Financial System"
May 22, 2001

Today, the Committee is meeting to hear from the Secretary of the Treasury, Mr. Paul H. O'Neill, on the state of the international economy. This hearing is mandated by the FY 1999 Foreign Operations appropriations bill. That law provided for an $18 billion increase in U.S. funding to the International Monetary Fund. To ensure that the IMF would effectively use these funds, Congress included the requirement, authored by Representative Mike Castle, that the Treasury Department report annually on IMF reforms and testify to this Committee on the state of the international financial system.

Earlier this year, the Committee heard from Federal Reserve Board Chairman Alan Greenspan about the conduct of monetary policy and the state of the domestic economy. Given the interdependence of the U.S. with the rest of the world, economic growth in the United States is greatly affected by disturbances or crises in the international economy. For instance, the recent 30 percent drop in the Turkish lira, caused Ohio-based Procter and Gamble to blame the Turkish economic crisis for a decline in earnings projections for the second half of 2001. Accordingly, the Committee welcomes this opportunity to oversee U.S. international economic policy.

An important way the U.S. has influenced the direction of the international economy is through its participation in international financial institutions, principally the IMF and the World Bank. These two institutions, as well as the General Agreement on Tariffs and Trade (GATT), were the result of the Bretton Woods Conference in 1944, and comprised the Western world's response to the Great Depression and World War II.

The IMF's traditional focus has been on exchange rates and balance of payments and how they affect trade and the stability and growth of the global economy. The World Bank has traditionally focused on providing loans to assist countries in developing their basic infrastructures. As the international economy has evolved so too have the institutions' programs, with the IMF now also providing longer-term loans for "development" purposes and the World Bank providing short-term structural adjustment loans.

Most commentators agree that the Bretton Woods institutions were successful in reconstructing post-World War II Europe and Japan, assisting in the economic development of a number of less-developed economies, and avoiding international economic depressions. What there isn't agreement on is their success in providing development in poorer countries and combating economic crises in a more interdependent world. The last half of the 1990s was marked by recurrent financial crises and a recognition that the economic situation in some of the world's poorest countries has gotten worse, not better, despite billions of dollars in development loans. As a consequence, both the international financial system and the multilateral lending institutions have been the subject of widespread calls for reform.

In that regard, the IMF legislation also had a provision authored by International Subcommittee Chairman Doug Bereuter calling for the establishment of an advisory commission to review the need to reform the World Bank, the IMF, and other multilateral organizations. This so-called Meltzer Commission issued its report last year and will no doubt be the subject of review by this Committee today and in the future as it conducts its oversight of the international financial institutions under its jurisdiction.

In addition to U.S. participation in the international financial institutions, I am sure the Committee will want to hear the Secretary's thoughts on how the U.S. should respond to some of the economic problems in other countries and other regions of the world. Japan's economic stagnation, Turkey's and Argentina's currency woes, EU's interest rate policy, and foreign exchange policy may all be subjects on which the Committee will seek guidance from the Secretary today.

In closing, this hearing gives this new Committee with its enhanced jurisdiction over the financial services sector a chance to hear from a new Administration on how best to use these international organizations to encourage trade and economic growth. From my own perspective, I am supportive of international efforts to improve trade and economic cooperation among countries. While some would prefer to take a more isolationist stance and withdraw U.S. participation and leadership from these institutions, such a stance is neither desirable nor conceivable in the 21st century. A much more constructive route is to focus on how to best reform and use these institutions to increase economic prosperity for the U.S. and our trading partners.

With that, I welcome you to your first appearance before the Committee on Financial Services and look forward to your testimony.

Opening Statement
Hearing with Testimony from the Secretary of the Treasury
May 22, 2001
The Honorable Doug Bereuter
Chairman
Subcommittee on International Monetary Policy and Trade

Chairman Oxley and Ranking Member LaFalce, I would like to thank you for conducting this important hearing with testimony from the Secretary of the Treasury, Paul O'Neill. Most importantly, I would like to welcome Secretary O'Neill in this, his first, appearance before the House Financial Services Committee. As is well known, Secretary O'Neill brings significant public and private sector experience to the Department of Treasury. He has been the Deputy Director of the Office of Management and Budget (OMB) and most recently, the Chairman of Alcoa.

The Secretary of Treasury is required annually to come before this Committee and the Senate Committee on Foreign Relations to report on the condition of the international financial system and on the progress in reforming these institutions. This requirement was enacted by Congress in 1998 as part of the FY1999 Omnibus Appropriations Act (P.L. 105-277) which also provided for an $18 billion increase in the U.S. quota for the IMF. As the Secretary may know, the Financial Services Subcommittee on International Monetary Policy and Trade, which I chair, has jurisdiction over these international financial institutions.

The United States was the leading founder and continues to be the largest contributor to both the World Bank and the IMF. In addition, the U.S. is an active member of the regional multilateral development banks. The Secretary of the Treasury and his representatives are responsible for implementing U.S. policy involving these institutions.

The United States, with the urging and support of the U.S. Congress, has been a key supporter of reform efforts at the international financial institutions. Our goals have included increasing transparency of the financial institutions and promoting greater financial disclosure by member countries. The U.S. has urged the World Bank and the IMF to focus on crisis prevention and on the importance of better debt management policies.

Before proceeding, I would like to offer a few candid remarks on the IMF. Regrettably, I believe that the IMF and the Treasury Department under the Clinton Administration, was unwilling to admit to some of its errors and misjudgments. During the Asian financial crisis, the IMF, with strong encouragement from the Clinton Administration, employed counterproductive policies in both Thailand and South Korea, inappropriately treating them as the usual fiscal basket-cases at the beginning even though their fiscal situation was sound. In addition, there were also loans to Russia, which might better be labeled "Yeltsin loans," and which will be shown, over time, to be part of one of the biggest blunders of the late 20th Century. However, at the same time, we in Congress need to candidly admit that if we didn't have an IMF or an institution somewhat like it, we would have to create one.

Moving on, I would like to particularly emphasize two items this afternoon: the relevant current activities of the Financial Services Subcommittee on International Monetary Policy and Trade and the findings of the Meltzer Commission.

Activities of the International Monetary Policy and Trade Subcommittee

First, the International Monetary Policy and Trade Subcommittee has already been quite active on the subject of international financial institutions. In fact, my Subcommittee has already held two hearings relating to Africa and the international financial institutions. Our first hearing was on the African Development Bank and Fund. The U.S. is a non-regional member of both the Bank and the Fund. The Bank provides "hard" loans on commercial terms (non-concessional terms) to creditworthy borrowers while the Fund gives loans on highly concessional terms to the poorest African countries. As is well documented, the Bank and the Fund have had the most difficult fiscal and management problems of all the multilateral development banks. Since the annual meeting of the African Development Bank and Fund is in late May, I am interested in the thoughts of the Department of the Treasury on how to improve the effectiveness of this international financial institution.

In addition, my Subcommittee also conducted a hearing on World Bank and IMF activities in Africa. The main subjects discussed at this hearing were poverty reduction, debt relief and HIV/AIDS. With respect to debt relief, the Highly Indebted Poor Countries (HIPC) Initiative has provided both bilateral and multilateral debt relief to 18 countries in Sub-Saharan Africa. The U.S. and other donor countries have pledged to provide 100% bilateral debt relief to the HIPC countries. Furthermore, this initiative also includes World Bank and IMF multilateral debt relief to the HIPC countries.

It is important to note that Congress has already fully authorized and appropriated funding for U.S. bilateral debt relief. However, further authorization and appropriation for the World Bank/IMF multilateral debt is still needed to complete the U.S. pledge of $600 million to the HIPC trust fund. The Administration has requested that $224 million be appropriated for FY2002, with $165 million required to be authorized by the Subcommittee and Committee for FY2002.

It has been estimated that 36 million people are now living with HIV/AIDS. Seventy percent of these people are in Sub-Saharan Africa. I am aware that on May 11th, President Bush pledged an initial $200 million to a global trust fund to combat HIV/AIDS. In addition to the President, the United Nations Secretary General and the President of the World Bank have called for the creation of this international fund. I am interested in the Administration's strategy on HIV/AIDS and am looking forward to more details on this international fund.

In addition to Africa, the Subcommittee I chair will also review the U.S. role in the IMF and the World Bank in general. We also expect authorization requests this year for the Asian Development Fund and the International Fund for Agriculture Development (IFAD). Furthermore, we will continue to carefully watch the economic situation in Japan and the financial difficulties in Argentina and Turkey.

Meltzer Commission

Second, I would mention that I take a particular interest in the work of the International Financial Institution Advisory Commission known as the Meltzer Commission since I authored the language, which was included in the FY1999 Omnibus Appropriations Act. Today or through written response, I would like to know the views of you, Mr. Secretary, and the Treasury Department on both the majority and the dissenting views of the Meltzer Commission. This 11-person bipartisan Commission was charged with performing a fundamental re-examination and review of the IMF, the World Bank, and other international financial institutions.

The Meltzer Commission recommended that the IMF withdraw from questionable long-term concessional loans and focus instead on the extension of more manageable short term (4 to 8 months) credit. Moreover, the Meltzer Commission recommended that the IMF should lend only to countries that meet certain pre-qualification criteria. I appreciate the independent judgment of the dissenting members of the Commission who contend that limiting the IMF to a set of pre-qualification criteria would preclude certain countries, which are central to macroeconomic global financial stability, from receiving assistance. For example, if this prequalification criteria would have been applied to the 1997 Asian financial crisis, the global contagion may have in fact been worse.

With regard to the World Bank, the Meltzer Commission recommended that the World Bank shift from highly concessional loans to a system of performance-base grants to the poorest countries of the world that lack reasonable access to funds in the capital market. Furthermore, the Meltzer Commission also recommended that the World Bank defer to the regional multilateral development banks for lending activities in Asia and Latin America.

Congress should study the comprehensive recommendations and the dissenting views of the Meltzer Commission. As the Subcommittee Chairman of the International Monetary Policy and Trade Subcommittee, I intend to be a constructive part of this process.

Lastly, I look forward to the testimony of Secretary O'Neill. Thank you.

OPENING STATEMENT BY REP. JULIA CARSON (D-IN)

FINANCIAL SERVICES FULL COMMITTEE HEARING

ANNUAL TESTIMONY OF THE TREASURY SECRETARY ON THE INTERNATIONAL FINANCIAL SYSTEM

2128 RHOB
May 21, 2001

- I would also like to thank today's witness, Secretary O'Neill, for being with us to discuss issues of importance regarding the international financial institutions. From what I understand, your comments today will focus on the policies of the World Bank and IMF.

- I can think of no better topic on which to focus a hearing, Mr. Secretary. Given the huge amounts of U.S. taxpayer dollars spent, as well as the millions of lives affected by World Bank and IMF programs and policies, the topic of this hearing carries much weight here in our own country and around the world.

- I would like to briefly explain some of my biggest concerns as they relate to reform of the international monetary institutions.

- Mr. Secretary, I am concerned about the need to focus the missions of the World Bank and IMF.

- As we all know, the World Bank was established specifically to provide development assistance, first to Europe and later on to developing countries in other regions.

  At this time, Mr. Secretary, too many World Bank loans go to countries who already have significant access to private capital. This money should be redirected to fund 100% debt cancellation to poor countries, and for grants that go towards poverty reduction projects.

- The IMF on the other hand, was created to promote international financial stability through orderly exchange rates, a sound multilateral system of payments and temporary assistance to members with balance of payments problems.

- Unfortunately, the IMF has strayed far from its founding mission and today provides long-term, highly concessional loans conditioned upon the willingness of a country to restructure their economy.

- I am in agreement with the Meltzer Commission's unanimous recommendation that the IMF should return to its core mission by restricting its lending to short-term liquidity needs and discontinuing long term, concessional loans for poverty reduction and other programs.

- Unfortunately, the recent GAO report on IMF reform indicates that the IMF has no intention of making this transition, or of giving up its heavy-handed involvement in countries' economies.

- Mr. Secretary, I applaud your interest in supporting programs that produce better economic growth for poor countries. Clearly, previous World Bank and IMF policies have not been successful in this regard.

- At the same time, we are all aware that economic growth does not mean sustainable growth. Increased productivity will not automatically translate into a higher standard of living for the poor majorities in the developing world.

- As a Committee, we must look at ways to ensure that poverty reduction is our emphasis and not just the rhetoric of the day. How do we show that we are committed to this principle:

  1) Prohibit the World Bank and IMF from including user fees as conditions for loans and grants.
  2) Work to secure 100% multilateral debt cancellation for the world's poorest countries.
  3) Prohibit the World Bank and IMF from requiring poor countries to restructure their economies and privatize public goods in ways that harm the poor.

- As you are aware, last year language was included in the Foreign Operations Conference report to eliminate World Bank and IMF-promoted "user fees."

- This language requires the U.S. to oppose any World Bank, IMF or regional development bank loan or debt relief agreement that includes user fees or other charges for primary education or primary health care.

- I read in your May 15 testimony before the House Foreign Operations Subcommittee, that you advocate expanding and improving education as an integral part of increasing productivity and economic growth.

- Mr. Secretary, your desire to increase educational access for people in the developing world cannot be achieved through the reinstatement of user fees, which is called for in the FY 2002 Budget Proposal.

- User fees have been shown to reduce poor families' access to vital education and health services.

- In impoverished nations in Africa, school fees to attend public primary schools or clinic fees for primary health services have kept millions of children out of school and left millions of people without access to the most basic health care. When Uganda recently eliminated school fees in 1998, the primary school enrollment rate climbed from 50% to 90%.
- The ability of all children to attend schools is a critical component of national development. Furthermore, at a time when 7,000 people are dying daily of AIDS in Sub-Saharan Africa, I hope that the Administration will focus its efforts on increasing, as opposed to decreasing, poor peoples' access to basic health services.
- Although we support the Administration's recent announcement of $200 million for the global fight against AIDS, we question why the Administration would support policies in its FY 2002 Budget that clearly decrease access to programs that slow the spread of HIV/AIDS.
- I urge you to support Section 596 and to support the extension of it to include actions by government agencies other than Treasury, particularly USAID.
- Third, Mr. Secretary, it is imperative that we address the crisis of debt that continues to cripple the lives of people living in the developing world.
- Furthermore, this debt undermines the ability of national governments to address the educational and health needs of poor people.
- The Meltzer Commission was unanimous in its recommendation that all IMF, World Bank, and other multilateral debt held by heavily indebted countries should be forgiven.
- It would cost the World Bank $215 million annually and the IMF $215 annually to cancel the debts of the 22 countries who have already started to receive debt relief under the **HIPC Initiative**.
- It would cost an additional $353 million annually for the World Bank, and $368 million annually for the IMF to fully fund debt cancellation to the 14 countries included under **HIPC** who have yet to receive any debt relief.
- The World Bank has been averaging an annual profit of $2 billion.
- The IMF has $3.4 billion in its reserve account for the "Poverty Reduction and Growth Facility."
- If we are truly committed to supporting poverty reduction policies, then we should request that this money be used for full debt cancellation for the world's poorest and most heavily indebted countries.

- Finally, Mr. Secretary, it is my hope that during this year, the policies we advocate through **HIPC,** the World Bank and the IMF, the HIV/AIDS Global Trust Fund, as well as our policies on user fees and privatization policies will begin to compliment, rather than undermine one another.

- At this time, we are asked to authorize additional money for HIV/AIDS at the same time that the Administration is proposing to reinstate user fees. Mr. Secretary, this policies contradict one another and undermine the intentions of each program.

- At the same time, the correlation between high debt burdens and high rates of HIV/AIDS is a real one. Until countries in Sub-Saharan Africa are granted full bilateral and multilateral debt relief, they will continue to be drained of the very resources they need to respond to the AIDS crisis, no matter how much money is pumped into the global HIV/AIDS fund.

Congressman Harold Ford, Jr.
Committee on Financial Services
Hearing to Receive Testimony of Treasury Secretary Paul O'Neill
May 22, 2001

I want to welcome Secretary O'Neill to the Committee. I look forward to a productive relationship between this Committee and Treasury.

The importance of the International Monetary Fund will continue to expand as the world's economy becomes increasingly integrated through the free flow of goods, services, and information across borders and across oceans. Notwithstanding the problems of the past, the IMF is absolutely indispensable in promoting global financial stability and building wealth in developing nations.

The Mexico crisis in 1994 and the global financial meltdown of 1997-1998 demonstrated both the growing need for an international financial architecture and the need for American leadership in this area. Our leadership in this area does not just advance economic development and humanitarian causes across the world – we have a critical economic and national security stake in the strength of international financial institutions.

40 percent of our exports go to the developing world, and that number will only increase. We are major stakeholders in boosting economic development and financial stability in developing nations. Moreover, in today's world national security concerns are inseparable from economic concerns -- national security policy is not the exclusive province of the NSC or Pentagon. Our ability to stem economic instability and distress in other nations depends greatly on our participation in and leadership of international financial institutions like the IMF.

One of the major obstacles to improving the quality of life of people around the world is the stifling debt of the governments of many poor nations. Free market reforms are essential for developing nations to promote economic growth and wealth creation. But without improvements in basic education, infrastructure, or health care, many nations will remain impoverished, unable to join the global economy that defines the twenty-first century. Many nations in sub-Saharan Africa are struggling with the devastating AIDS epidemic.

The Enhanced HIPC Initiative -- developed by the G-7 nations during the Summit meeting in Cologne, Germany, in June of 1999 -- was intended to relief the debts of the world's poorest countries and require these countries to invest in health care, education, and economic development. Last year, Congress appropriated $435 million for debt relief for the countries included in this initiative. Under the Enhanced HIPC Initiative, many countries have begun to invest in key areas. I would hope that the Administration will lead the international community in supporting debt relief for the world's poorest nations.

But one issue overshadows everything we do here, and that is the massive and irresponsible tax cut that this Administration has made its central focus. With the Baby Boom generation beginning to retire and draw Social Security and Medicare benefits within the next ten years, this is not the time to gamble with our fiscal future. The tax cut we will vote on later this week will cost the Treasury at least $2 trillion over the next ten years and as much as $4 trillion for the ten years after that. We have seen the benefits of fiscal discipline over the past decade, and we saw the dangers of fiscal recklessness during the decade before. We cannot afford to repeat the mistakes of the past. While it is not the subject of this hearing per se, the tax cut overshadows all the debates in Washington and will determine our ability to accomplish all of our common priorities.

Although the Administration is pushing its tax cut through the Congress with unbending urgency and lack of concern for bipartisan compromise, I would hope that this Committee can work with you, Secretary O'Neill, and the Treasury on the many issues over which we share responsibility. We welcome you to Committee today.

Congresswoman Barbara Lee – Statement
Hearing: Treasury Secretary Paul O'Neill
State of the International Financial System, IMF Reform and Compliance with IMF Agreements
May 22, 2001

Good afternoon, I want to thank Chairman Oxley and Ranking Member LaFalce for holding today's hearing on the State of the International Financial Institutions, including the World Bank and the International Monetary Fund (IMF).

For decades now, the World Bank and the IMF's development programs in poor countries, particularly those in Africa, have not yielded sustainable economic growth or a reduction of absolute poverty.

I believe that this hearing is timely especially in light of the challenges that poverty and crippling economies play in exacerbating the African AIDS crisis.

Each day over 6,000 people in Africa die from AIDS. In many African nations, people live on less than one dollar a day; yet, addressing the AIDS crisis through education and treatment will cost billions of dollars each year.

In light of this, the World Bank and the International Monetary Fund continue to provide loans to countries who cannot afford them, but have no alternative to try to provide human needs for their people, including access to basic health care.

Last year, Congressman James Leach and I led a bipartisan effort to establish an international AIDS trust fund at the World Bank that would provide grants, not loans, to African nations, civil society and non-governmental organizations so that they could respond to the HIV/AIDS crisis.

I am pleased to say that we are now seeing considerable movement on this initiative in the international community.

Until the international trust fund is fully negotiated and fully funded, we must utilize all strategies to counter the devastating impact of HIV/AIDS.

Over the past several months, Congressman Leach and I have led a bipartisan, bicameral coalition to raise the level of attention and response for a multilateral initiative to address the global AIDS crisis.

As a part of this effort, we have repeatedly requested that the Treasury Department brief the Congress on the progress of the International Trust Fund. This request has not been complied to.

I understand and appreciate the level of attention the Administration has placed on the development of an international AIDS trust fund, however, the bill which authorized the establishment of an AIDS trust fund at the World Bank was signed into law last year in August.

The appropriation for such a fund, although meager ($20 million), was approved in December 2000.

It is now May 2001. The Trust Fund has not been established, the report on the progress of the Trust Fund which was due on April 30th has not been submitted, and my colleagues and I have been unable to receive, at a minimum, a briefing on the status or about the progress of the negotiation for the AIDS trust fund.

I remind you that everyday over 6,000 Africans die. Since the law passed to establish an international trust fund, 275 days have passed– over 1.65 million Africans have died.

Yet the Administration appears to continue to drag its feet on the most important humanitarian and moral issue of our time.

I appreciate the $200 million gesture President Bush announced a week ago, but the rest of the world is calling for $10 -$15 billion dollars for such a fund.

When I wrote the legislation to establish such a fund nearly two years ago, we were seeking a billion dollar campaign.

Earlier this year, I introduced legislation, H.R. 1567, the Debt Cancellation for HIV/AIDS Response Act of 2001, to raise awareness of the need for burden sharing, to link debt relief to the HIV/AIDS pandemic and to move that agenda forward in a bipartisan manner. I encourage my colleagues on the subcommittee to cosponsor this important legislation.

AIDS kills and debt kills. To kill AIDS, we must kill debt-- particularly multilateral debt owed to the World Bank and the International Monetary Fund.

Another aspect of this effort must be targeted at the IMF. In many countries, as leaders attempt to develop and implement primary health and education programs, they are forced to pay the IMF user fees. These are primary services which are a basic human right of all people. We must eliminate user fees.

Last year the U.S. Congress and the Administration, in a gesture of good faith, provided $435 million in fiscal year 2001 for bilateral debt cancellation and multilateral debt reduction.

It is my firm belief that this action should encourage these international financial institutions to match the debt cancellation efforts of the G-8 countries to ensure burden sharing.

Finally, I would like to reiterate the devastating toll that HIV/AIDS is having in Africa and many developing nations throughout the world.

Last year the World Bank announced a $500 million loan program for Africa to help mitigate the affects of the HIV/AIDS pandemic. While I can appreciate the gesture by the World Bank, I must disagree with their tactic. These poor countries must not be forced to incur more debt in order to provide life saving services for their people.

I hope that today's hearing will encourage an increase in grants, not loans.

Thank you.

Hearing on International Financial Institutions
Committee on Financial Services
Statement by Rep. Maxine Waters
May 22, 2001

I would like to thank Chairman Michael Oxley for organizing this hearing on the state of the international financial system and the International Monetary Fund (IMF). I am also grateful to the Honorable Paul O'Neill, the Secretary of the Treasury, for his willingness to testify before the Financial Services Committee today.

I am deeply concerned by the failure of the IMF and the World Bank to provide adequate debt relief to heavily indebted poor countries. The Enhanced HIPC (Heavily Indebted Poor Countries) Initiative was developed by creditor countries, the IMF and the World Bank in 1999 to provide debt relief to the world's poorest countries and require these countries to invest the savings from debt relief in HIV/AIDS treatment and prevention, health care, education and poverty reduction programs. Pursuant to the Enhanced HIPC Initiative, the United States agreed to cancel 100 percent of the debts of these impoverished countries. The United Kingdom, Canada and Italy have also provided 100 percent debt cancellation.

The Enhanced HIPC Initiative has already yielded some promising results. Tanzania has eliminated school fees, and Honduras is offering three more years of free schooling for public school students. Uganda has doubled school enrollment and significantly reduced the rate of HIV transmission. Mali, Mozambique and Senegal are also planning to use the savings from debt relief to increase their spending on HIV/AIDS prevention in order to stop the spread of this deadly epidemic.

Unfortunately, the IMF and the World Bank have not provided sufficient levels of debt relief, and many impoverished countries continue to struggle under the weight of international debts. Only twenty-two countries have begun to receive debt relief under the Enhanced HIPC Initiative, and their debt payments have been reduced by an average of only 27 percent. Sixteen of these twenty-two countries are still spending more money on debt payments than they are on health care.

To provide complete debt cancellation to these twenty-two impoverished countries would cost only \$287 million per year for the IMF and \$215 million per year for the World Bank. This is a very modest amount of money considering the fact that Congress appropriated \$435 million for debt relief last year alone. <u>It is time for the IMF and the World Bank to do their share.</u>

The IMF has also imposed structural adjustment programs on poor countries as a condition for debt relief. These structural adjustment conditions have required poor countries to cut government spending on poverty reduction programs, impose user fees on health and education services, and privatize water supplies and other public utilities. These policies usually result in the denial of health care, basic education and other essential public services to the people who need them the most.

In November of 1999, in response to widespread international criticism of IMF structural adjustment conditions, the IMF changed the name of its concessional lending program from the Enhanced Structural Adjustment Facility to the Poverty Reduction and Growth Facility. A report by the General Accounting Office released last week confirms that this new IMF program differs little from the previous program.

On February 16, 2001, I sent a letter to Secretary Paul O'Neill, urging him to support complete debt cancellation for the world's poorest countries during the February meeting of the G-7 Finance Ministers in Palermo, Sicily. Seventy-three Members of Congress, including several Republican and Democratic members of this committee, signed this letter. I am disappointed to report that I did not receive a response to this letter until yesterday afternoon. Furthermore, the response that I did receive does not provide a clear statement of the Secretary's position on debt cancellation or deeper debt relief. I am also disappointed that no progress towards deeper debt relief was made at the G-7 Finance Ministers' meeting. Moreover, no progress towards deeper debt relief was made at the IMF and World Bank Spring Meetings, which were concluded on April 30, 2001, here in Washington, D.C.

On April 26, 2001, I introduced H.R. 1642, The Debt Cancellation for the New Millennium Act. This bill would require the IMF and the World Bank to provide complete cancellation of 100 percent of the debts that poor countries owe them. The bill would also eliminate the devastating structural adjustment programs that have been imposed by the IMF as a condition for debt relief. H.R. 1642 has over fifty cosponsors, representing both political parties.

I look forward to hearing the testimony of Secretary O'Neill at today's hearing, and I hope he will clarify his views regarding the progress of the Enhanced HIPC Initiative and the need for deeper debt relief. Finally, I strongly urge Secretary O'Neill to support complete debt cancellation by the IMF and the World Bank without structural adjustment conditions for the world's most impoverished countries.

I thank the Chairman for the time.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

STATEMENT BY TREASURY SECRETARY PAUL H. O'NEILL
HOUSE COMMITTEE ON FINANCIAL SERVICES
May 22, 2001

Chairman Oxley, Ranking Member LaFalce, members of this Committee, I welcome this opportunity to present my views on reform of the International Monetary Fund (IMF), the World Bank, and the other multilateral development banks (MDBs). I also look forward to hearing your views, to answering your questions, and to discussing these important issues with you.

I believe that we now have a great opportunity to explore ways to reform the international financial institutions, and we must make the tough decisions that will bring about these needed reforms. This is our fiduciary responsibility to the American people who pay the taxes that go to fund these institutions.

I believe that the international financial institutions have an important role to play in the world economy. They can deal with critical problems facing the international financial system, and they can improve the standard of living of people around the world. But I also believe that they can do a much better job than they have done in the past. I want them to be more often associated with success than with failure.

I recognize that reform of these institutions has been a concern of many people and that informative congressional hearings and reports have been completed. Thanks to this work, useful reforms have been proposed. Some of these have been implemented. But there is still much to do.

The International Monetary Fund

I believe that the core objectives of the IMF are to (1) promote sound monetary, fiscal, exchange rate and financial sector policies, (2) carefully monitor economic conditions, and (3) deal with critical problems in the international financial system as soon as they are detected. By achieving these objectives, the IMF can provide greater stability to the international financial system and facilitate the unimpeded exchange of goods, services, and ideas so essential for economic growth. My experience in government and business tells me that the more the IMF focuses on these core objectives, the more effective it will be. And I think there can be more focus.

Crisis prevention is essential. Crises strike when there is a failure to detect financial stresses or imbalances, or when there is a failure to make the necessary decisions to reduce the stresses and imbalances that have been detected. In reviewing past crises, it seems to me that some economists and financial analysts saw economic conditions deteriorating and that not enough was done at the time to keep crises from gathering steam. The primary responsibility for avoiding crises lies with individual countries' own policy choices. Nonetheless, we in the international community also need to make better efforts to prevent crises – both through better monitoring and through better decision making – so that the IMF devotes less taxpayer money to resolving crises. Further work is needed to identify the most relevant indicators. I hope that the creation of a new capital markets section at the IMF will in fact improve crisis prevention capabilities.

A necessary element of crisis prevention is the pursuit of sound policies and the development of robust financial sectors in each country. The adoption of standards and codes representing the accepted international best practices in financial systems – such as bank capital and supervisory standards and accounting principles – is critical.

Transparency is essential. Even the most telling information is of little use if it does not reach those who rely on it. Ensuring that these assessments capture the most relevant factors and reach the private sector quickly in an easily digested format is essential both to enable markets to make informed judgments and to give countries strong incentives to pursue sound policies. Holding back such information only means that the surprises are bigger when the information finally gets out. Big surprises lead to big changes in prices and can trigger crises.

I strongly support the efforts that many in Congress, as well as other critics of the IMF, have made to increase transparency at the IMF. The IMF is now making transparency a priority, and we are beginning to see changes. Directly through its own website and other publications, and indirectly by asking member countries to increase disclosure, the IMF has helped to increase the information available on countries' economic policies and prospects.

Accountability is essential. Steps need to be taken to increase accountability to IMF shareholders and to the taxpayers. I hope that the creation of the new independent evaluation office at the IMF will in fact increase accountability.

It is also essential that the IMF not create expectations that reduce the incentives for countries and for individuals to take policy actions that are essential to prevent crises. Whenever possible, policy actions should be taken prior to the start of IMF programs. Expectations of continued or additional financial support in the case of poor policy decisions in a country reduce the incentives to make good economic decisions. Moreover, expectations that countries can and will use IMF financial support to meet payments on debt instruments held by the private sector reduce the due diligence that is required to make sound financial decisions. These perverse incentives associated with expectations of large and long-duration IMF funding are compounded if funding is provided at interest rates well below market interest rates.

The actions taken in November to change IMF lending policy are a good step toward reform. By raising the rate of interest charged for large loans and shortening the expected period of time that loans will be outstanding, the IMF can create stronger incentives for countries and private investors to make the right decisions. I hope to see such policies actually used in practice by the IMF. The new Contingent Credit Line (CCL) will also carry higher interest rates, and I like its emphasis on prior actions or pre-qualifications, which will reduce the likelihood of financial crises and contagion. Again I hope to see this new type of loan used in practice.

It is also essential for the IMF to focus its work on areas in which it has expertise and responsibility. In the past I believe that the IMF got involved in a much too wide set of policies in borrowing countries. It went well beyond relevant macroeconomic reforms within its expertise, and this of course increases the likelihood of giving poor advice. The long list of conditions attached to the IMF loan to Indonesia in the late 1990s is an important example. The IMF is now reviewing the conditions it attaches to its programs; I support the effort to sharpen the focus of these conditions. It is essential that the conditions, including prior actions, maintain the integrity and accountability of the Fund.

The Multilateral Development Banks

Like the IMF, the World Bank and the other multilateral development banks should also have a clear set of objectives. In my view their number one priority should be to raise the standard of living of people throughout the world. History tells us that the driving force behind increases in income per capita is rising productivity – the amount that each worker can produce.

If you look at per capita income in different parts of the world, the disparities between countries are clear. Virtually all of those differences can be explained by differences in productivity. Poor countries are poor – poverty exists – because productivity is low in these countries. If we are really going to reduce poverty, there is simply no alternative to increasing productivity in poor countries. I can tell you from my own experience in business that the opportunities for increasing productivity are now greater than at any time in history. The technology and the ideas are there. The challenge is to spread these ideas and to use them.

I believe that the scope of the World Bank has been too diffuse, and this reduces its focus on the core objective of raising income per capita. In the case of each new loan, each new grant we need to ask: how is this decision going to raise income per capita, or raise productivity? Economic research and historical experience tell us that more and better education is an essential ingredient for higher productivity growth. I would like to see the MDBs place greater emphasis on education. President Bush has made education a top priority for the U.S. economy. It should also be a top priority for the world economy.

Productivity can also be increased through more capital and better technology. Entrepreneurial activity in the private sector is what will make these productivity increases happen. Open markets, free trade, low tax rates and sensible regulation – the keys to U.S. growth over the past 20 years – are essential to sparking such entrepreneurial activity and, therefore, productivity. I also believe that greater priority should be given to strengthening the rule of law and promoting good governance. Assessments of borrower fiduciary policies should be central and done prior to any grants or loans. Eliminating corruption should factor more directly in Bank lending decisions.

In addition to these external changes, internal MDB governance should also ensure compliance with approved policies and maximize transparency. We must achieve stronger internal oversight mechanisms to oversee compliance with internal policies and broader information disclosure practices to enhance accountability.

When we recommend that these institutions become more focussed, we must also provide guidance on areas that can be scaled back. I am not of the view that each MDB must be a full-service "supermarket" for the developing world. Each of them could, for instance, focus their lending and grants on essential development goals. While we will be working to give some direction on this front in the coming months, cultural heritage projects that have a peripheral development impact and large infrastructure projects that could easily attract private finance are some areas that come to mind. We also have questions about MDB involvement in sophisticated electronic information sharing systems that may duplicate work being undertaken by the private sector and that do not take into account the more basic information and capacity improvement needs of these countries.

I also believe that the MDBs should focus their resources more on countries that do not enjoy access to private finance, recognizing that many other countries' financing needs are more suitably met through the private markets.

I can also see scope for differentiated loan pricing to achieve better prioritization of lending to middle income countries and better incentives for these countries to rely on private markets. In some cases, we should provide more grants. Grants should be tied to performance. Grants are also more transparent than loans that are not likely to be repaid. If it is a grant we should call it a grant and not a loan.

I also believe that the multilateral development banks can improve their coordination. More work is needed to bring greater consistency where more than one institution is operating in a particular country. The MDBs need to do a better job of sharing ideas and lessons learned about what works and what does not work.

I will also press for results-based performance indicators. We need to know more about what we are getting for our money. I see greater scope for prior actions in loans. We should certainly not increase budget support without evidence that it yields higher development effectiveness and without a clear assessment of its operational and fiduciary risks.

Conclusion

Reform of the international financial institutions is a key priority for the Bush Administration. I have given you some of my views, and I look forward to hearing more about yours. I can promise you that we will dedicate ourselves to these reform goals.

Because these institutions are international, reforming them means working closely with the other shareholders. We at Treasury are now in close contact with our colleagues from around the world to review the work of the IMF and World Bank. I am optimistic that there will be real reforms.

Page 21, line 468 – Insert for the Record: Treasury Secretary O'Neill Statement on OECD Tax Havens

TREASURY NEWS

FROM THE OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
May 10,2001
PO-366

TREASURY SECRETARY O'NEILL STATEMENT ON OECD TAX HAVENS

Treasury Secretary Paul O'Neill made the following statement on OECD tax havens:

Recently, I have had cause to re-evaluate the United States' participation in the Organization for Economic Cooperation and Development's working group that targets 'harmful tax practices.' Following up on the thoughts I shared with my G7 counterparts at recent meetings, I want to make clear what is important to the United States and what is not.

Although the OECD has accomplished many great things over the years, I share many of the serious concerns that have been expressed recently about the direction of the OECD initiative. I am troubled by the underlying premise that low tax rates are somehow suspect and by the notion that any country, or group of countries, should interfere in any other country's decision about how to structure its own tax system. I also am concerned about the potentially unfair treatment of some non-OECD countries. The United States does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems. The United States simply has no interest in stifling the competition that forces governments - like businesses - to create efficiencies.

In fact, the Administration is actively working to lower tax rates for all Americans. After reducing our tax burden, we will turn our attention toward reforming our system to make it simpler and more efficient. On these principles the United States remains firm.

When I took my oath of office as Secretary in January, I pledged faithfully to execute the laws of the United States. In its current form as established by Congress, the U.S. tax code generally taxes income on a worldwide basis. We have an obligation to enforce our tax laws as written because failing to do so undermines the confidence of honest taxpaying Americans in the fairness of our tax system. We cannot turn a blind eye toward tax cheating in any form.

That means pursuing those who illegally evade taxes by hiding income in offshore accounts. In today's world of instant information on the Internet, offshore bank accounts are no longer an obscure perk of the very rich. Just type in "offshore brokerage account" in any Internet search engine. The number of sites offering easy, affordable, secret offshore brokerage accounts for investing in U.S. stocks is astonishing.

As one Internet site advertising offshore brokerage accounts in Dominica boasts, "U.S. stocks, bonds, options, currencies and mutual funds are frequently bought through offshore companies because they are not liable to U.S. capital gains taxes." Consider just how unfair this is to law abiding U.S. investors who invest in U.S. stocks and pay taxes. The tax evading U.S. investor, investing in the very same U.S. stocks through a secret offshore account, does not.

Anyone who doubts that the U.S. needs information from offshore tax havens in order to prosecute tax evaders need look no further than the case of John Mathewson. Mathewson ran a bank in the Cayman Islands. When shut down in 1995, Mathewson had over 1,000 customers and, according to Mathewson, 95% of his customers were U.S. citizens. With Mathewson's cooperation, the IRS obtained tax evasion convictions on, and collected substantial back taxes from, over 20 of Mathewson's clients. These cases were made possible because of Mathewson's extraordinary cooperation. Without it - and without any tax information exchange agreement with the Cayman Islands - this large-scale illegal tax evasion would have gone unpunished.

To enforce our tax laws, we must have a multi-prong strategy. If the United States believes that a particular U.S. taxpayer is illegally evading the U.S. tax laws through the use of offshore entities or secret bank accounts, the United States must make every effort on our own to obtain the necessary information to enforce the U.S. tax laws. In addition, the United States has negotiated individual treaties or agreements with over 60 countries so it can obtain needed information in cases of tax evasion. Finally, in appropriate circumstances, organizations like the OECD can be used to build a framework for exchanging specific and limited information necessary for the prosecution of illegal activity. We do - and will - guard against over-broad information exchanges in which foreign governments seek information for improper purposes or without proper safeguards. We cannot tolerate those who cheat on their U.S. taxes by hiding behind a cloak of secrecy.

Where we share common goals, we will continue to work with our G7 partners to achieve these goals. The work of this particular OECD initiative, however, must be refocused on the core element that is our common goal: the need for countries to be able to obtain specific information from other countries upon request in order to prevent the illegal evasion of their tax laws by the dishonest few. In its current form, the project is too broad and it is not in line with this Administration's tax and economic priorities.

INSERT #2

Page 45 - Insert for the Record: Request from Rep. Bachus regarding Analysis of Proposals for 100 Percent Debt Reduction from the International Financial Institutions for the Heavily Indebted Poor Countries (HIPCs)

There have been numerous proposals for expanding debt relief beyond the current enhanced HIPC initiative. Although additional debt reduction, if provided in the context of economic reforms, can certainly be beneficial for a debtor country, there are significant costs involved, and tradeoffs to be considered in determining the best use of donor and IFI resources. The current HIPC initiative is only partially implemented, and is not yet fully financed. On both cost and equity grounds, the Department of the Treasury believes that it makes sense to concentrate on implementing the current HIPC initiative before considering new proposals.

There have been a number of proposals for 100% debt reduction from all multilateral institutions for all 41 HIPCs. This would increase the cost for all multilateral institutions, as measured by the net present value of debt reduced, from about $14 billion under the current HIPC program to somewhere in the range of $40 billion (about $43 billion using IMF/World Bank end-1998 figures), or an increase of about $26-29 billion.

The most recent proposals by non-governmental groups focus on 100% debt reduction by the IMF and World Bank (only; i.e., not by all multilateral institutions) for HIPC countries that have reached decision points. Although this proposal would be less costly than 100% reduction by all multilaterals for all 41 HIPCs, it would still involve substantial additional costs. For the 22 countries that reached decision points in 2000, increasing IMF and World Bank debt reduction to 100% would increase their costs, as measured in net present value terms, by somewhere in the range of an additional $6-7 billion. Costs would increase further as additional HIPCs reached decision points. In addition, we believe this narrower approach would result in substantial pressure to expand 100% debt reduction to other multilateral development banks, and to a broader group of countries as well, thus increasing costs further.

The impact of these additional costs would fall most heavily on the International Development Association (IDA), the concessional lending window of the World Bank Group with the bulk of exposure to HIPC debt. A substantial portion of new concessional assistance from IDA comes from resources that are paid back to the institution by previous borrowers. For example, under the current IDA-12 replenishment, 38 percent of the resources for new lending will come from repaid loans, or "reflows." Reduction of additional IDA debt would result in a dollar-for-dollar reduction in resources available for new assistance. To the extent that complete debt forgiveness would require depleting resources for new assistance to poor non-HIPC countries, it would in effect be "the poor funding the poor." To the extent such lost revenues are replaced, the replacement funds would have to come from increased bilateral contributions to future IDA replenishments.

Moving to 100% IFI debt reduction for HIPCs, which already have had their debt reduced on average below the levels of non-HIPC poor countries, would also deepen the arbitrary line drawn between HIPCs and non-HIPCs. HIPCs would have 100% of their debt canceled, while other poor and significantly indebted countries, which may have done better jobs of managing their economies and debt obligations, would receive no debt reduction. The purpose of the enhanced HIPC initiative, in part, is to enhance the prospects for debt sustainability by reducing debt to a manageable level, placing HIPCs on a more equal footing with other developing countries. Forgiving 100% of IFI debt for a specific group of impoverished countries poses a moral hazard for other poor countries. In a sense, 100% debt reduction would reward HIPCs in a manner that may reduce future development assistance for other poor countries.

In conclusion, the Department of the Treasury believes we should concentrate on achieving full funding and implementing the current enhanced HIPC initiative in an effective manner. We should also expand our focus to the broader development challenges beyond debt relief that will help these countries increase productivity and growth, and reduce poverty.

INSERT #3

Page 51 - Insert for the Record: Request from Representative Bentsen regarding the administration's long-term view on dealing with bailouts

In general, the important considerations in extending new lending are the capacity of borrowing country to repay the loan, and requiring that the loan be used for productive results. With respect to the HIPC countries, it is clear that most of these are very poor countries that would need to have strong economic growth for a sustained period of time before they would be able to handle market-rate debt. I believe the MDBs need to adopt a more aggressive stance on the use of grants for the poorest countries. I also believe that we need to be more rigorous about measuring the results of multilateral assistance.

INSERT # 4

Page 51 -Insert for the Record: Request from Representative Bentsen regarding Secretary O'Neill's or the Administration's view on monetary control boards and dollarization.

The Administration neither advocates nor opposes currency board arrangements. This is a decision that the authorities in the respective country would need to make.

When a country's monetary authorities lack credibility, a hard peg such as a currency board may be helpful in re-establishing integrity by eliminating discretionary monetary policy. This may be constructive for some countries in stabilizing financial markets and fostering growth. It should be kept in mind, however, that since neither monetary nor exchange rate policy can be used to adjust to economic shocks, the authorities must be willing, as necessary, to subordinate other policy goals to that of maintaining the hard peg.

The Administration neither advocates nor opposes dollarization. However, such a decision has consequences for the United States as well as for the dollarizing country, and it is reasonable to hope and expect that countries would consult with us in advance.

Dollarization can facilitate higher economic growth in the dollarized country through a reduction in inflation, through greater trade and financial integration with the United States, and by lowering vulnerability to currency crises. However, the Administration believes that dollarization will provide little benefit to the dollarized country in the absence of sound macroeconomic policies and flexible factor markets.

It should be noted that dollarization will not influence U.S. monetary policy. The United States has repeatedly stated that dollarized countries will not have access to the Federal Reserve's discount window and will not have a say in U.S. monetary policy.

INSERT # 5

Page 55, line 1281 – Insert for the Record:
Exchange Stabilization Fund Report (March 30, 2001)

FINANCIAL MANAGEMENT:
Audit of the Exchange Stabilization Fund's
Fiscal Years 2000 and 1999
Financial Statements

OIG-01-061 March 30, 2001

Office of Inspector General

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The Department of the Treasury

Contents

OIG

Report of the Office of Inspector General

The Department of the Treasury
Office of Inspector General

March 30, 2001

To the Assistant Secretary for International Affairs:

We audited the Exchange Stabilization Fund's (ESF) Statements of Financial Position as of September 30, 2000 and 1999, and the related Statements of Income and Retained Earnings, and Cash Flows for the years then ended.

Results in Brief

Our opinion on ESF's Fiscal Years 2000 and 1999 financial statements is unqualified. Our Fiscal Year 2000 audit disclosed the following matters involving the internal control and its operation that we consider to be reportable conditions, as defined on page 4 of this report:

- Supervisory Review and Approval of Transactions Recorded in the General Ledger Need to be Consistently Performed (see page 5).
- Detailed Written Procedures Documenting Accounting Operations and the Financial Statement Preparation Process Need to be Established (see page 6).

Our audit disclosed no reportable instances of noncompliance with laws and regulations.

Management's Responsibilities

Management is responsible for:

- Preparing the financial statements in conformity with generally accepted accounting principles as published by the Financial Accounting Standards Board and for preparing the Policy and Operations Statements of ESF.
- Establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the benefits and related costs of internal accounting policies and procedures.
- Complying with laws and regulations applicable to ESF.

Scope of Audits

We conducted our audits in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements* (OMB Bulletin No. 01-02). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our responsibility is to express an opinion on the financial statements based on our audits. We believe that our audits provide a reasonable basis for our opinion.

In planning and conducting our audit of ESF's financial statements for the year ended September 30, 2000, we considered its internal control over financial reporting and compliance with laws and regulations. Specifically, we obtained an understanding of the design of ESF's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting and compliance with laws and regulations. Consequently, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of ESF's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

We have read the information in the Policy and Operations Statements and assessed whether such information, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the financial statements.

Results of Audits

Opinion on the Financial Statements

In our opinion, the financial statements present fairly, in all material respects the financial position of ESF as of September 30, 2000 and 1999, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Other Information

Our audits were conducted for the purpose of expressing an opinion on ESF's Fiscal Years 2000 and 1999 financial statements referred to above. The information contained in the Policy and Operations Statements of ESF is presented for the purpose of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it. However, we compared this information for consistency with the financial statements and, based on this limited work, we found no material inconsistencies.

Internal Control

Internal control is a process, effected by management and other personnel, designed to provide reasonable assurance that the following objectives are met:

- Reliability of financial reporting - transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with generally accepted accounting principles as published by the Financial Accounting Standards Board, and the safeguarding of assets against loss from unauthorized acquisition, use, or disposition; and

- Compliance with applicable laws and regulations that could have a direct and material effect on the financial statements.

Because of limitations inherent in any internal control, errors or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that internal control may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

As defined in OMB Bulletin No. 01-02, reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of the internal control, that could adversely affect ESF management's ability to meet the internal control objectives as defined above. Material weaknesses are reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud,

NOTES TO THE FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

The Exchange Stabilization Fund (ESF) was established as a result of the Gold Reserve Act of 1934, as amended, to be operated by the Secretary of the Treasury, with the approval of the President, consistent with the obligations of the U.S. Government in the International Monetary Fund (IMF) on orderly exchange arrangements and a stable system of exchange rates. To this end, the Secretary of the Treasury may deal in gold, foreign exchange, and other instrument of credit and securities.

A. Basis of Accounting & Presentation

The ESF has historically prepared its financial statements in accordance with generally accepted accounting principles, based on accounting standards issued by the Financial Accounting Standards Board (FASB), the private-sector standards-setting body. In October 1999, the Federal Accounting Standards Advisory Board (FASAB) was designated by the American Institute of Certified Public Accountants (AICPA) as the standards-setting body for financial statements of federal government entities, with respect to the establishment of generally accepted accounting principles. FASAB has indicated, however, that financial statements prepared based upon accounting standards published by the FASB may also be regarded as in accordance with generally accepted accounting principles for those federal entities, such as the ESF, that have issued financial statements based upon FASB accounting standards in the past. Accordingly, consistent with historical reporting, the ESF financial statements are presented in accordance with accounting standards published by the FASB.

In accordance with generally accepted accounting principles, the preparation of financial statements requires the use of management estimates. Certain immaterial reclassifications have been made to the 1999 financial statements to conform to the presentation used in 2000.

B. Fair Values of Financial Instruments

Cash and Cash Equivalents, which consist of U.S. Government securities and Foreign Currency Denominated Assets (FCDA), are reported in the Statement of Financial Position at amounts that approximate their fair values. The fair value of Investment Securities is based upon quoted market prices (See Note 5). FCDAs, Other FCDAs, Special Drawing Right (SDR) Holdings, and SDR Allocations have been revalued in the Statement of Financial Position, using current exchange rates, to amounts which approximate fair value. The SDR Certificates issued to Federal Reserve Banks (FRB) are reflected on the Statement of Financial Position at their face value. It is not practicable to estimate the fair value of these Certificates issued to FRBs since these Certificates contain no specific terms of repayment.

Note 1. Summary of Significant Accounting Policies (continued)

ESF enters into guarantee agreements which represent commitments by Treasury with lenders and/or investors that provide for repayment of all or part of the principal and/or interest on certain debt obligations of a borrower and/or issuer. The ESF is exposed to credit risk on guarantees in the event that it has to honor a guarantee and is unable to recover from the borrower the amounts advanced under the guarantee. It is not practicable to estimate the fair value of these guarantee agreements because no similar agreements that have comparable credit risk could be readily identified. Therefore, excessive costs would be incurred to estimate the fair value of these guarantee agreements.

C. Translation of Foreign Currency Denominated Assets and Liabilities

In accordance with Statement of Financial Accounting Standards (SFAS) No. 52, "Foreign Currency Translation," foreign currency denominated assets (FCDA) and liabilities are revalued monthly to reflect current exchange rates in effect as of the reporting date. The unrealized gains or losses resulting from changes in exchange rates are reported separately in the Statement of Income and Retained Earnings.

D. U.S. Government Securities

ESF invests dollars in excess of its immediate needs in overnight, non-marketable U.S. Government securities issued by the Treasury. The interest rate paid on the investments is the overnight repurchase agreement rate as established by the Bureau of Public Debt.

Note 2. Cash and Cash Equivalents

Cash equivalents are short-term, highly liquid investments that are both readily convertible to known amounts of cash, and so near their maturity that they present insignificant risk of change in value due to changes in interest rates. Generally, only investments with original maturities of three months or less qualify under that definition. U.S. Government securities and FCDAs with original maturities of three months or less, except for foreign currencies acquired under swap agreements with developing countries, are treated as cash equivalents.

The ESF invests a portion of its European Euro holdings through repurchase agreements in securities issued by, and backed by the full faith and credit of, the Federal Republic of Germany. As of September 30, 2000 and September 30, 1999, the amounts of repurchase agreements were approximately $1.2 billion. These repurchase agreements are considered to be FCDA with original maturities of three months or less, which are treated as cash equivalents, as discussed above. Such investments are made by the Federal Reserve Bank of New York (FRBNY), as fiscal agent of the Treasury, in connection with the ESF's participation in such repurchase agreements. In this capacity, FRBNY enters into agreements under which German government securities are purchased from, and subsequently resold to, private counterparties. Such transactions are settled through a tri-party agent, Deutsche Bank. The securities are held by Deutsche Bank for FRBNY pending resale and are not transferred back to a private counterparty upon resale until cash has been received. The FRBNY instructs the tri-party agent on matters

Note 2. Cash and Cash Equivalents (continued)

related to these investments. The amounts held as of September 30, 2000 and September 30, 1999 were as follows:

September 30	2000	1999
Cash and Cash Equivalents (In Thousands):		
U. S. Government Securities	$11,028,570	$15,232,198
FCDAs		
European Euro	$ 3,205,979	$ 3,173,695
Japanese Yen	$ 5,298,391	$ 5,827,576
Total Foreign Currency Denominated Assets	$ 8,504,370	$ 9,001,271
Total Cash and Cash Equivalents	$19,532,940	$24,233,469

Note 3. Other Foreign Currency Denominated Assets

Operations of the ESF result in the holding of various foreign currencies. The ESF normally invests its foreign currency holdings in interest bearing assets issued by or held through foreign governments or monetary authorities. Other FCDAs are assets with maturities greater than three months, and include foreign currencies acquired under swap agreements with various countries (See Note 7).

September 30	2000	1999
Other FCDAs (In Thousands):		
European Euro	$ 2,404,450	$ 2,513,215
Total Other FCDAs	$ 2,404,450	$ 2,513,215

Note 4. Special Drawing Rights (SDR)

The SDR is an international reserve asset created by the International Monetary Fund (IMF). It was created as a supplement to existing reserve assets, and on several occasions SDRs have been allocated by the IMF to members participating in the IMF's SDR department. Its value as a reserve asset derives, essentially, from the commitments of participants to hold and accept SDRs and to honor various obligations connected with its proper functioning as a reserve asset.

Note 4. Special Drawing Rights (SDR) (continued)

Pursuant to the Special Drawing Rights Act of 1968, as amended, SDRs allocated to or otherwise acquired by the United States are resources of ESF. SDRs, once allocated, are permanent resources unless:

a. they are canceled by an 85 percent majority decision of the total voting power of the Board of Governors of the IMF;

b. the SDR Department of the IMF is liquidated;

c. the IMF is liquidated; or

d. the United States chooses to withdraw from the IMF or terminate its participation in the SDR Department.

Except for the payment of interest and charges on SDR allocations to the United States, the payment of the ESF's liability related to the SDR allocations is conditional on events listed above, in which the United States has a substantial or controlling voice. Allocations of SDRs were made on January 1, 1970, 1971, 1972, 1979, 1980 and 1981. Since 1981, the IMF has made no further allocations of SDRs. As of September 30, 2000 and September 30, 1999, the amounts of SDR allocations was the equivalent of $6.4 billion and $6.8 billion, respectively.

On a daily basis, the IMF calculates the value of the SDR using the market value, in terms of the U.S. dollar, of each of the five freely usable weighted currencies, as defined by the IMF. These currencies are the U.S. dollar, the European Euro, Deutsche Mark, the Japanese yen, the French franc, and the pound sterling. The ESF's SDR holdings and allocations are revalued monthly based on the SDR valuation rate calculated by the IMF, and an unrealized gain or loss on revaluation is recognized.

During Fiscal Years (FY) 2000 and 1999, the ESF purchased, at the prevailing rates, $577.6 million and $707.2 million, respectively, equivalent of SDRs received from the IMF by the General Fund of the U.S. Government as remuneration (interest) on the U.S. reserve position in the IMF, and paid the General Fund $6.0 million and $3.7 million in FYs 2000 and 1999, respectively, in interest on dollars due the General Fund in return for SDRs received as remuneration. ESF did not directly sell SDRs to or purchase SDRs from participating members during FY 2000. During FY 1999, ESF sold and purchased $1.2 billion and $444 million, respectively, equivalent of SDRs with participating members.

The following charts reflect the actual activity (i.e. amounts paid and received) related to SDRs during FYs 2000 and 1999.

Note 4. Special Drawing Rights (SDR) (continued)

September 30, 2000	SDR	Dollar Equivalent
Special Drawing Rights (In Thousands):		
Beginning Balance:	7,410,706	$ 10,283,763
Interest Received on Holdings	302,670	405,182
Interest Paid on Allocations	(194,569)	(260,567)
Remunerations	430,550	577,587
IMF Annual Assessment	(755)	(1,016)
Net Loss on Valuation of Holdings	-	(688,534)
Ending Balance:	7,948,602	$ 10,316,415

September 30, 1999	SDR	Dollar Equivalent
Special Drawing Rights (In Thousands):		
Beginning Balance:	7,369,313	$ 10,105,705
Interest Received on Holdings	263,705	364,030
Interest Paid on Allocations	(176,415)	(243,468)
Remunerations	512,357	707,200
Sales of SDRs	(884,000)	(1,225,269)
Purchases of SDRs	326,546	443,708
IMF Annual Assessment	(800)	(1,081)
Net Gain on Valuation of Holdings	-	132,938
Ending Balance:	7,410,706	$ 10,283,763

Note 5. Investment Securities, Held to Maturity

In accordance with SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities", securities that the ESF has both the positive intent and ability to hold to maturity are classified as investment securities held to maturity and carried at historical cost, adjusted for amortization of premiums and accretion of discounts. Interest on investment securities, amortization of premiums, and accretion of discounts are reported in interest on investment securities.

The following schedule shows investment securities at their amortized cost and by year of maturity as of September 30, 2000 and September 30, 1999. The only investment securities maturing after one year are the German bonds. There are no securities maturing after 10 years.

Note 5. Investments and Related Interest (continued)

September 30	2000	1999
Securities, Held to Maturity (In Thousands):		
All Securities (at Amortized Cost)		
German Bonds	$ 1,016,089	$ 1,253,613
German Bubills	215,398	262,833
Japanese T- Bills	3,000,155	3,004,725
Japanese Financing Bills	435,212	-
Total Amortized Cost	$4,666,854	$ 4,521,171
Maturing Within 1 Year		
Fair Value:		
German Bonds	$ 100,064	$ 122,536
German Bubills	218,523	262,898
Japanese T-Bills	3,000,298	3,004,812
Japanese Financing Bills	435,265	0
Total Fair Value	$3,754,150	$3,390,246
Amortized Cost:		
German Bonds	$ 97,737	118,850
German Bubills	215,398	262,833
Japanese T- Bills	3,000,155	3,004,725
Japanese Financing Bills	435,212	0
Total Amortized Cost	$3,748,502	$3,386,408
Gross Unrealized Holdings Gain:		
German Bonds	$ 2,327	$ 3,686
German Bubills	3,125	65
Japanese T-Bills	143	87
Japanese Financing Bills	53	0
Total Gross Unrealized Holdings Gain	$ 5,648	$ 3,838

Note 5. Investments and Related Interest (continued)

September 30	2000	1999
Maturing after 1 Year through 5 Years (German Bonds only)		
Total Fair Value	$ 421,006	$ 521,269
Total Amortized Cost	$ 421,985	$ 514,425
Total Gross Unrealized Holdings (Loss) Gain	($ 979)	$ 6,844
Maturing after 5 Years through 10 Years (German Bonds only)		
Total Fair Value	$ 494,421	$ 612,489
Total Amortized Cost	$ 496,367	$ 620,338
Total Gross Unrealized Holdings Loss	($ 1,946)	($ 7,849)

Note 6. Certificates Issued to Federal Reserve Banks

The Special Drawing Rights Act of 1968 authorized the Secretary of the Treasury to issue certificates, not to exceed the value of SDR holdings, to the Federal Reserve Bank in return for interest free dollar amounts equal to the face value of certificates issued (SDR monetization). The certificates may be issued for the purpose of financing the acquisition of SDRs from other countries or to provide resources for financing other ESF operations. Certificates issued are to be redeemed by ESF at such times and in such amounts as the Secretary of the Treasury may determine (SDR demonetization).

As of September 30, 2000 and September 30, 1999 the amounts of SDR certificates outstanding were $3.2 billion and $7.2 billion respectively, while the value of SDR holdings was $10.3 billion on both dates, for a difference of $7.1 billion and $3.1 billion respectively. During FYs 2000 and 1999, ESF transacted no monetizations. Also, during FYs 2000 and 1999, ESF transacted $4.0 billion and $1.0 billion demonetizations respectively.

Note 7. Foreign Currency Agreements and Guarantees

Foreign Currency Agreements represent swap agreements between Treasury and various countries that provide for drawings of dollars by those countries and/or drawings of foreign currencies by Treasury. The Treasury enters into these agreements through the ESF. Any

Note 7. Foreign Currency Agreements and Guarantees (continued)

balances the ESF may hold under such agreements are held for other than trading purposes and are reflected as Other Foreign Currency Denominated Assets in the Statement of Financial Position (See Note 3). The ESF is exposed to credit risk on foreign currency agreements in the event of default by counterparties to the extent of any amounts that have been recorded in the Statement of Financial Position. Market risk occurs as a result of fluctuations in currency exchange rates. The ESF is not exposed to market risk on foreign currency agreements that could occur as a result of fluctuations in currency exchange rates. Under these agreements, the ESF will receive an agreed upon amount in dollars upon maturity regardless of currency fluctuations.

ESF enters into guarantee agreements which represent commitments by Treasury with lenders and/or investors that provide for repayment of all or part of the principal and/or interest on certain debt obligations of a borrower and/or issuer. ESF is exposed to credit risk on guarantees in the event it has to honor a guarantee and is unable to recover from the borrower amounts advanced under the guarantee.

ESF's foreign currency agreements and guarantees consisted of the following at September 30, 2000 and September 30, 1999:

a. In April 1994, Treasury signed the North American Framework Agreement, which includes an Exchange Stabilization Agreement (ESA), with Mexico. The ESA provides for a $3 billion standing swap line. The amounts and terms (including the assured source of repayment) of any new borrowings under the North American Framework Agreement would need to be negotiated. There were no drawings outstanding on these agreements as of September 30, 2000 and 1999. In December 2000, the Treasury and FRB renewed this agreement for another year to December 2001.

b. On November 6, 1998, Secretary Rubin agreed the United States would commit to guarantee up to $5 billion from the ESF to participate in a multilateral guarantee of a $13.2 billion Bank for International Settlement (BIS) Credit Facility for Brazil. The termination date for the BIS facility is the later of (1) December 14, 1999 or (2) the date on which each drawing or rollover under the agreement is repaid in full. Any drawing or rollover by Brazil under the BIS Credit Facility shall mature no later than the date of Brazil's final repurchase under the IMF's Supplemental Reserve Facility. Under the terms of the BIS Credit Facility, Brazil can seek drawings or renew drawings until December 14, 1999, one year after the effective date of the credit facility.

   During FY 1999, Brazil made two drawings on the BIS' credit facility partially guaranteed by ESF. These drawings were made in December 1998 and April 1999 for $4.2 billion and $4.5 billion respectively and the ESF' shares of the guarantee were $1.6 billion and 1.7 billion respectively. In this regard, the Treasury Department authorized the Federal Reserve Bank of New York to invest ESF's share of the guarantee in Treasury non-marketable securities on behalf of ESF on those dates. On June 18, 1999, Brazil repaid approximately 30% of the December 1998 drawing and ESF was paid a commission of $35.5 million. On October 12, 1999 Brazil also repaid approximately 30 % of the April 1999 drawing

Note 7. Foreign Currency Agreements and Guarantees (continued)

and ESF received a commission of $43.8 million. The balance of the December 1998 drawing was repaid in December 1999 and ESF received a commission of $30.9 million. Also, in April 2000, Brazil repaid the balance of its April 1999 drawings and ESF received a commission of $30.1 million. With this last payment, the credit facility granted to Brazil by BIS and partially guaranteed by ESF was terminated. Accordingly, ESF had no loan guarantee obligations on the BIS credit facility to Brazil as of September 30, 2000.

or noncompliance in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We identified the following matters involving the internal control and its operation that we consider to be reportable conditions as defined above.

Reportable Conditions

1. **Supervisory Review and Approval of Transactions Recorded in the General Ledger Need to be Consistently Performed**

   ESF management requires supervisory review and approval of batch runs of transactions before they are posted to the general ledger, to prevent mispostings. We noted in our audit that the batch runs of October 1999 through July 2000 transactions were not reviewed or approved. This lack of review allowed a number of inaccurate entries to be recorded in the general ledger without detection. Specifically, we noted errors in calculations of monthly interest revenue accruals and monthly revaluations of foreign currency denominated assets due to the use of incorrect interest rates, holding periods, and exchange rates. We also noted adjustments to the general ledger to correct errors made in prior periods which could not be explained or supported. ESF performed review and approval of transaction batch runs and adjustments for the months of August and September 2000.

Recommendation

The Director, Office of Financial Management should ensure that batch runs of transactions and adjustments are consistently reviewed and approved by a supervisor before they are posted to the general ledger. This review should include examining supporting documentation and calculations to support these entries.

2. **Detailed Written Procedures Documenting Accounting Operations and the Financial Statement Preparation Process Need to be Established**

ESF does not have written procedures detailing how to process transactions or prepare its financial statements. During FY 2000, ESF experienced turnover of its accounting staff and supervisor. As a result of no written procedures, certain transactions were not processed accurately, consistently, or timely. Also, staff did not have procedures to prepare year-end accruals, adjustments, closing entries, and the financial statements. As a result, it was necessary for us to provide management with significant assistance to complete the year-end close and prepare the financial statements.

Recommendation:

The Director, Office of Financial Management should ensure that ESF's management establishes written procedures detailing the process for recording all transactions, performing year-end closing, and preparing financial statements.

* * * * * *

Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe the reportable conditions described above are material weaknesses.

Compliance with Laws and Regulations

The results of our tests of compliance in Fiscal Year 2000 with laws and regulations disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards,* and OMB Bulletin No. 01-02.

* * * * * *

We have reviewed our findings and recommendations with ESF's financial management and have incorporated their comments as appropriate. The response to our audit report from the Deputy Chief Financial Officer, Departmental Offices is included in Appendix 1 to this report. In accordance with Department of the Treasury Directive No. 40-01, we request a corrective action plan be provided to us within 30 days of the date of this report. We recognize that certain corrective actions have already been undertaken. We encourage these efforts and will continue to provide advice and assistance to you in this regard.

Should you or you staff have any questions, you may contact me at (202) 927 5430 or a member of your staff may contact Mike Fitzgerald, Director, Financial Audits, at (202) 927-5789. We appreciate the corporation and the courtesies extended to our staff.

This report is intended solely for the information and use of the management of ESF, the Department of the Treasury, OMB, and the Congress, and is not intended to be and should not be used by anyone other than these specified parties.

William H. Pugh

William H. Pugh
Deputy Assistant Inspector General for Financial Management
and Information Technology Audits
December 22, 2000

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 21, 2001

MEMORANDUM FOR: WILLIAM H. PUGH
DEPUTY ASSISTANT INSPECTOR GENERAL FOR FINANCIAL MANAGEMENT AND INFORMATION TECHNOLOGY AUDITS

FROM: for Barry Hudson, David M. Ligon
Deputy Chief Financial Officer, Departmental Offices

SUBJECT: Draft Audit Report on the Department of the Treasury Exchange Stabilization Fund FY 2000 Financial Statements

We have reviewed your office's draft audit report on the Department of the Treasury Exchange Stabilization Fund FY 2000 financial statements. We have no comments on the report. I appreciate the efforts of you and your staff in the audit and we look forward to working with you again on the FY 2001 audit.

Financial Audits Division

Mike Fitzgerald, Director
Marie Maguire, Audit Manager
Ade Bankole, Lead Auditor
Alex Biggs, Auditor
Catherine Yi, Auditor

The Department of the Treasury

The Secretary of the Treasury
Office of International Affairs
Office of Management
Office of Accounting and Internal Control
Office of Financial Management

SECTION II

EXCHANGE STABILIZATION FUND
FISCAL YEARS 2000 AND 1999
FINANCIAL STATEMENTS

Exchange Stabilization Fund
Policy and Operations Statements
Fiscal Year 2000

The Nature and Function of the Exchange Stabilization Act

The Gold Reserve Act of 1934 established a fund to be operated by the Secretary of the Treasury, with the approval of the President. Section 10 of the Act provided that "For the purpose of stabilizing the exchange value of the dollar, the Secretary of the Treasury, with the approval of the President, directly or through such agencies as he may designate, is authorized, for the account of the fund established in this section, to deal in gold and foreign exchange and such other instruments of credit and securities as he may deem necessary to carry out the purpose of this section." To this end, the Congress, in 1934, appropriated to the Exchange Stabilization Fund (ESF) the sum of $2 billion out of the increment resulting from the reduction in the "weight of the gold dollar." Subsequent amendments to the Gold Reserve Act approved the operation of the ESF through June 30, 1945. Section 7 of the Bretton Woods Agreements Acts, approved July 31, 1945, continued its operations permanently.

The Bretton Woods Agreements Act also directed the Secretary of the Treasury to pay $1.8 billion from the ESF to the International Monetary Fund (IMF), for the initial U.S. quota subscription in the IMF, thereby reducing the ESF's appropriated capital to $200 million.

Reflecting termination of the fixed exchange rate system, legislation enacted in 1976 (P.L. 94-564, effective April 1, 1978, the date of entry into force of the Second Amendment of the IMF Articles of Agreement) amended the language of Section 10 of the Gold Reserve Act to specify that the ESF is to be utilized as the Secretary "may deem necessary to and consistent with the United States obligations in the International Monetary Fund." In 1977, P.L. 95-147 further amended Section 10 of the Gold Reserve Act. Following codification, Section 10 now provides as follows:

> Consistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates, the Secretary or an agency designated by the Secretary, with the approval of the President, may deal in gold, foreign exchange, and other instruments of credit and securities the Secretary considers necessary. However, a loan or credit to a foreign entity or government of a foreign country may be made for more than 6 months in a 12-month period only if the President gives Congress a written statement that unique or emergency circumstances require the loan or credit be for more than 6 months (31 U.S.C. 5302 (b)).

Pursuant to the Special Drawing Rights Act of 1968 (P.L. 90-349, amended by P.L. 94-564, which was approved October 18, 1976 and became effective April 1, 1978), Special Drawing Rights (SDRs) allocated by the IMF to the United States or otherwise acquired by the United States are resources of the ESF.

Section 286p of Title 22 of the United States Code allows for SDRs to be monetized/demonetized through the issuance/redemption by the Secretary of the Treasury of SDR certificates to the Federal Reserve Banks in exchange for dollars. The total amount of SDR certificates outstanding cannot exceed the dollar equivalent of ESF (i.e., U.S.) holdings of SDRs; such certificates are a liability of the ESF.

Foreign Currency Operations

During fiscal year 2000, the ESF engaged in a single market transaction. On September 22, 2000, the ESF bought $669.7 million equivalent of euros in an operation coordinated with the European Central Bank, the Bank of Japan, and other G-7 monetary authorities.

a. Euros

During fiscal year 2000, the ESF had a net unrealized loss of $1.259 billion on its euro holdings and investment income of $239.6 million equivalent on investment of euro assets.

b. Japanese yen

During fiscal year 2000 the ESF had a net unrealized loss of $84.4 million on its yen holdings and interest earnings of $2.0 million equivalent on investment of yen assets.

c. Brazil

In October 1999, December 1999 and April 2000, the ESF received commissions of $43.8 million, $30.9 million and $30.1 million respectively from the Bank for International Settlements (BIS) when Brazil completed the repayments of its two drawings on a credit arrangement provided by the BIS. The United States, through the ESF, participated in a multilateral guarantee of this credit arrangement, which was established in December 1998. The ESF earned a total of $140.3 million in commissions under this guarantee, of which $104.8 million was in connection with repayments by Brazil to the BIS during fiscal year 2000 and $35.5 million was in connection with repayments in fiscal year 1999.

d. Mexico

After the end of fiscal year 2000, in December 2000, the Treasury and Federal Reserve Bank of New York renewed the Exchange Stabilization Agreement with Mexico for another year to December 2001.

SDR Operations

ESF holdings of SDRs increased by SDR 537.9 million during fiscal year 2000 to SDR 7.95 billion. The dollar value of these SDR holdings increased by $32.7 million, a difference that is due both to the net change in SDRs and a change in the value of the SDR in dollars, a figure calculated by the IMF. The ESF reimbursed the Treasury's General Fund $444.2 million for SDRs received from the IMF as remuneration on the U.S. reserve position in the IMF. The ESF earned interest of $438.5 million on its SDR holdings.

As of September 30, 2000, cumulative allocations to (liabilities of) the United States totaled SDR 4.9 billion ($6.4 billion). These liabilities would come due only in the event of liquidation of, or U.S. withdrawal from, the SDR Department of the IMF, or cancellation of SDRs. As of September 30, 2000, U.S. holdings (assets) of SDRs exceeded cumulative allocations and totaled SDR 7.9 billion ($10.3 billion).

The ESF redeemed $4 billion of SDR certificates from the Federal Reserve in fiscal year 2000, leaving $3.2 billion of SDR certificates outstanding at the end of the fiscal year. Subsequent to the end of the fiscal year, the ESF redeemed a further $1 billion of SDR certificates.

Income and Expense

Interest revenue totaled $1.49 billion, consisting of $807.5 million in interest on dollar holdings invested in U.S. Government securities, $438.5 million equivalent in interest on SDR holdings, and $241.6 million in interest on foreign currency investment.

The ESF earned $104.8 million in commission for its role in guaranteeing the BIS credit facility for Brazil.

Interest expense totaled $281.1 million, of which $275.1 million was in charges on SDR allocations and $6.0 million was interest paid by the ESF to the Treasury General Fund on the dollar counterpart of SDRs received as remuneration on the U.S. reserve position in the IMF.

Department of the Treasury
Exchange Stabilization Fund
Statement of Financial Position
(In Thousands)

September 30	2000	1999
Assets		
Cash and Cash Equivalents (Note 2)		
U.S. Government Securities	$ 11,028,570	$ 15,232,198
Foreign Currency Denominated Assets	8,504,370	9,001,271
Total Cash and Cash Equivalents	19,532,940	24,233,469
Other Foreign Currency Denominated Assets (Note 3)	2,404,450	2,513,215
Special Drawing Right Holdings (Note 4)	10,316,415	10,283,763
Investment Securities, Held to Maturity (Note 5)	4,666,854	4,521,171
Accrued Interest Receivable	146,839	112,668
Total Assets	$ 37,067,498	$ 41,664,286
Liabilities and Equity		
Liabilities		
Certificiates Issued to Federal Reserve Banks (Note 6)	$ 3,200,000	$ 7,200,000
Special Drawing Right Allocations (Note 4)	6,359,054	6,799,029
Unearned Income and Advances	87	13,283
Accrued Expenses	188,037	39,491
Total Liabilities	9,747,178	14,051,803
Equity		
Appropriated Capital	200,000	200,000
Retained Earnings	27,120,320	27,412,483
Total Equity	27,320,320	27,612,483
Total Liabilities and Equity	$ 37,067,498	$ 41,664,286

The accompanying notes are an integral part of the financial statements

Department of the Treasury
Exchange Stabilization Fund
Statement of Income and Retained Earnings
(In Thousands)

Years Ended September 30	2000	1999
Interest Revenue		
Interest on U. S. Government Securities	$ 807,535	$ 802,860
Interest on Foreign Currency Denominated Assets	186,377	153,777
Interest on Special Drawing Right Holdings	438,494	348,990
Interest on Investment Securities	55,247	47,197
Total Interest Revenue	1,487,653	1,352,824
Interest Expense		
Interest on Special Drawing Right Allocations	275,153	233,262
Interest on Special Drawing Right Received as Remuneration by the U.S. Treasury	5,961	3,680
Total Interest Expense	281,114	236,942
Net Interest Revenue	1,206,539	1,115,882
Other Revenue		
Commissions	104,773	35,547
Total Other Revenue	104,773	35,547
Net Gains and Losses		
Unrealized (Loss) Gain on Valuation of Special Drawing Rights	(255,181)	54,197
Net Realized Gain on Sales of Foreign Currency Denominated Assets	-	151,598
Unrealized (Loss) Gain on Valuation of Foreign Currency Denominated Assets	(1,347,761)	1,485,799
Total Net (Loss) Gain	(1,602,942)	1,691,594
Other Expenses		
International Monetary Fund Annual Assessment	533	967
Total Other Expenses	533	967
Net (Loss) Income	$ (292,163)	$ 2,842,056
Retained Earnings, Beginning of Year	27,412,483	24,570,427
Retained Earnings, End of Year	$ 27,120,320	$ 27,412,483

The accompanying notes are an integral part of the financial statements.

Department of the Treasury
Exchange Stabilization Fund
Statement of Cash Flows
(In Thousands)

Years Ended September 30		2000		1999
Cash Flows from Operating Activities				
Interest Received on U.S. Government Securities	$	805,597	$	804,237
Interest Received on Foreign Currency Denominated Assets		171,876		159,316
Interest Received on Investment Securities		50,507		37,631
Commissions Received on Credit Facility		104,773		35,547
Net Realized Gain on Sale of Foreign Currency Denominated Assets		-		151,598
Net Unrealized (Loss) Gain on Valuation of Foreign Currency Denominated Assets		(1,334,759)		1,486,828
Other		(17,365)		13,283
Net Cash (Used in) Provided by Operating Activities		(219,371)		2,688,440
Cash Flows from Investing Activities				
Net Decrease (Increase) in Foreign Currency Denominated Assets		108,766		(418,962)
Net Increase in Investment Securities		(145,683)		(797,142)
Purchases of Special Drawings Rights Received as Remuneration by the U.S. Treasury and Related Interest		(444,241)		(710,974)
Purchases of Special Drawings Rights		-		(443,708)
Sales of Special Drawing Rights		-		1,225,269
Net Cash Used in Investing Activities		(481,158)		(1,145,517)
Cash Flows from Financing Activities				
Certificates Redeemed from Federal Reserve Banks		(4,000,000)		(2,000,000)
Other		-		(749)
Net Cash Used in Financing Activities		(4,000,000)		(2,000,749)
Net Decrease in Cash and Cash Equivalents		(4,700,529)		(457,826)
Cash and Cash Equivalents at Beginning of Year		24,233,469		24,691,295
Cash and Cash Equivalents at End of Year	$	19,532,940	$	24,233,469
Reconciliation of Net (Loss) Income to Net Cash (Used in) Provided by Operating Activities				
Net (Loss) Income	$	(292,163)	$	2,842,056
Adjustments to Reconcile Net (Loss) Income to Net Cash (Used in) Provided by Operating Activities:				
Decrease (Increase) in Special Drawing Right Holdings Due to Valuation		411,588		(247,896)
(Increase) Decrease in Accrued Interest Receivable		(34,171)		9,801
(Decrease) Increase in Special Drawing Right Allocations Due to Valuation		(439,975)		80,193
Increase (Decrease) in Accrued Expenses		148,546		(8,997)
(Decrease) Increase in Unearned Income and Advances		(13,196)		13,283
Total Adjustments		72,792		(153,616)
Net Cash (Used in) Provided by Operating Activities	$	(219,371)	$	2,688,440

The accompanying notes are an integral part of the financial statements.

INSERT #6

Page 58, line 1359 – Insert for the Record: Report on International AIDS Trust Fund

REPORT ON INTERNATIONAL AIDS TRUST FUND

This report is presented in compliance with the Conference Report (H.R. 106-997) to the Foreign Appropriations Act, 2001 (Pub. L. 106-429) on progress toward establishment of an international AIDS Trust Fund. To date, U.S. Government (USG) agencies have had extensive discussions with other potential donors on the creation of a global fund to respond to the challenges of HIV/AIDS, tuberculosis (TB), and malaria. There have been various international proposals for such a fund, in terms of structure, organization and the type of assistance to be provided to fight HIV/AIDS and other major infectious diseases. The U.S. has sought to build a consensus around a shared, sound approach which ensures that the fund will have a real impact on these diseases. To this end, on May 11, President Bush announced the United States' support for a new global fund ("Global Fund to Combat HIV/AIDS, Tuberculosis and Malaria") targeting HIV/AIDS, TB, and malaria. The President pledged a founding U.S. contribution of $200 million to such a fund.

Looking ahead, there are ongoing active discussions and negotiations in the G-7/8 Sherpa process to try to achieve a unified approach prior to the UN General Assembly Special Session on AIDS in June and the Genoa Economic Summit in July. Also, Secretary Annan and WHO Director General Brundtland have held productive discussions with Secretaries Powell and Thompson on principles to undergird a fund. A consensus is emerging, especially since the U.S. weighed in with a large financial commitment in support of a new global fund. There is growing momentum for combating three major infectious diseases – HIV/AIDS, TB, and malaria. There is also a clear consensus that the global fund include substantial assistance for HIV/AIDS. However, there are still differences about the structure, scope, size and operation of the fund, although they are less pronounced now than earlier this year.

U.S.G. Activities

The Global AIDS and Tuberculosis Relief Act of 2000 (P.L. 106-264) passed by Congress last year authorized $150 million in each of FY 2001 and FY 2002 for an HIV/AIDS trust fund to be located at the World Bank. The FY 2001 Foreign Appropriations Act appropriated $20 million for "a United States contribution to an international HIV/AIDS fund as authorized by subtitle B, title I of Public Law 106-264, or a comparable international HIV/AIDS fund." The Treasury Department, with USAID's participation, began negotiations with the World Bank in December 2000 on a governance structure for the International AIDS Trust Fund (IATF). After an active exchange between Treasury and Bank staff, and in consultation with UNAIDS Secretariat, we reached an understanding in early February on a possible structure that is broadly similar to the one envisioned in the authorizing legislation. Subsequently, Treasury Deputy Assistant Secretary for International Development, Debt, and Environment Policy, William Schuerch, approached a wide range of donors while in Europe in February for international meetings:

- UK Department for International Development (February 14). DAS Schuerch met with the senior official in charge of health and population programs at DFID. DAS Schuerch presented the IATF initiative and was told of the UK's interest in a UK-Canada initiative ("Ottawa Fund"), which is structured primarily as a commodity purchase fund.

- Palermo G-7 Deputies Deputies Meeting (February 16-17). DAS Schuerch, as the United States Government representative, put forward the IATF proposal in the context of a broad discussion of development challenges beyond HIPC. Italy also put forward a trust fund proposal that would cover a wide range of diseases. There was a general discussion of the governance structure of trust funds.

- Italian Government Officials (February 19). While in Rome for International Fund for Agricultural Development meetings (IFAD), DAS Schuerch met with Italian officials from the Ministry of Treasury and Ministry of Foreign Affairs, who will have important roles in preparing initiatives for the July Genoa Economic Summit. The Italians provided additional information on their global health fund proposal.

- EU Commission (February 23). DAS Schuerch presented the IATF proposal to a range of EU officials, including senior officials from the External Relations and Development Directorates and the Commission's leading authority on AIDS. Commission officials described the EU draft program for accelerated action for HIV/AIDS, malaria, and tuberculosis, and its preference for sector-wide approaches, which would channel funds directly to health ministry budgets.

- IDA Deputies Meeting, Paris (February 26-27). DAS Schuerch used the occasion of the IDA Deputies meetings to raise the IATF proposal with a number of other country representatives.

Subsequent to these meetings, Treasury, State, and USAID continued to promote support for the IATF, while leaving open the possibility of coordinating among the various proposals.

- A senior USAID official raised and promoted support for the U.S. proposal in a February meeting in New York with counterpart bilateral aid agencies to discuss the Ottawa Fund. At a subsequent meeting, USAID discussed ways in which the IATF might be coordinated with the Ottawa Fund.

- State Acting Assistant Secretary Tony Wayne raised the IATF proposal at the February G-8 Foreign Affairs Sous Sherpa meeting.

- Treasury, State, and USAID officials met with UNDP HIV/AIDS experts to learn about a UNDP proposed trust fund on HIV/AIDS and to explain the function of IATF.

- The U.S. delegation to U.S.-EU technical level discussions on health raised the U.S. proposal for a global health trust fund in early March.

- The U.S. delegation (State, Treasury, USAID, HHS) to the G-8 Health Experts Group meeting in March in Rome presented the IATF proposal to the other health experts.

- Treasury Acting Assistant Secretary Mark Sobel raised the IATF proposal at the March meeting of the G-7/8 Finance Sous Sherpas.

The response of other potential donors to the IATF proposal has been non-committal. While there has been considerable interest in providing additional resources to combat HIV/AIDS, a number of donors of (UK, Italy, EU) have either put forward or are developing their own proposals for broader international health trust funds, and a few, at least initially, have expressed opposition to any new trust fund.

Over the past two months, there has been considerable effort internationally to coordinate and consolidate the various fund proposals through a broad international health fund. The G-8 Sherpas, which are Personal Representatives of the Heads of State or Government from the G-8 nations, have discussed the various proposals and will continue to do so in the run-up to the Genoa Economic Summit. As a result of these efforts, there is now an emerging consensus for a fund to be established to combat HIV/AIDS, TB and malaria, with an emphasis on HIV/AIDS.

In April 2001, the Development Committee (the ministerial-level governing body of the World Bank) recognized the need for a substantial increase in global resources for HIV/AIDS-related analysis, research and action programs. It indicated that a portion of such increased funding might be channeled through a possible new multilateral trust fund for HIV/AIDS, malaria and TB. The Committee also called on participants in the June 2001 UN General Assembly Special Session on HIV/AIDS to make concrete commitments that would produce a rapid intensification of global action on HIV/AIDS.

Still, there remain differing views on the scope, size, and operation of global health trust fund.

U.S. Initiative

As exemplified by the President's statement on May 11, this issue has received high-level attention in the USG. A task force led by Secretary of State Powell and Secretary of Health and Human Services Thompson has developed a U.S. proposal that builds on the emerging international consensus, and would provide crucial resources for improving our supplemental and ongoing bilateral programs and for facilitating central international cooperation. In particular, the U.S. proposed global fund would:

- target HIV/AIDS, TB and malaria;
- support an integrated approach to fighting these diseases, along a continuum of prevention, health systems development, and care and treatment;
- incorporate sound medical and public health oversight and accountability, and needed financial transparency;
- support local capacity-building to deliver effective care and treatment;
- promote public and private sector participation, in part, by recognizing that intellectual property rights create critical incentives for the development of new drugs and other treatments;
- recognizing that intellectual property rights create critical incentives for the development of new drugs and other treatments; and
- permit flexibility in the manner in which donors target the use of their funds.

FACT SHEET
Office of the Press Secretary, The White House
Washington, DC
May 15, 2001

Global Fund to Fight HIV/AIDS, Malaria, and Tuberculosis

- On May 11, 2001, President Bush outlined the United States' commitment to support a multilateral global trust fund for HIV/AIDS, tuberculosis and malaria.
- This international public-private partnership will provide grants for prevention, treatment, and care.
- The United States will back this international effort by providing $200 million in seed money for FY 2002. Additionally, the Administration will work with the G-8 and other countries, as well as private foundations, corporations, faith-based groups and other organizations to more effectively fight these diseases through support for this global effort.

Facts and Figures

- Collectively, HIV/AIDS, malaria and tuberculosis are ravaging developing nations, causing 25% of all deaths worldwide.
- The Joint United Nations Programme on HIV/AIDS (UNAIDS) estimates that 36 million people are now living with HIV/AIDS. Seventy percent of these people are in sub-Saharan Africa, where HIV/AIDS is now the leading cause of death.
- Worldwide, more than 22 million people have died since the AIDS epidemic began in the 1970s.
- Tuberculosis accounted for 1.7 million deaths last year.
- Malaria killed more than 1 million people last year – mostly children in Africa.

The Administration's International Leadership on Preventing Disease

- The United States is the largest bilateral donor of HIV/AIDS assistance, providing for nearly 50% of all international HIV/AIDS funding.
- Under President Bush's leadership, the United States will continue to pursue an integrated approach to fighting disease, focusing on prevention of new infections and training medical professionals, as well as treatment and care. The United States believes that we must continue and expand our efforts on prevention – the most proven and cost-effective way to address these global challenges, realizing the critical role medical treatment plays in creating an incentive to get tested and in diminishing the stigma afforded to HIV infected individuals and their families.
- The global fund to fight HIV/AIDS, malaria and tuberculosis will be an important multilateral tool for addressing these global epidemics.
- The United States will continue to work with other countries to ensure that the global fund: (1) is a public-private partnership; (2) pursues an integrated approach, emphasizing prevention in a continuum of treatment and care; (3) focuses on "best practices" by funding a core menu of programs proven to work, then scaling up; (4) promotes scientific and medical accountability by requiring proposals to be reviewed for effectiveness by medical and public health experts; and (5) respects intellectual

The Bush Administration's HIV/AIDS Task Force

- In April, President Bush expanded the mandate of the Office of National AIDS Policy (ONAP) to better facilitate domestic and international policy efforts on HIV/AIDS.
- ONAP is supporting a new high-level task force -- co-chaired by the Secretary of State and the Secretary of Health and Human Services, and including the White House Domestic Policy Advisor and the National Security Advisor -- to coordinate the Administration's proactive activities and responses to all aspects of the domestic and international HIV/AIDS crisis.

The President's Budget Provides Needed Resources to Fight Infectious Diseases

In addition to the $200 million commitment to the new Global Fund, the President's budget:

- Allocates $480 million in funding to fight the international HIV/AIDS epidemic, a 113 % increase from Fiscal Year 2000.
- Provides $2.5 billion for the National Institutes of Health for HIV/AIDS research, an increase of $258 million or 12%.

Contact: White House Press Office

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Remarks by the President During Announcement of Proposal for Global Fund to Fight HIV/AIDS

President Bush
The Rose Garden
Washington, DC
May 11, 2001

PRESIDENT BUSH: It is my honor to welcome our friend, the President of Nigeria, to the Rose Garden. Mr. President, welcome to Washington, the Rose Garden. And of course, Kofi Annan, the Secretary General of the United Nations. Mr. Secretary General, thank you for coming.

As well, we are joined by two members of my Cabinet, Secretary of State Powell, Secretary of Health and Human Services, Tommy Thompson. I want to thank them both for being here. Scott Evertz, who is the Director of the National AIDS Policy Office is with us. Scott, thank you for being here. And, of course, Condoleezza Rice, the National Security Advisor.

I am looking forward to meeting with the President on a range of issues that are important to our nations. This morning, we've spoken about another matter that involves countless lives. Together, we've been discussing a strategy to halt the spread of AIDS and other infectious diseases across the African continent and across the world.

The devastation across the globe left by AIDS, malaria, tuberculosis, the sheer number of those infected and dying is almost beyond comprehension. Suffering on the African continent has been especially great. AIDS alone has left at least 11 million orphans in sub-Sahara Africa. In several African countries, as many as half of today's 15-year-olds could die of AIDS. In a part of the world where so many have suffered from war and want and famine, these latest tribulations are the cruelest of fates.

We have the power to help. The United States is committed to working with other nations to reduce suffering and to spare lives. And working together is the key.

Only through sustained and focused international cooperation can we address problems so grave and suffering so great. My guests today have been doing their part and more, and I thank them for their leadership.

President Obasanjo last month led the nations of Africa in drafting the Abuja declaration which lays out crucial guidelines for the international effort we all envision. Secretary General Annan too has made this issue an urgent priority. He has been an eloquent voice in rallying the resources and conviction needed in this cause.

When he visited the White House in March, we talked about the AIDS pandemic. We agreed on a goal of creating a global fund to fight HIV/AIDS, malaria and tuberculosis. The G-8 has been discussing the potential fund.

Our high-level task force chaired by Secretaries Powell and Thompson has developed a proposal that we have shared with U.N. officials, developing nations and our G-8 partners. We will need ideas from all sources. We must all show leadership and all share responsibility.

For our part, I am today committing the United States of America to support a new worldwide fund with a founding contribution of $200 million. This is in addition to the billions we spend on research and to the $760 million we're spending this year to help the international effort to fight AIDS. This $200 million will go exclusively to a global fund, with more to follow as we learn where our support can be most effective.

Based on this morning's meetings, I believe a consensus is forming on the basic elements that must shape the

Global Fund and its use. First, we agree on the need for partnerships across borders and among both the public and private sectors. We must call upon the compassion, energy and generosity of people everywhere. This means that not only governments can help but also private corporations, foundations, faith-based groups and nongovernmental organizations as well.

Second, we agree on an integrated approach that emphasizes prevention and training of medical personnel as well as treatment and care. Prevention is indispensable to any strategy of controlling a pandemic such as we now face.

Third, we must concentrate our efforts on programs that work, proven best practices. Whenever the Global Fund supports any health program, we must know that it meets certain essential criteria. We must know that the money is well spent, victims are well cared for and local populations are well served.

That leads to the fourth criterion, namely that all proposals must be reviewed for effectiveness by medical and public health experts. Addressing a plague of this magnitude requires scientific accountability to ensure results.

And, finally, we understand the importance of innovation in creating lifesaving medicines that combat diseases. That's why we believe the fund must respect intellectual property rights, as an incentive for vital research and development.

This morning, we have made a good beginning. I expect the upcoming U.N. Special Session and this summer's G-8 summit in Italy to turn these ideas into reality. This is one of those moments that reminds us all in public service why we're here. It challenges us to act wisely and act together and to act quickly. Across the world at this moment, there are people in true desperation, and we must help.

It is now my honor to bring to the podium, the President of Nigeria. Mr. President.

PRESIDENT OBASANJO: Mr. President, Secretary General of the U.N., I am particularly grateful to you, President Bush, for making this ceremony to coincide with my visit to you here at the White House in Washington, D.C., on your very kind invitation.

When African leaders gathered in Abuja, two weeks ago, to indicate their unflinching commitment to fight the scourge of HIV/AIDS and related diseases, the joint message of the Secretary of State and the Secretary of Health was brought to us as a message of hope from the United States of America. Today, Mr. President, you have begun to concreteize that hope for Africa, and particularly for millions of Africans infected and affected by HIV/AIDS.

We are still far from the $7 billion to $8 billion annually that experts reckon will be needed to make impression on the ravaging effects of this dreadful scourge. But with this beginning, and just the beginning, as you have kindly emphasized, for the U.S., all nations, governments, foundations, private individuals and private sector and indeed all human kind who are stakeholders in the health of humanity are challenged and called upon to make contributions to the Global Trust Fund for HIV/AIDS and related diseases.

Mr. President, I thank you, on behalf of all AIDS sufferers in the world, but particularly on behalf of all AIDS sufferers in Africa, for launching the global fight against HIV/AIDS pandemic.

PRESIDENT BUSH: Thank you, Mr. President. Thank you very much. Mr. Secretary General.

SECRETARY GENERAL ANNAN: President Bush, President Obasanjo. I wish to thank you, President Bush, for committing yourself today to placing the United States at the forefront of the global fight against HIV/AIDS. It is a visionary decision that reflects your nation's natural leadership in the United Nations, as well as your recognition of the threat posed by this global catastrophe.

To defeat this epidemic that haunts humanity and to give hope to the millions infected with the virus, we need a response that matches the challenge. We should now build on the remarkable progress over the last year in galvanizing global awareness of the threat of HIV/AIDS.

I believe we can all agree on five key objectives for our response. First, to ensure that people everywhere, particularly young people, know what to do to avoid infection; second, to stop perhaps the most tragic form of HIV transmission, from mother to child; third, to provide treatment for all those infected; fourth, to redouble the search for vaccine as well as cure; and, fifth, to care for all those whose lives have been devastated by AIDS, particularly the orphans, and there are an estimated 13 million of them worldwide today and their numbers are growing.

As we declare global war on AIDS, we will need a war chest to fight it. We need to mobilize an additional $7 million to $10 million a year to fight this disease worldwide. The Global Aids and Health Fund that I have called for as part of this total effort would be open to the nations, as you heard from the two Presidents, from governments, civil society, private sector, foundations and individuals -- all hands on deck. And the resources provided must be over and above what is being spent today on the disease and on development assistance to poor countries.

This founding contribution by the US with the promise to do more will encourage or energize others to act. Africa, of course, is the continent that is most profoundly affected by the spread of HIV/AIDS, and the continent most in need of hope for a better future.

The peoples and the leaders of the continent are rising to the challenge, as President Obasanjo showed most recently, by hosting the Abuja AIDS Summit. However, we must not forget that other parts of the world from the Caribbean to Asia to Eastern Europe are also confronting the spread of this virus and need urgent assistance.

Mr. President, it is my hope that your commitment today will set an example for other leaders. When we meet at the General Assembly Special Session on HIV/AIDS on the 25th of June in New York City, there will be a strong support for the Global Aids and Health Fund. As that happens, I believe today will be remembered as the day we began to turn the tide.

Thank you very much.

PRESIDENT BUSH: It has been my honor to host this very important announcement. It's also my honor to recognize two members of the United States Congress who are going to work with this administration to make sure that our commitment becomes reality, Senator Frist and Senator Leahy. We're so thrilled you're here. We appreciate your vision and we appreciate your leadership. Thank you all for coming.

[End]