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THE REPORT TO THE CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICIES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

ON

THE REPORT TO THE CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICIES

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C O N T E N T S

THURSDAY, MAY 18, 2006

WITNESS

THE REPORT TO THE CONGRESS ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICIES

THURSDAY, MAY 18, 2006

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 9:36 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order. We are very pleased this morning to welcome Secretary of the Treasury John Snow again to testify on the Treasury Department's Report to the Congress on International Economic and Exchange Rate Policies.

Secretary Snow, the Treasury report indicates that no major partner of the United States met the technical requirements for currency manipulation under the Omnibus Trade and Competitiveness Act of 1988 during the second half of 2005. Many Members of Congress, including myself, find the continued imbalance of trade with China to be a significant concern. As you will hear this morning, Mr. Secretary, there is considerable disappointment that once again, Treasury has failed to find a currency manipulation determination with respect to China.

My own view, Mr. Secretary, is that China is manipulating its currency, and I would be interested in hearing more this morning about why Treasury believes that it is not possible to make that determination. Now, I understand the political and economic ramifications of doing that. But reforming China's exchange rate, Mr. Secretary, is a matter which affects the global community and clearly, Mr. Secretary, requires the attention of the international community.

The pace of China's actions will have an impact on China's domestic economy as well, now, as on the world economy. While I disagree with your assessment on the lack of manipulation, I concur that this imbalance is a matter of extreme urgency. I will be very interested this morning, and others will be, too, to hear more about how international bodies such as GEF, IMF, and perhaps the Asian Development Bank can play a role in facilitating increased flexibility here.

In 2005, the U.S. current account deficit reached $805 billion, Mr. Secretary, or 6.4 percent of GDP. The deficit has been growing rapidly since 1997, when it stood at just 1.7 percent of GDP. Despite these numbers, our economic performance has remained strong up until now, with steady economic growth and low unemployment. That is the good news. However, signs of a gradual adjustment to bring the imbalances to a more sustainable level would also be very good news to the Congress, the Treasury, and U.S. workers.

Secretary Snow, this Committee would like to engage you in a serious discussion this morning about the specific measures that the Administration, led by you, will take in the next 6 months to move China forward on a flexible rate plan. Over the long-term, both the United States and the global economy will benefit the most from the continued pursuit of free trade and flexible exchange rates policy. The most desirable way to reduce our current account deficit would be through stronger growth abroad and more open trading markets and policies. I look forward to a thorough discussion with you this morning, and I know the other Members do, too.

Senator Johnson.

COMMENTS OF SENATOR TIM JOHNSON

Senator JOHNSON. Thank you, Mr. Chairman. I want to welcome Secretary Snow to the hearing this morning, and thank him for his appearance before the Committee.

Chairman SHELBY. Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman, and Secretary, welcome to this hearing.

Recently, we had a hearing somewhat on the same subject in the Joint Economic Committee, and I have asked the staff of the Committee to give some statistics, which I will lay out for you now. My Republican colleagues know I cannot discuss this without bringing up some charts, so I will spring a few, and I have copies for those who may want them and warn you in advance these are the areas in which I am going to pursue the questioning.

The first one shows the current account balances, and the colors there, for those that do not have a copy themselves, the red color is the United States, and as the Chairman has said, the current account balance in the United States deficit has been growing ever since 1997. The trend started in 1997, continued, ameliorated just a little bit in 2001 and then continued on down.

The China line is relatively flat, and there are other forces at work. We have the fuel exporters that are going up. We have the advanced economies, and then, we have the other developing economies, and you can see from this, it is a mixture of the other economies and not just China alone. So, I will be questioning you on the impact of fuel prices on the account deficit and the other economies.

The second chart has to do with the fact that the United States is the world's largest net debtor. As a group, other advanced economies remain the largest creditors. And once again, the red, which shows—this is as a percentage of world GDP—the United States started to become a major debtor in 1996, and the trend has continued from 1996 on, has ameliorated in 2002 and started to get better in 2003 and 2004.

But once again, the China line on that chart is relatively flat, and the net foreign asset positions that have mirrored America's debt have been, overwhelmingly, the other advanced economies. So the investments in America have not come from China. They have come from our European friends, the Japanese, et cetera. I will be discussing these two charts with you and the implications of this as we go on, because I think we need to focus not only on China but also the impact of the fuel exporters and the role that they play in driving up or driving down the account deficit.

Thank you, Mr. Chairman. I look forward to the exchange with the Secretary.

Chairman SHELBY. Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Thank you, Mr. Chairman.

Mr. Secretary, it is great to see you, and thanks for joining us and for your service to our country. Others have already mentioned that we are interested in your report on currency manipulation. I am anxious to hear what the rationale is for concluding that there is no official finding of manipulation on the part of China.

We had before us on another Committee, Mr. Secretary, Ambassador Rob Portman, who, as you know, has been nominated to be the head of the Office of Management and Budget, and he is an old friend and a fellow I like a lot and I admire, as I do you. I mentioned to him that I also admired his two predecessors in that post, the first of whom is now Governor of Indiana, and during his watch as head of OMB, our national debt grew by $900 billion and the immediate predecessor to Ambassador Portman is now the President's Chief of Staff, and under his watch at OMB, the national debt grew by about $1.5 trillion.

And today, our trade deficit as of last year was about $750 billion. And as we prepare to talk with you today about currency and whether or not the Chinese are manipulating, and I acknowledge that there has been some movement in the value of their currency, I also want us to come back and focus on the trade deficits, how we are doing there, and I would like to focus a bit on the budget deficit and how we are doing there.

And finally, I would like to hear from you any progress that the President's Working Group is making with respect to the Terrorism Risk Insurance Act, and particularly, I would be interested to know how the Federal Government is working with the private sector to develop a comprehensive approach to terrorism insurance, and I am sorry to say that that is an issue that is not likely to go away.

And finally, I look forward to working with you, Mr. Secretary, and with others on this Committee and across the aisle and in the Administration as we try to create a world class regulator for Government Sponsored Enterprises while also preserving the unique and crucial mission of the GSE's.

And Secretary, thank you again for joining us. We look forward to hearing from you and having a chance to explore some of these issues with you today. Thank you.

Thanks, Mr. Chairman.

Chairman SHELBY. Thank you.

Senator Bunning.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman.

Thank you, Secretary Snow, for joining us today to testify. I am glad we are holding this hearing today. This is an issue that is important to me, and I have been talking about it for quite a while. I am glad that many others share my concerns and that more attention is being paid to our currency exchange rates, particularly with China.

I have long been a critic of our trade relationship with China. I opposed permanent normal trade status with them, and I still think that it was the wrong move. China continues to oppress its people and act aggressively toward Taiwan. In my view, China has not yet shown itself to be a responsible trading partner deserving favored status.

Because of cheap labor, Chinese goods have replaced American goods all over the marketplace. Those goods have only been made cheaper by the lower value of the Chinese currency. I support international trade, but we have to be careful when trading with countries that use artificial means to get huge price advantages.

Last week's report by the Treasury Department does not make me feel much better. I am glad that the Administration and others share my concerns about the value of the Chinese currency, but not much progress has been made since China agreed to let their currency float.

Since the initial move last July, the yuan has strengthened by less than 1.5 percent to the dollar. That makes me wonder if they are really letting the currency float, or are they letting it move a bit for show? Mr. Secretary, I appreciate your efforts so far to engage China on the issue, but I think more needs to be done quickly. The test of whether the effort of the United States and others is working is the result, and so far, the results are not that good.

You stopped short of calling China a manipulator because you did not have enough evidence. I want to know what it is going to take for you to find more evidence. I want to know how much progress we are going to see and how long it is going to take. Last year, it took the certainty of Congressional action to get China to move, and I want to know if we will have to have more Congressional action to keep China moving.

I look forward to the hearing and your answering our questions. Thank you, Mr. Chairman, for the time.

Chairman SHELBY. If I could digress for just a minute, we have a quorum, Mr. Secretary, if you will indulge us, it is hard to get a quorum sometimes.

[Recess.]

We will go back to regular order. Senator Stabenow is recognized on today's hearing.

STATEMENT OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman, and welcome, Mr. Secretary.

This is an incredibly important issue for my State in Michigan as well as the country, and I think today, while we are focused on exchange rates, there is really a larger agenda that is very significant for our country, as we are in a global economy: The question of how we are going to succeed on behalf and how we are going to support American businesses and American workers. Are we going to create a level playing field or not in this country? This is a very big issue.

And currency manipulation, as you know, Mr. Secretary, is a very big part of that. More and more businesses are facing unfair trade practices. How many jobs are we going to lose because of currency manipulation before we decide that technically, we have met the requirements. I agree with Senator Bunning in his statement in terms of the question of what is it technically? If it is not now, tell us what technically we need to do in order to be able to say what we know is already going on. How many patents are we going to have stolen before we take a stand on this?

Today's CEO's of our major auto companies are in town, and we are going to hear about this issue and not just with China. From an auto industry standpoint, this is about Japan. We saw yesterday Japan come forward to make statements again that directly relate to what is happening with the yen, and it has a profound impact on the auto industry.

So we need to be taking action. This is the 23rd consecutive Treasury report, and the message continues to be the same: We are very upset, but we always stop short of fixing the problem. So my question, Mr. Secretary, is when are we going to fix the problem rather than just being upset?

For example, on September 9, 2004, the Assistant Secretary for Public Affairs for Treasury said China must continue to do more to ensure progress continues. We will act as aggressively as necessary to achieve results on this issue. What does that mean? What is acting aggressively? When are we going to see it?

Yet, over the past 2 years, the yuan continues to be undervalued anywhere from 15 to 40 percent. On top of health care costs, on top of differentials in wages and pensions, we are adding a 15 to 40 percent tax and a penalty on the American businesses trying to compete in the global economy. I do not know how in the world we think that is in our best interests.

I continue to tell Michigan constituents who are losing their jobs and worried about their pensions that it is the Government's responsibility, the Federal Government's responsibility, to make sure there is a level playing field. But year after year, report after report, the Administration threatens to do something but has not solved the problem. So, I am very interested in knowing what is going to happen before the 24th report, and are we going to stop just rattling the sabers, and are we going to actually stand up and fight for American businesses and American workers?

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you.

Senator Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman, and Mr. Secretary, I also appreciate your being here. I will defer making a long statement and simply indicate that I share the concern that you heard from so many of my colleagues about the Treasury's decision not to designate China as a currency manipulator. I agree with my colleagues on this issue and look forward to a robust discussion with you here at the hearing.

Thank you for coming.

Chairman SHELBY. Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Thank you very much, Mr. Chairman.

This is a very important hearing, and the state of the international financial system is not good, and this Administration's policies are part of the problem rather than part of the solution. The U.S. contribution to the large payment imbalances that now characterize the international financial system begins with our own budget deficit.

President Bush inherited a $5.6 billion, 10-year budget surplus, achieved through responsible budget policies and a strong economy in the 1990's. That legacy of fiscal discipline has been squandered and turned into a legacy of deficits and debts. The result has been a sharp decline in our national saving and increased borrowing from the rest of the world to finance a budget deficit and excess spending.

The consequence of our borrowing binge is that the United States is by far the world's largest international debtor. Last year, the U.S. current account deficit was $805 billion, which means that spending by American citizens and the Federal Government outstripped our income by an amount equal to 6.4 percent of GDP.

Borrowing such large sums from the rest of the world does not strike me as a wise or sustainable economic strategy. Foreign holdings of U.S. Treasury securities have more than doubled since President Bush took office. Almost all of the increase in publicly held debts has been purchases of U.S. Treasury securities by foreigners, including foreign governments. The Governments of Japan and China are our two largest official creditors. China has increased its holdings of Treasury securities by 423 percent since 2001, and much of that increase has come as a result of purchases by their Central Bank to prevent the country's currency from appreciating against the dollar.

Last week, the Administration resisted branding China a currency manipulator, but even you, Mr. Secretary, acknowledged the pace of change by Chinese leaders is slow and disappointing. We cannot turn a blind eye to China's role in creating large payment imbalances, but I come back to our own role: Our Nation cannot prosper in the long-run with persistent large budget deficits that drain our national savings and a large trade deficit financed by foreign borrowing.

Strong investment financed by our own national savings, not foreign borrowing is the foundation of a strong and sustained economic growth. If we do not change course, our children and grandchildren will have to repay these irresponsible debts, and their standards of living will suffer.

Mr. Secretary, I look forward to your testimony and to exploring the policies we can pursue to address the imbalances that exist in our international financial system and create more broadly shared prosperity for the United States and its trading partners.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, I want to thank you for holding this hearing. As you know, as we are all realizing that the International Economic and Exchange Report is of great interest to the Committee. And we have had many informative discussions, I think, at previous hearings, and I am sure today's hearing will be just as educational.

The Treasury Department's report is required under the Omnibus Trade and Competitiveness Act of 1988 and reviews the effects that significant economic developments have had on the United States and foreign countries. And this report also evaluates certain factors that may bring about those economic developments.

As one of the rising economic powers of the world, much of the attention obviously is devoted to China and in particular China's movement toward a free-floating exchange rate. I will be very interested to hear what China has made as well as what remains to be done and what the Administration is doing to get them here.

We must look beyond the exchange rate, though, to develop a consistent and comprehensive policy for dealing with China. As their economy continues to grow, how will their trade and monetary policies affect the United States, and how should we respond? Today's hearing will help us better understand this very complex matter.

I will also be interested in hearing more about our current accounts deficit, which currently stands at $821 billion. What are the economic implications of the current accounts deficit for our economy as well as for our economic security? I would like to thank Secretary Snow for appearing before the Committee today, and as always, Mr. Secretary, it is a lively and informative discussion when you are here, and thank you for your testimony.

Chairman SHELBY. Senator Schumer.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman. Thank you, Mr. Secretary, and welcome back to the Committee. As I have said before, Senator Graham and I appreciate that you have become more an ally on the issue of China currency over the last year, and it is good to see you again.

Since I have only a few minutes I want to get right to the point. Despite my renewed confidence that you share our view that China should and could reform its currency practices at a faster pace, I am very disappointed in Treasury's recent Report to Congress on International Exchange Rate Policies, as disappointed as I am in China's progress to date.

In fact, while I came back from China believing that it was moving forward on the currency issue, I have now scaled back my optimism a notch or two. I now believe that China is only facing forward but not yet moving forward. They simply made too little measurable progress since July for any reasonable person to argue that China has moved. The lack of any real appreciation of the yuan in recent months supports that view.

Now, in the report you issued last week, the executive summary says that the Treasury Department is, "unable to determine from the evidence at hand that China's foreign exchange system was operated during the last half of 2005 with the purpose, that is, with the intent, of preventing adjustments in China's balance of payments or gaining China an unfair competitive advantage."

With all due respect, Mr. Secretary, this is a technical and legalistic dodge that prevents the Administration from stating publicly what is obvious to every one of us: China is a manipulator, and the Administration is simply afraid to say so. After all, if it walks like a duck and quacks like a duck, it is a duck. Calling it a swan does not change that simple fact.

Now, let us look at what happened to the yuan in the 4 weeks since President Hu visited the United States. From April 17 to 21, the yuan did not appreciate at all, even though the week coincided with President Hu's visit here. From April 24 to 28, the same story. From May 1 to 5, again, the same story.

Finally, last week, the yuan appreciated by one-tenth of 1 percent. It is essentially just as flat as it was before China eliminated the dollar peg, and during the same 4 weeks, the other major Asian currencies were all appreciating against the dollar.

This chart goes back to April 1 of this year. It tells a pretty convincing story. Every other currency has appreciated: The sterling, the franc, the yen, the Australian dollar, Canadian dollar, euro, Korean won, Taiwan dollar, but not the yuan.

It defies logic to say that the yuan is not being manipulated when every other currency has appreciated significantly, and it stays right here. And we know that. We know the Chinese Central Bank is intervening to keep it low. Despite the dollar's decline against every other currency, the yuan appreciated only 0.2 percent.

Now, the second chart shows a similar trend. This graph shows U.S. dollar exchange rates for various Asian currencies since July, when China reportedly removed the peg. The green line is Malaysia; the orange the Japanese yen; the purple is the South Korean won. Particularly with South Korea and Japan, you can see lots of movement because of market forces that were actually allowed to work. But if you look at the blue line, it looks as dead as, unfortunately, a patient on an EKG who has expired. There is no movement. That is the yuan, despite the movements of every other currency.

So one of the things I want to discuss with you, Mr. Secretary, when it is my turn for questions is this: You argue that you cannot find the Chinese guilty of manipulation since we cannot tell their intent, but looking at this data and this chart, how can you possibly argue that it is an accident? It defies credibility, America's credibility, to believe that it is, and yet, that is essentially what you are arguing, and it is absurd considering the evidence.

I look forward to discussing this issue with you during the question and answer period.

Chairman SHELBY. Senator Sarbanes.

Senator Dole, I apologize.

STATEMENT OF SENATOR ELIZABETH DOLE

Senator DOLE. Thank you. I just came in a moment ago, Mr. Chairman. Thank you very much.

Secretary Snow, thank you for joining us today. While your report focuses on a number of different countries, obviously, China remains the major focus. I want to thank you for your efforts, for your accessibility on the issue of the Chinese currency peg, but I have to say that I am again greatly disappointed with the failure to recognize China's currency manipulation.

Chinese currency is grossly undervalued. The steps taken by China last summer and again earlier this week to revalue the yuan, while welcome, cannot even be described as baby steps in addressing the problem of China's tight currency controls. I know firsthand through my own experiences with the Chinese Government back during the 1980's when I served as President Reagan's Transportation Secretary that negotiations can be difficult and frustrating, and I appreciate many of the sentiments that you express in your report.

And I want to quote, for example, this important excerpt: "while these developments suggest that progress is being made, China's advances are far too slow and hesitant, given China's own needs and its responsibilities to the international financial community. The delay in introducing additional exchange rate flexibility is unjustified given the strength of the Chinese economy and the progress of China's transition. China needs to move quickly to introduce exchange rate flexibility at a far faster pace than it has done to date."

While I may have used some stronger adjectives, Mr. Secretary, this statement demonstrates our mutual concern. How many times have we said in this Committee, in North Carolina, and across the country, manufacturers have been hurt by China's undervaluing its currency. When I talk to industry leaders about this issue, many of whom have been forced to lay off loyal, hardworking North Carolinians because of unfair competition from China, it is just not enough for me to say I agree, and the Administration agrees.

We must act. We must take action and generate results. Secretary Snow, I know that you and the President have invested a great deal of time and energy in working with the Chinese leadership to address this issue, but we must bolster our efforts. In the coming months, the Senate is expected to again consider this issue. It is my hope that through aggressive talks and strong pressure from the Administration and Congress, we can make real and significant progress to induce China to freely float its currency.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman. I want to thank you for calling this important hearing on the Treasury Department's International Economic and Exchange Rate Policies Report. And I join with my colleagues in welcoming the Secretary. I think we are going to have an interesting hearing this morning.

[Laughter.]

Mr. Chairman, I commend you for your continued interest and active oversight on this issue. The report, which is the basis for today's hearing, is required under the Omnibus Trade and Competitiveness Act of 1988. In fact, that title came out of this Committee, and this Committee has taken a keen interest.

The legislation requires: The Secretary of the Treasury shall analyze on an annual basis the exchange rate policies of foreign countries in consultation with the International Monetary Fund and consider whether countries manipulate the rate of exchange between their currency and the U.S. dollar for the purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade.

As I stated previously in these hearings, it has been my view for some time that some nations, first and foremost China, have been doing exactly that with their currency in order to gain unfair competitive advantage in international trade.

The facts supporting this position are clear: China, Japan, Taiwan, South Korea are all running material global account surpluses and significant bilateral trade surpluses with the United States. I have a chart that shows the global current account surpluses and bilateral trade surpluses of each of these countries. I want to focus especially on China. This is China's trade surplus, Mr. Secretary. That is 2000 over there on the left, and this is 2006 over here. It has run up from maybe about $70 billion, and it is now up to almost $200 billion.

Senator SCHUMER. It is out of control.

Senator SARBANES. The largest bilateral trade deficit between any two countries in history.

And of course, as these countries run these gigantic trade deficits with the United States, they have been accumulating vast amounts of foreign reserves. Now, let me just show you, this is China's stock of foreign reserves. And this ascending line over here is almost up to $900 billion, foreign reserves that China has accumulated. When you look at the European Union, where they are not playing this game, you get quite a different picture, and you also, this is the European Union. They let the currency move, and then, you get the adjustments, and this is what has happened to their stock of reserves over this period, which reflects the chart Schumer showed, where they were getting appreciation in their currencies vis-á-vis the dollar and therefore helping to straighten out the trade imbalances, which is the mechanism by which, as I understand it, we adjust these matters.

Now, these trade imbalances are breathtaking. I want to show the trade deficit, U.S. trade deficit and how it has grown since 2001.

Senator SCHUMER. Ooh.

Senator SARBANES. I mean, it almost leaves you speechless to look at this chart. That is the U.S. trade deficit. This is 2005; I think the largest trade deficit in our history, the largest trade deficit in our history. The current account deficit is even a little worse; hard to believe, but the current account deficit is worse. It is now at 6.5 percent of GDP. This is the current account deficit. The U.S. current account deficit.

Senator SCHUMER. What was the first year on this chart? I cannot see.

Senator SARBANES. 1980; and this is 2005, $805 billion, 6.5 percent of GDP.

You are the Secretary of the Treasury. I always thought Secretaries of the Treasury worried about this kind of thing, that it was kind of a prime item on their agenda, not something to be dismissed or taken lightly. The sharp deterioration in our international net position has left us at an unsustainable level. Warren Buffett recently said right now, the rest of the world owns $3 trillion more of us than we own of them. And he went on: In my view, it will create political turmoil at some point. Pretty soon, I think there will be a big adjustment.

Buffett is not along in these warnings. The International Monetary Fund recently stated in the World Economic Outlook, the large current account deficit in the United States increases the risk of a downward adjustment in the U.S. dollar, which would push U.S. interest rates up sharply and possibly lead to a recession.

Despite these warnings, Treasury has not found any country guilty of manipulating this currency. Actually, last year, Mr. Secretary, you said if current trends continue without substantial alteration, China's policies will likely meet the technical requirements of the statute for designation. Since then, the Chinese currency has appreciated by just over 3 percent.

At the hearing last year, I specifically asked you whether a move of that magnitude, 3 to 5 percent, would be acceptable. You responded, this adjustment has to be material and has to be significant. And you went on to state that failure to do it, a significant move, will weigh very heavily on us when we do our next report.

Your report this year says far too little progress has been made. Yet despite the threats from last year's report, a failure on China's part to make a material movement—most experts think it would need to move 20 to 40 percent—the Treasury continues to fail to designate China. In failing to do so, the Treasury states it is unable to determine from the evidence at hand that Treasury's foreign exchange system was operated during the last half of 2005 for the purpose of preventing adjustments in China's balance of payments or gaining an unfair competitive advantage.

Let me just show you one other chart. Do we have this? Treasury found that China was manipulating its currency in May 1992 and December 1992. That was Bush I Administration. This was before Clinton came into office; the last year of the Bush I Administration. Look at these comparative figures. This was the trade surplus with the United States that they found: $12.7 billion, $16.7 billion; percent of GDP, 3.1, 3.5. This is back in 1992. Global account, current account, $12.2 billion, $13.5 billion, 3 percent, 2.8 percent. On the basis of those figures, they found currency manipulation.

Chairman SHELBY. Can you move that around just a little bit so we can see it?

Senator SARBANES. On the basis of those figures, they found currency manipulation.

Senator SCHUMER. That was China?

Senator SARBANES. China.

Chairman SHELBY. Yes, the Bush I.

Senator SARBANES. Now, May 2006, $202 billion trade surplus, 9.1 percent of GDP; global account balance, $161 billion, 7.2 percent. These figures dwarf these figures, and yet, the Treasury does not find currency manipulation. And these are the accumulation of reserves are up here to $209 billion. I mean, this thing is just going on and on and on.

Now, you can find currency manipulation, and then, you can not go into negotiations just by sending us a finding that it would be seriously detrimental impact on vital national economic and security interests. But you have not done that. You have not done that, and obviously, this is a matter we want to pursue in the question period.

Mr. Chairman, I know we have a vote. Thank you very much.

Chairman SHELBY. Mr. Chairman, we are going to recess. We have a vote, and we are coming to the end of the second warning, so we will come back as soon as the vote—or if Senator Bennett comes back, he can start the hearing.

Thank you. We are in recess.

[Recess.]

Senator BENNETT. [Presiding.] The hearing will come to order.

The Chairman and other Members of the Committee are in the process of voting, but the Chairman has asked that I reconvene the Committee in the interests of moving things along. I think it may be that he does not want to hear my questions or the observations that I may make here. It is fairly clear, Mr. Secretary, that the thrust of the hearing is going to be on China, and I think my colleagues are more than qualified to raise all of those questions, so I would like not to, not that I do not think that is an important issue but because I think it gets redundant, and I want to look at other aspects of the international trade situation independent of China.

If I could put the charts back up, let us go to the chart that deals with current account balance. Do you have a copy of that chart in front of you, Mr. Secretary?

Oh, I am sorry. I am told you have not yet made your statement.

Secretary SNOW. I can make a brief statement.

Senator BENNETT. I am sorry. I assumed that had been done.

Secretary SNOW. I will be very brief.

Senator BENNETT. So why do you not make your opening statement, and then, we will go to question.

STATEMENT OF JOHN W. SNOW SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary SNOW. I have submitted a statement for the record. I will make a brief statement.

I gather from the comments that I have received before that the Committee would not have written the report the way that we did.

Senator BENNETT. I think that you have made an accurate assessment of the Committee's——

Secretary SNOW. I think we arrived at the right conclusion, and in response to the questions, I will be able to elaborate further why. It took us a long time to get into the current account situation, and it will take us awhile to get out. As Chairman Greenspan and Chairman Bernanke have said, the best way to get out of this is to let the market adjustment processes work. We are trying to encourage that. We are trying to put in place a framework, Senator Bennett, Senator Bunning, that will allow an effective global adjustment process to take place in which the United States raises our savings rates, reduces our deficit, in which Europe grows faster and China and Japan. They need to grow faster.

They have fallen short of their potential, and that means they are not generating as much disposable income. They are not generating as much in the way of investment opportunities, and that lack of growth there, that shortfall on growth contributes directly to this situation.

And the third piece of this equation, of course, is China and inflexible exchange rates, because they prevent this adjustment process from occurring. I made it clear in the report we are not happy with this situation. We want to see China move faster. I think there is agreement on that. And we are going to continue to press China forward to move faster. That is an overview of the Administration's approach to this issue, and in the interests of time, I will keep my opening comment brief.

Thank you.

Senator BENNETT. Thank you very much. Again, my apologies for not realizing that you had not had an opportunity to make an opening statement.

Picking up from what you have said, let us go to the chart. The colors on the chart here are different from the colors I have passed out, so that was a little confusing to me, but the red line, which is heading south, that is the American account balance. These are all expressed as a percentage of world GDP, and these come from the IMF World Economic Outlook. These are not figures that were put together here in the Senate. The almost straight line through the middle, dark blue on the chart there as well as on the chart you have in front of you is China.

And the two lines that are above China, the green and the black one on the one I have and the darker on that chart, the green is the fuel exporting economies, the fuel exporters, and the other are the other advanced economies. And the point that I want to make from this chart and get your comment on is that the American account deficit started growing significantly in 1997.

This is a trend that is now almost 10 years old. It was not triggered by an election in the United States. It was not triggered by any one administration in the United States. It was triggered by a series of world trends and events. And the one corresponding upward trend to our downward trend that is the most pronounced are the fuel exporters.

So my question to you is would it be helpful if, in the United States, we were to take actions to increase our domestic production and therefore our dependence on foreign fuel exporters? And indeed, would that not be more helpful in bringing the American account deficit under control than concentrating entirely on Chinese currency?

Secretary SNOW. Senator Bennett, I agree with you very much. This has been in the making for a long time, and the high energy prices that we have lived with for some time now show up in very large surpluses in the oil exporting states. And America's dependence on oil from that part of the world significantly increases our net imbalances. So absolutely, if we can make ourselves less dependent on energy from faraway places, we would do ourselves a real favor in terms of the current account issues; absolutely.

Senator BENNETT. I make that point, because we get exorcised about China, and some hysterical commentators on cable news go overboard talking about China, and then, when the discussion about greater drilling on the outer continental shelf or opening up ANWR, no, no, they do not connect that to the account deficit, but as this chart makes clear, that is a much greater contributor to the account deficit than anything China is doing.

Secretary SNOW. I think it is one-third, if I recall the numbers, of our current account deficit is directly related to oil.

Senator BENNETT. That is an interesting statistic. Could you put a percentage on China's contribution to the current account deficit? I am assuming it would not approach one-third.

Secretary SNOW. No, well, we are in imbalance there about $200 billion on a base of $800 billion, so one quarter. The oil is significantly larger in terms of the imbalance itself, as a contributor to the imbalance.

Senator BENNETT. Thank you. Do you believe that enactment of protectionist trade barriers, whether they are formal tariffs or they are informal nontariff barriers, would be a viable solution to the trade imbalance?

Secretary SNOW. No, Senator, I do not. I think it would be counterproductive. I do not think it would have the intended effect of reducing our deficits with the world. It might with a particular country, but in China's case, China has become the assembler of manufactured products from Asia that used to be produced in Asia. They now assemble them there. They import the materials; they assemble them; and they export them.

What we see is simply a diversion of what goes on in China back to some other place in Southeast Asia for most of those activities, so I do not think it would be effective, and in fact, it would be counterproductive, because it would, of course, invite protectionist policies in other parts of the world, and that would hurt our exporters and would shrink the size of the globe and reduce global prosperity. Now, I think that is clearly the wrong way to go.

Senator BENNETT. Thank you very much.

Senator Reed.

Senator REED. Thank you very much, Senator Bennett.

Mr. Secretary, according to the Treasury statistics, China's ownership of United States debt is now over five times greater than it was in January 2001, rising from about $60 billion to over $300 billion, and their overall dollar reserves have grown even more. Now, if China is not buying dollars to keep their exchange rate from appreciating, what are they doing?

Secretary SNOW. Well, of course, pardon me, China is generating huge amounts of savings, and we are not on a net basis. And that is the crux of this problem. China's surplus savings is, some part of it, is finding its way into United States capital markets, which is why I said earlier, Senator Reed, the solution to this problem is really threefold.

One is getting the United States to have higher savings rates, and that is partly the deficit that we talked about earlier. But another part of this is getting China to develop their own domestic economy, put less emphasis on exports and more emphasis on domestic demand so they will absorb more of those savings. And we have heard from the Chinese they intend to do that. They intend to push development of their domestic market to absorb their savings, and then, those yuan would not be flowing into dollars to buy capital assets in the United States. They would be going into consumer goods in China. I think that is a healthy way to approach these imbalances.

Senator REED. There is no portion of their policy to acquire U.S. Treasury debt that is related to their currency levels? It is completely just the market activity.

Secretary SNOW. Well, what we know is they have these very high savings rates, and the savings rates exceed their own domestic investment rates. So that excess finds its way into the world market. Part of it goes into other things, but part of it goes to the U.S. markets, and that is really what this phenomenon is about.

Senator REED. But I just want to be clear. So you see no conscious correlation between their acquisition of Treasury securities and holding dollars and maintaining their yuan? There is nothing there? It is completely coincidental.

Secretary SNOW. Well, they have a policy of not having a flexible yuan. The evidence is pretty good that the effect of not having a flexible yuan is to have the yuan trading at a level that is somewhat lower than it would be if they had a flexible yuan; that is, if the yuan was really based more on the interplay of demand and supply and market forces. I think that is what almost all the analysis suggests. Well, that leads to a larger trade surplus, and that trade surplus leads to the ability for them to translate that surplus into purchases of capital assets in the United States and elsewhere. So there certainly is an indirect relationship.

Senator REED. But does that conscious policy also require them to buy Treasury securities, that is, is their acquisition of securities and holding of dollars related to the peg they have established on the yuan?

Secretary SNOW. Well, as I said, there is an indirect relationship to the extent that the currency is held below the level that the market would take it to. That would stimulate more exports and reduce imports, which will lead to a trade balance, which will lead to the surpluses that come back into the rest of the world. Sure.

Senator REED. You mention, Mr. Secretary, that part of an approach to resolving this issue is stimulating domestic demand in China. What steps is the Administration taking to help achieve that?

Secretary SNOW. Senator, the President of China was here several weeks back, now maybe 3 or 4 weeks ago, and in his comments on the South Lawn, he stated the policy to develop their domestic markets. That is a policy that I have urged on China. It is a policy that Under Secretary Adams has urged on China, and now, we need to see the actions, but the actions are actions that the Chinese have to take, investing in their safety net, in pensions and reducing taxes and a variety of things that they are talking about doing.

Senator REED. But you are suggesting there is nothing directly the United States can do to help increase their domestic demand?

Senator BUNNING. Sure, there is.

Secretary SNOW. Well, they are a sovereign country and responsible for their own macroeconomic policy. So they have articulated this policy. We have urged them to do so. It is the right policy for them. It is the right policy for the global economy. And now, we are going to watch their actions to see that they follow through. But we are providing technical assistance. We have a financial attaché in Beijing who works closely with the economic authorities in China. We have a number of delegations back and forth. We continue to meet with our counterparts in the Economic Ministry and the Central Bank.

So there is a lot of interaction here between us where they are drawing on our lessons, and we are providing technical assistance on things they can be doing. One of the things they can be doing is allowing foreign investment in their financial system. We are urging them to do that, disappointed that they are not moving faster there, because a better functioning financial system will mobilize those savings and give them higher returns and make them available to higher uses. So there are a lot of things that we are working with them on.

Senator REED. I would assume, Mr. Secretary, that you would agree that we would be better off financing our investment with national savings rather than with foreign savings; is that correct?

Senator BENNETT. He said that.

Secretary SNOW. Senator, the imbalance we have means we cannot do that. Our economy is growing at such a good clip, and I think you want us to continue to have this economy grow. One way to finance our own investments is to grow a lot more slowly. We could do that, but that would not be a good outcome for us or for the global economy. I mean, one way to think of this, Senator, is a recession would solve this problem real fast. Nobody wants that, do they?

We could solve this problem real fast by the United States growing much more slowly. You would not urge that. I would not urge that, and neither would the rest of the world. The United States is at the center of the high growth rates. We are the engine of the global economy today. So, I think we want to solve the issue of the global imbalances but sustain high growth rates for the global economy.

Senator REED. Thank you.

Chairman SHELBY. [Presiding.] Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman.

I am going to go to the mundane, as Senator Bennett said. Your report stops short of calling China a currency manipulator. What further evidence do you need to make such a finding? We all seem to have made it up here, but the Administration has not.

Secretary SNOW. Senator, the lack of a finding should not be in any way interpreted as satisfaction with China. I think we have a heated agreement here among ourselves here that we are very disappointed, very unhappy with China's behavior on its currency. I will just stipulate to that. We did not make the finding, the specific designation here this time because in the end, we concluded, given all the fact, all the circumstances, the statutory test, which is a test that includes intent, intent was not met. The statute requires an intent to manipulate the currency for the purpose of frustrating the global adjustment process.

Senator BUNNING. And the Administration absolutely feels that there was no intent?

Secretary SNOW. Well, we were not completely satisfied that the intent test was met. Part of the reasoning there, Senator, if I could take a minute, Senator, part of the reasoning there was the expressions of the political and economic leadership of that country to move to flexibility. They have said that over and over again. They have taken some steps—too small, too short—but they have taken some steps to put in place this trading mechanism; did the revaluation within the time period of this report, last July.

We have seen some movement, way inadequate. They have articulated this policy of not running a surplus. The President said that on the South Lawn. They have articulated a policy of developing domestic demand and allowing more foreign investment in the face of their leadership, including the top leadership of the country expressing this, a clear intent to address the problem.

We felt that it was not appropriate at this point. Actions speak louder than words. We know that.

Senator BUNNING. Mr. Secretary, I have heard this song before. You were not here. I was in the House, 1987. We have been discussing China's talking one way and acting another. My frustration with that is that we are still believing what they said, although they never have done very much to back up their words. Are there any signs that China is going to allow strengthening, other than talk?

Secretary SNOW. There are some, Senator. There are some. They have now entered into an agreement with the Chicago Mercantile Exchange, just finalized, to allow hedging on their currency.

Now, clearly, you would not put in a hedging vehicle unless you had some expectation of a currency that created risks of fluctuation. They are allowing more foreign information into their financial sector, and they are allowing their banks, more and more of their banks, to trade currencies. So they are doing some things, not enough; I do not want to give you the impression I am satisfied, because I am not satisfied.

Senator BUNNING. No, but Mr. Secretary, is the value of the yuan driven by the market, or is it really driven by the Chinese Government, since it is only allowed to trade in very narrow bands, less than a third of a percent up or down from the price set by the Central Bank?

So how much progress can talking make? And you have said that the Administration pretty well cannot do anything about it, but I will guarantee you the people sitting here in these seats up here at the Committee can do something about it. You can veto the bill, but we can sure as heck pass one that requires China to get in line. And there are enough of us frustrated up here to the point of saying to the Administration we are sorry, Administration, you are not doing enough. And when you have an opportunity to do something, you back off.

Secretary SNOW. Senator, as I say, I think we have a heated agreement here. You are frustrated; we are frustrated. We are very unhappy we are not seeing more action. We want to see action.

I will say though, that many commentators, upon seeing our decision, said now that the threat has been removed for the next few months, 6 months, the possibility of China raising their currency value and allowing it to get more in alignment with market forces goes up. I actually think that is the better reading of the situation.

Senator BUNNING. Well, for 20 years, it has not been.

Thank you.

Chairman SHELBY. Thank you.

Senator Stabenow.

Senator STABENOW. Thank you, Mr. Chairman.

Mr. Secretary, I know you are hearing, and it is not the first time, the frustration that we have here in the Committee, and this is not a theoretical debate. Today, there is something, an ad here that is in *CQ Today, Congressional Quarterly,* the truth about U.S. automakers' jobs and where they come from. And even though every time we see a plant close from a U.S. automaker, we are not seeing one automatically open from our people from China, Japan, or Korea, 80 percent of the auto parts used by our automakers are American. You are talking about millions and millions of jobs.

This is not theoretical in my State or any other State, and every year, we wait; 23rd report. We are talking about thousands more people who are going to have to decide how do they take care of their family in the next week or the next month or the next year? This is not theoretical.

I know my colleagues have spoken about China, but I want to speak about Japan, because I concur with my colleagues on China. But Japan's longstanding manipulation in terms of their actions on currency hits us directly with the auto industry. While Japan has halted its massive interventions over the last year or so and therefore not provided an absolute, clear-cut reason to cite them, they have continued to verbally intervene in global currency markets.

This type of intervention that prevents the yen from strengthening contradicts several G–7 meetings worth of statements about how free markets should set currency values. Just take the last few weeks as an example. Following the G–7 meeting, the yen began to strengthen against the dollar, and a number of very senior Japanese officials began to make pointed comments about rapid fluctuations and other similar comments.

This time, Under Secretary Adams made some public comments that really clarified the United States and G–7 position and counteracted this verbal intervention, and in response, Minister Tanagaki and others made comments that a weak yen is necessary for Japan's export-oriented industries. He further indicated that a yen below 110 could damage the profits of export-oriented Japanese companies.

Well, why are we not worrying about damaging the profits of American companies and the loss of American job? And I would gladly have you come to Michigan, and whether it is Southeastern Michigan, the west side of Michigan, Northern Michigan, it is not just autos; it is furniture; it is auto suppliers; it is computers. I can show you company after company that is fighting an unfair situation, a disadvantage, because of these verbal statements or specific actions.

This verbal intervention is blatantly a problem and goes against our trade laws. My question is this: Japan, Korea, China, all deserve to have their currency policies officially and publicly criticized. Both over the last 5 years, when Japan was massively intervening, and now, when China maintains a peg. Japan continues to make explicit comments with the intention of manipulating their currency, and Korea follows the same path.

If the current technical requirements of the 1988 Act do not meet your specifications to report on these issues, tell us what you need. And this is a follow up. I know my colleague asked the same thing, but tell us what you need in order to publish a report and to get tough, and also, what are your thoughts about Minister Tanagaki's comments? I mean, my experience is that people are very polite with us and will nod and smile, and they do not take us seriously for a minute.

When the European Union took us to court and won and caused us to have to change our tax laws, international tax laws or threatened tariffs, they won; they proposed tariffs; we changed our law. What is wrong with this picture? We are the only country that does not step up in a global economy and fight for our own.

Mr. Secretary, this is of great concern and frustration to me.

Secretary SNOW. Senator, thank you very much for those good comments. Our policy on this is really very clear, and because of the efforts of Under Secretary Adams, myself, and others, those policies are reflected in statements of the G–7 and the IMF policies, the G–20 policies, and the policy is very clear. Currency values should be set in open, competitive markets. That is what the G–7 communique says. That is the IMF policy.

We now have the IMF much more engaged in macroeconomic surveillance looking at the question of currencies and the role of currencies in the adjustment policy. Japan has not, to our knowledge, directly intervened in their currency since March 2004.

Senator STABENOW. Mr. Secretary, if I might just intervene, what about the comments that are being made? Are they of concern to you?

Secretary SNOW. I think the best policy is to minimize comments on currencies.

Senator STABENOW. So what we hear is we have a lot of pieces of paper, we have a lot of statements, and we are going to go back to our businesses and say here, and by the way, as you are struggling and maybe closing up shop, you will feel really good about reading this statement. Good luck.

Where do we get the action on this for people? Where do we actually do what other countries do, threaten tariffs, level the playing field, see how fast things change if they think we are serious? If I were them, I would not think we were serious.

Secretary SNOW. We are engaged, as I think you know, Senator, through the USTR in trying to create a level playing field with all our trading partners. And the fact of the matter is the United States is more open than most of our trading partners. We want to make sure trade is a two-way street. We believe in free trade, but it has to be a two-way street. It has to be based on rules. It has to be mutually advantageous.

And we have pressed China, we have pressed Japan. Your former colleague in the Congress, Rob Portman, has been very forceful on trade openings with these countries.

But on the currency issue, let me just be as clear as I can: We oppose any beggar thy neighbor policies. We do not engage in those policies, and nobody should engage in those policies. The currency values should be set in open, competitive markets, and beggar thy neighbor policies are the wrong way to go. I think the IMF, which does have supervisory authority, oversight authority on currencies, shares that view and will become even more vigorous in the future, much more vigorous in the future in seeing that countries adhere to good currency policy.

Senator STABENOW. Thank you, Mr. Chairman. I would just say time is running out for American businesses and American workers, and it is time for us to act.

Chairman SHELBY. Senator Allard.

Senator ALLARD. Thank you, Mr. Chairman.

Mr. Secretary, you have heard consistent concerns here about how important it is that we have a free floating exchange rate, and you indicated in the last hearing, I think, that we need a freely floating exchange rate, and has there been any kind of a timeline established where we can have some guidance over time as to whether, how serious they are, whether it is something that has just been discussed and laid out on the table in an informal way or whether we have a more formal type of timeline in place?

Secretary SNOW. There is not, to my knowledge, a formal timeline, but our conversations with the Chinese indicate they are serious about continuing to move forward, and while they did not say March 15, 2010, they are clearly suggesting that they are going to accelerate this case and move forward with it.

Senator ALLARD. What leverage do we have to get them to do more?

Secretary SNOW. Yes, Senator, we have to do, I think, what we have been doing, quiet diplomacy. I do not think they respond well to threats. I do think this quiet diplomacy is having some benefits. They are now much more forthcoming in what they are saying. We need to see action. But at least the words—words always have to proceed action. I mean, they are at least conceptually on board with this now, which is more than we can say 2 years ago.

They have taken some steps, too small. They have indicated that they are going to keep pressing this forward. Market analysts, J.P. Morgan and others, foresee a fairly significant move in the currency if current trends are continued over the next 12 months or so.

It is in their own interests, Senator. I think what is going to drive this forward is it is in China's own interest to allow their currency to better reflect fundamentals, because after all, they are importing an awful lot of stuff from Southeast Asia that they then handle and export to the world, including oil that is an important part of their economy.

If their currency is being held down, then, they are paying more for those things. Their citizens' standard of living is being suppressed as a result, and they are creating the wrong price signals for their economy, leading them to put more emphasis on the export sector and less on the domestic sector, all of which is going to slow their long-term growth rates and hurt their standard of living.

So ultimately, I think it is their recognition that having a fluctuating exchange rate based on market values is in their interest.

Senator ALLARD. Let me ask you about energy. Now, you indicated that our trade deficits here, a third of that is because of the high cost of energy, oil in particular.

Secretary SNOW. Something on that order, right.

Senator ALLARD. China, one of the reasons that there is a higher cost on the world market for oil, I have been told, is because China is buying up a lot of fuel. They are buying a lot of barrels of oil. If they are buying that like we are, if they are out there competing and paying the same price, why do we not see a comparable reflection in their trade deficits as to what we are seeing in our country?

Secretary SNOW. Because their export sector is so much larger as a fraction of their total economic activity I think basically is the answer.

Senator ALLARD. Now, I think my colleagues are trying to suggest somehow or the other that you have trade reprisals of some kind or another. My initial reaction to that is that that would hurt us probably more than it would them. I would like to hear your reaction to that.

Secretary SNOW. Well, I think the United States would be damaged very much by trade reprisals, because trade reprisals by us would make much of what we import more expensive. That is like a tax on American consumers. So trade reprisals really need to be looked at as something that hurt American consumers.

Senator ALLARD. And certain sectors might be more adversely impacted than others, and one of the sectors that I have seen discussed that might be adversely impacted would be the agricultural sector. Would you agree with that?

Secretary SNOW. I think so, absolutely.

Senator ALLARD. And we do so much exporting of agricultural products, I know that from my State's viewpoint, I do not know that that would be very good.

Secretary SNOW. Senator, well, I agree with those sentiments. The United States benefits from an open global trading system, and we are the leader of the policies that have led to an open global trading system. If we turn our back on that, I think we can expect others to, and that will hurt Colorado agricultural interests and others.

Senator ALLARD. And those States that have high urban populations, like New York, Illinois, and California, maybe—well, California has pretty good sized agriculture, but maybe they may not be as concerned about that, but I for one would be concerned.

Secretary SNOW. But I think every State has important export interests, and policies that we initiate to restrain trade and limit trade would invite reprisals from other countries that would be damaging, I think, generally.

Senator ALLARD. Mr. Chairman, I see my time has expired.

Chairman SHELBY. Thank you.

Senator Schumer.

Senator SCHUMER. Thank you, Mr. Secretary, and I know it is not so easy for you to be here.

I guess my first question is just to get your view a little bit more on predicting not the yuan but the Congress. You have dealt with many of the Senators on this issue, and you know we have legislation. I know you do not agree with that legislation, nor does the Administration. Let me just say, the goal of our legislation is the same as your goal: It is to get China to move. And we are caught in a position—where they say, do not talk tough, and then they will do something.

Well, the Administration has done a very good job of not talking tough for quite a while, and they have not done much, particularly here. But I have an initial question just to get your view. As you know, with our legislation, we are now scheduled to call it up by September 30. Obviously, if there is real movement, which Senator Graham and I hope there will be, and the Chinese indicated there would be when we went there just in terms of their own internal needs, but let us say there is no real movement in the currency between now and the end of September.

What do you think the chances are that our bill will pass?

Secretary SNOW. Well, Senator, I think failure of China to be responsive heightens the prospect, clearly, of your legislation and any legislation that takes action against China.

Senator SCHUMER. Well, last time, we got 67 votes. Do you think we get more or less this time?

Secretary SNOW. Senator, you would be much better at reading that.

Senator SCHUMER. Well, what do you think? You have talked to a lot of Senators.

Secretary SNOW. When you were out, I commented to Senator Bennett, based on the comments from the Members from both sides, I do not think the Committee would have written the report the way we did. He seemed to nod in agreement with that.

Now, look, there is real concern not only in the Senate but also in the House and across the country about this issue of China and China trade. And so, I think there is broad-based support for something, and China can reduce that pressure by moving, by taking action. That is why I urge them to do so.

Senator SCHUMER. Thank you, but let me just get a yes or no answer. Do you think it is likely our legislation—the Administration agrees that it is likely our legislation would pass if there is no movement, and it were brought to a vote. Remember: We got 67 votes last time, majorities in both parties. It is an easy question to answer. I just want to get your answer to it.

Secretary SNOW. Well, again, I will preface my answer by saying I am not the Senate whip for either side, and I have not consulted with people who would help advise me on this. But the sentiment is pretty strong to do something against China, and I think the handwriting is on the wall: China needs to act.

Senator SCHUMER. Right.

Secretary SNOW. And if they do not act, it heightens the odds of legislation.

Senator SCHUMER. Next question.

Secretary SNOW. Yes.

Senator SCHUMER. And thank you. I will take that as a yes in very diplomatic terms.

[Laughter.]

Senator SCHUMER. In any case, the frustration some of us have with this currency report is that you have been saying for the last few currency reports that if China did nothing by the next report, you would probably have to find them guilty of manipulation. Yet every time, you come right up to the line without crossing it.

And so, the question is, if there is no real movement in the currency between now and the next report, what will the Treasury do? How long will it take—you saw the charts that I showed and the charts that Senator Sarbanes showed—how long will it take for you to find them a manipulator? You keep saying—basically, we are not finding them a manipulator, and there is a wink involved. We know they are manipulating, but we are more likely to get them to act if we do not find them a manipulator.

Well, when will the time come? Assume that the value of the yuan does not cross the 8 mark. Is there any way—I mean, are you not likely to find them a manipulator next time?

Secretary SNOW. Senator, I do not want to forecast what we might do, but obviously, if there is not movement in the currency, and these imbalances continue, that heightens the odds very much of making the case that the statute calls for, yes.

Senator SCHUMER. Right, but in all due respect, and I mean this sincerely in all due respect, you have said that in the past, and there has not been much movement, and you do not do it, and that is why many of us feel we have to take action in Congress, because the Administration is not taking obviously needed action.

Secretary SNOW. Senator, let me say on that that the report covers the last half of 2005.

Senator SCHUMER. Right.

Secretary SNOW. And in the last half of 2005, China did take action to move to the delinking and did the small step and then said they would do more and have done something.

Senator SCHUMER. Okay; I got it. So if China took less movement in the first half of 2006 than they took in the last half of 2005, which would be less than about 3 percent, you would be more likely to find them a manipulator.

Secretary SNOW. That would be troubling, yes.

Senator SCHUMER. And you would be more likely to find them a manipulator.

Secretary SNOW. Yes.

Senator SCHUMER. Let the record show he nodded his head yes.

[Laughter.]

We have to take what we can get, Mr. Secretary.

Secretary SNOW. We would expect more movement than that.

Senator SCHUMER. My time has expired.

Yes, thank you.

Chairman SHELBY. Senator Carper.

Senator CARPER. Was that more movement of your head or—— [Laughter.]

Secretary SNOW. No, more movement in the yuan.

Senator CARPER. Well, we will look forward to whatever movement we can get.

I think you have probably been asked enough about the Chinese currency at least for a few minutes. Let me turn to another one, another hot topic that cooled off a little bit, but it is still one I wanted to question you about. And the issue is the Dubai Ports World, and they promised to divest themselves of their investments in American ports today when purchased Peninsular and Oriental Steam Navigation Company. And I would appreciate if you would share with us the status of this divestiture, and when do you expect it might be completed?

Secretary SNOW. Yes; Senator, the company has committed to a complete divestiture, and within, I think they said 6 months of like 2 months ago. So within the next few months, we would expect to see the complete divestiture.

Senator CARPER. Any idea how it is progressing?

Secretary SNOW. I will have to get back to you on that. People at Treasury are monitoring it, but I have not talked to them on that.

Senator CARPER. Let me ask two short follow up questions and ask you to answer them on the record if you would.

Secretary SNOW. Sure.

Senator CARPER. And one of those is what course of action can the Administration take to enforce Dubai Ports World's promise to divest itself of U.S. port operations if it is not acted on? You suggested it will be, but if it is not acted on, what action is available to the Administration to enforce the promise? And second, if Dubai Ports World does not stay true to its promise to divest, what are the implications for security assurances that they gave CFIUS before receiving approval for the acquisition in the first place? Those are my two follow-up questions. You are welcome to respond to them now or——

Secretary SNOW. Yes; I will give you a full answer for the record, but when I went over that at the time, I satisfied myself we have very ample authority here which creates the incentives for them to live up to their promises with the ability to break up any subsequent transaction if they do not.

Senator CARPER. Second subject I would like to address, and I do not know that it has been raised here, but I mentioned in my opening statement, Mr. Secretary, the issue of long-term availability and affordable of terrorism risk insurance, and I think there is a Presidential Working Group that has been formed on this, and as I recall, they have an obligation to come back to us by sometime later this year; I believe it is September 30 with their report.

The deadline is now about, oh, gosh, 4 months away, and I just want to make sure that the study is examining the right issues and is looking at those issues in a comprehensive way. I along with a number of my colleagues here strongly believe that a long-term terrorism risk insurance mechanism must be in place and that the President's Working Group study process plays an important role in getting us where we need to be, and I was just hoping you could give us an update on the progress or lack thereof.

Secretary SNOW. Yes.

Senator CARPER. Has the Working Group taken a look at what kinds of public-private partnerships would be viable in the future?

Secretary SNOW. They are, Senator. As I recall, that TRIA report is due to you on September 30. I think we are on track to get it to you on that date, the report to this Committee. Treasury is in the lead in gathering data, reviewing comments, going out for comments to the whole sector of the industry, the buyers, the providers of the insurance products, the construction industry, builders, and so on, and I will commit to you that we will have a thorough and well-considered report to you by the statutory deadline of September 30. It is being worked hard. It is an important issue; I agree with you.

Senator CARPER. Well, last question: I mentioned in my opening statement my continued concern, I think the concern of a lot of us about the still large trade deficits. And do you recall what our trade deficit was last year just roughly?

Secretary SNOW. Yes; 6 percent or so of GDP.

Senator CARPER. Just put a number—$700 billion?

Secretary SNOW. Yes, $700 billion roughly.

Senator CARPER. $750 billion; okay. Any idea what it was the year before that, just roughly?

Secretary SNOW. Well, roughly, a percentage or so lower. It has been rising, as the charts that Senator Bennett put up showed.

Senator CARPER. I missed those charts. What are you forecasting for this year in terms of dollars, not percentage but dollars?

Secretary SNOW. We do not do a forecast of that, but the trend line is to have it be somewhat higher.

Senator CARPER. All right; all right; thanks very much.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

Mr. Secretary, in last year's report, at the time of its release, you stated if current trends continue without substantial alteration, China's policies will likely meet the technical requirements of the statute for designation. As this year's report indicates, over the past year, China has allowed the yuan to appreciate by only 3.4 percent, an extremely small amount, considering most experts believe the currency is undervalued by 20 to 40 percent; you have a range of estimates.

At the hearing on the report last year, I specifically asked you what your thoughts would be about a movement of this magnitude, 3 to 5 percent. I quoted an analysis from Galaxy Securities that said, "the making of decisions in China is mostly consensus based, so that might lead to a compromise of a 3 to 5 percent rise in the renminbi's value." You responded: "this adjustment has to be material and has to be significant, has to be something that will significantly close the gap between the current value and a more appropriate value."

Do you think this small appreciation of the yuan over the past year has been material and has significantly closed the gap between the current value and an appropriate value?

Secretary SNOW. It has closed it somewhat, but it is insufficient, and we are clearly, as I have said over and over again, unhappy with the failure to see more rapid movement.

Senator SARBANES. Why do we not cite China under the statute?

Secretary SNOW. Senator, because of the intent portion of the statute.

Senator SARBANES. Where do you find that?

Secretary SNOW. If you look at the statute, I think it is in the first or second line, which says that the test is—let me read it to you—it is the (b), bilateral negotiations. The Secretary of the Treasury shall analyze on an annual basis the exchange rates with foreign countries in consultation with IMF—and this is the relevant language—and consider whether countries manipulate the rate of exchange between their currency and the United States for the purposes—this is the intent side—for the purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade.

Senator SARBANES. Well, let us parse that language. Do you think the Chinese are manipulating the rate of exchange between their currency and the United States dollar?

Secretary SNOW. The Chinese have stated that they are going to move to a fluctuating exchange rate, which is the contrary of manipulation.

Senator SARBANES. Well, they have not done that, have they?

Secretary SNOW. Well, but the intent is to move there. They have said that. Actions speak louder than words, but they have taken some actions.

Senator SARBANES. You seem to find the intent requirement here, which I have some doubts about, but in any event, with respect to the for purposes of, that is where you find the intent, right?

Secretary SNOW. Yes.

Senator SARBANES. For what purpose are they doing it.

Secretary SNOW. Yes, right.

Senator SARBANES. But they are manipulating.

Secretary SNOW. Well, they are not allowing their currency to move in accordance with market forces. The term manipulation has an emotive content to it, the use of which might make it more difficult to get the country in question to do what you want them to do.

Senator SARBANES. Where is that bill, that financial—no, the *Financial Times*.

Secretary SNOW. Which is why some have suggested that language like misalignment might be better language.

Senator SARBANES. There is an article in the *Financial Times* today by a columnist, which I take it is tongue in cheek, and he heads it, said this address to the Chinese Communist Party Central Committee by Zhao Xiaochuan, Governor of the Central Bank, has come into the *Financial Times'* hands. Have you seen this?

Secretary SNOW. No, I have not, Senator.

Senator SARBANES. All right.

Secretary SNOW. Well, I know the purported author.

[Laughter.]

Senator SARBANES. All right; yes, purported I think is right.

But listen to this. This is how some people see what you are doing. This is the start of the address: Comrades, by ducking out of branding China a currency manipulator, the U.S. Treasury has shown yet again that America is a paper tiger. It has not even accused us of the lesser crime of misalignment, not that that would mean much; just more of the interminable talks we have already held with Washington for years.

Now, why do you not cite China? Are you concerned about having to enter into negotiations with China if you cite them, since the statute would require you to take action to initiate negotiations on an expedited basis?

Secretary SNOW. No, Senator, because we are already engaged in precisely those sorts of negotiations. Intense negotiations and intense discussions go on regularly between the Treasury Department and our counterparts in China.

Senator SARBANES. Would you then invoke the provision that you are not required to initiate negotiations in cases where such negotiations would have a serious detrimental impact on vital or national security interests?

Secretary SNOW. No.

Senator SARBANES. Well, I do not quite understand where you are going. I mean, you keep telling us that you are working; you are going to get these adjustments. We do not get them. The magnitude of what is happening dwarfs anything that we have experienced in the past. China has been cited in the past, has it not?

Secretary SNOW. They were, Senator, back at a time when they had what was known as a dual currency system, an administered system for international and a separate one for domestic, which on its face clearly involved manipulation. That is what you cited to me earlier.

Senator SARBANES. Yes, that is exactly what I cited to you earlier. But the magnitude of these figures, they just dwarf the situation. What is the largest current account balance we have had with a country before this one with China?

Secretary SNOW. I think Japan back in the 1970's and 1980's.

Senator SARBANES. How much was that?

Secretary SNOW. It, I think, was as large or larger than this in real terms. I forget the precise—maybe somebody has that; yes, about 1.5 percent of GDP.

Senator SARBANES. One and a half? We are at 9.1 now on the trade surplus.

Secretary SNOW. No, not with China, though.

Senator SARBANES. No, no, no.

Secretary SNOW. You asked me on one country.

Senator SARBANES. Yes, yes.

Secretary SNOW. On one country, and China is large, but I think in the past——

Senator SARBANES. It was not anywhere near comparable with the situation now.

Secretary SNOW. Well, I think Japan rivaled or was larger in real terms than China is today, but I will get you that precisely, because earlier, you said——

Senator SARBANES. Well, you said 1.5 percent of GDP. China is at 9.1 percent.

Secretary SNOW. No, no, China is not. That 8 percent number is the total number, of which China is a couple hundred billion.

Senator SARBANES. Well, when I looked at the figures, the trade flows with China were running about 5-to-1.

Secretary SNOW. Right.

Senator SARBANES. So what we send to them is about 16 percent, 1/6, of what they send to us.

Secretary SNOW. Right, right.

Senator SARBANES. We have never had a disproportion of that magnitude. Even with Japan at the time we were concerned, it was running about 2-to-1, maybe.

Secretary SNOW. Right.

Senator SARBANES. Yes.

Secretary SNOW. Right.

Senator SARBANES. So this is a terribly unbalanced relationship. Now, you come in, you say we want to play by the rules of free trade, but one of the rules of free trade, as I understand it is the adjustments in the currencies that address the question of these severe trade imbalances and work those out over a period of time.

That is not happening here. It is not happening. Now, every year, you come here and tell us well we have been talking with them and so forth and so on, and we do not see any substantial movement. You, yourself today have, I think, in effect, conceded that the adjustment has not been material. It has not been significant. What are we going to do about that?

Secretary SNOW. Senator, within the month, the President of China was here and laid out——

Senator SARBANES. And got a free pass, I think.

Secretary SNOW. —and laid out a set of commitments to address this problem. He said we do not intend and expect not to have this large surplus with the United States. We are taking policy actions to bring that surplus down. We are committed to continuing reform of the currency to move to flexibility. We are committed to developing our domestic sector. We are committed to reducing emphasis on the export sector.

Now, those are words, but that set of policies articulated by the president of the country reflecting the discussion of the State Council and incorporated in the 5-Year Plan, if acted on—I do not think they put these 5-Year Plans together just for academic purposes. This is the 5-Year Plan to guide the economy. That plan reflects an intent to deal with the thing that is on your mind, the Chairman's mind, and my mind, and that is these large imbalances.

Senator SARBANES. Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Secretary, I have a number of questions that I will submit for the record. I know that you have a big trip that you have got to keep moving on.

I have a few observations, though. I have known you a long time. I know you are an economist. You have a Ph.D. in economics by training. You know a lot about the theory of economics, but you also know a lot about the world, because you were the CEO of one of our large companies.

But something is wrong here. And I think what is wrong is the Administration is not looking and finding what everybody else in the world has found long ago, has seen. To say that China is not manipulating its currency defies all logic, all common sense, all evidence.

You can just look at the chart that was used earlier. Look at, again, how the other foreign currencies have appreciated. Since April 1, 2006, the British pound has appreciated against the dollar 8.3 percent; the euro, 5.1; the Korean won, 3.5; the Japanese yen, 6.4; the Australian dollar, 6.3; the Canadian dollar, 5.1, and, as you have shown earlier, the Chinese yuan, 0.2.

So something is wrong. And none of us are interested in restraint of trade. We are interested in our consumers getting the best deal they can get, but at what expense? What is happening here? We are losing a lot of our manufacturing jobs. Our current account is way out of kilter. Our savings rate is—and that is not your fault; I am not blaming you for this—our savings rate is so low in this country that foreign governments basically are financing our deficit and everything. You know all this as an economist. You know this as Secretary of the Treasury.

But I still believe it defies all common sense, all evidence, to not say, as the previous Bush Administration found, I believe twice, that the Chinese were manipulating their currency, and this Administration, an Administration I support, but not in this instance, because I think they are totally wrong. Now, we know theoretically that the Chinese could grow, you know, the economy grows. We export more. They export less, or maybe their currency floats in a different way. But that has not happened. And I do not think that is going to happen.

I think the Chinese are too smart to let that really happen. But at whose expense? Ultimately, it is going to be the American worker and the American people who are going to pay this price, and this debt is going to be paid. And it is a debt, as you well know.

Thank you for your appearance, and thank you for your service.

Secretary SNOW. Thank you, Mr. Chairman.

Chairman SHELBY. The hearing is adjourned.

Secretary SNOW. Thank you, Senator Sarbanes.

[Whereupon, at 11:28 a.m., the hearing was adjourned.]

[Prepared statement supplied for the record follow:]

PREPARED STATEMENT OF JOHN W. SNOW

SECRETARY, U.S. DEPARTMENT OF THE TREASURY

MAY 18, 2006

Chairman Shelby and Senator Sarbanes, thank you for this opportunity to testify before the Committee on Treasury's latest Report on International Economic and Exchange Rate Policies.

Let me state at the outset: A strong dollar is in our Nation's interest, and currency values should be determined in open and competitive markets in response to underlying economic fundamentals.

The international economy is performing exceptionally well. Global growth this year will exceed 4 percent for the fourth consecutive year. Inflation remains low and global financial conditions are benign. This is the best global performance in three decades. It is all the more impressive considering the serious disturbances faced only several years ago and the sharp run-up in oil prices.

The robust U.S. economy is strongly contributing to the favorable performance. First quarter growth this year was 4.8 percent at a seasonally adjusted annual rate, bouncing back strongly from the lower fourth quarter result last year. Growth over the last four quarters was 3.5 percent, the best of any major industrialized economy. The labor market has strengthened with 32 straight months of job growth, totaling more than 5.2 million new jobs since the President's tax relief took effect in May 2003. Inflationary pressures remain well contained—consumer price inflation is running at 3.4 percent, but stripping out energy and food costs, core consumer price growth is only 2.1 percent over the past 12 months.

Key to the economic success of the United States is its openness. The United States must resist the forces of protectionism and isolationism. Foreign direct investment flows into the United States grew almost 60 percent in 2004 and more than 20 percent last year. Foreign direct investment generates a significant number of jobs—more than 5 million as of 2004.

Global imbalances are a key issue on the international economic agenda. They arise because of large growth disparities in major countries, differences in the relative attractiveness of investment in their economies, and divergent patterns of saving and investment. The U.S. current account deficit and corresponding surpluses elsewhere reflect these disparities. Reducing global imbalances, in an orderly manner that sustains and maximizes global growth, is a shared responsibility requiring complementary actions by a large number of countries. In this context, I have repeatedly emphasized that the international economy performs best when large economies embrace free trade, the free flow of capital, and flexible currencies.

The international community has an agreed strategy to reduce global imbalances. The United States is working to raise national saving by cutting the fiscal deficit and increasing private saving. Our policies to do so are working. To help boost personal saving, the President has proposed expanding tax-free savings opportunities and simplifying our current confusing system. He has proposed replacing current-law IRA's with Lifetime Savings Accounts and Retirement Savings Accounts, consolidating employer-based retirement savings accounts, and establishing Individual Retirement Accounts for lower-income households for the purposes of education, home purchase, and business start-ups. And the 2005 deficit was within the 40-year historical norm as a percentage of GDP. The Administration remains committed to cutting the fiscal deficit and meeting the President's goal of halving the deficit by 2009, when it is projected to be well below that goal at about 1.4 percent of GDP. Last year, tax revenues increased by almost 15 percent and they continue to grow by double digit percentages again this year. In fact, last week a Congressional Budget Office report said that the 2006 deficit is expected to be significantly less than originally anticipated due to the surge in Federal tax receipts. It is in the U.S. national interest to continue pursuing the path of fiscal consolidation, but one should not overestimate the impact fiscal consolidation will have in reducing global imbalances. Let me also underscore that the United States does not have a current account target. Our aim is to achieve continued good, low-inflationary growth.

Europe and Japan need to promote structural reforms to strengthen potential growth. Growth in the Euro-area is witnessing a modest cyclical pick-up this year, but there is much more to be done. The Euro-area's overall external position is in near balance, but I reject the view that Europe thus has little role to play in the global adjustment process. After struggling for many years, Japan's economy appears to have turned the corner. Corporate and banking sector restructuring have been largely completed, leading to rising full-time employment, investment and bank lending. As Japan emerges from deflation, a broad structural reform agenda is needed to raise productivity growth, promote sustained domestic demand-led growth, and lessen the economy's reliance on export-led growth.

Rising oil prices are also affecting global imbalances. In the last 3 years, oil revenues for the largest oil exporters have grown by $410 billion. These countries can contribute to the adjustment process through accelerated investment in capacity and increased diversification.

Let me turn to emerging Asia, and China specifically. Strong growth in China and the region have helped propel the global economy. But greater exchange rate flexibility in emerging Asia is an irreplaceable component of the adjustment of global imbalances, and Chinese exchange rate flexibility is the lynchpin of currency flexibility in emerging Asia.

China's international economic and exchange rate policies are deeply concerning. The United States has been joined by the international community, including the G–7, the IMF, and Asian Development Bank, in vigorously encouraging China to implement greater exchange rate flexibility. In the final analysis, though, the Treasury Department is unable to conclude that China's intent has been to manage its exchange rate regime for the purposes of preventing effective balance of payments adjustment or gaining unfair competitive advantage in international trade. Thus, we have not designated China pursuant to the 1988 Trade Act. Let me share with you our reasons.

China is engaged in an historic transformation to a market system. To achieve the requisite economic rebalancing, China must make its currency regime more flexible, strengthen consumption and modernize its financial system—the three pillars of our policy engagement.

China's leadership has publicly committed to take these steps. President Hu, in a meeting with President Bush on April 20, stated that China does not want a large current account surplus and will act to reduce it. Premier Wen made this same commitment in his speech to the National People's Congress and also committed to allow more exchange rate flexibility. China's recent 5-year plan places strong emphasis on consumption and rural development in order to spur domestic demand. China's Central Bank Governor laid out a five-point plan to reduce the surplus, including efforts to boost domestic demand, reduce China's high saving rate, accelerate removal of trade barriers, allow foreign firms greater access and achieve greater exchange rate flexibility.

Of course, words must be backed by action, and China is taking some action. On the exchange rate front, China abandoned its 8-year peg against the dollar last July, and the renminbi (RMB) has moved slightly higher against the dollar since that time. But given the close relationship between the RMB and the dollar and because the dollar appreciated last year across the board, China's currency on a trade-weighted basis appreciated by over 9 percent last year. China has also taken steps to create a deeper and more liquid foreign exchange market, allowing interbank foreign currency trading for the first time this year.

China is also acting to boost consumption, dampen its high saving rate, and promote domestic demand. Recently, China has put in place steps to cut taxes, develop rural areas, and raise minimum wages. China's efforts to modernize its weak financial sector are part of the strategy to spur consumption and more efficient investment. In the last year and a half, China has acted to tighten its risk classification system for bank loans, deregulate and raise bank lending rates, and bring in foreign expertise and knowhow to improve the soundness and market-orientation of the banking system. We strongly urge China to allow foreign firms greater access to China's financial system and to lift the ownership caps facing foreign entities.

Let me be clear: We are extremely dissatisfied with the slow and disappointing pace of reform of the Chinese exchange rate regime. The RMB's appreciation has done little to curb China's large current account surplus or cool its fast-growing economy, which last quarter was at an over 10 percent annual rate. Further exchange rate flexibility is a key tool for tightening financial conditions amid ample liquidity, reinforcing the effect of recent monetary policy actions aimed at cooling economic activity. Thus, this slow pace is neither in China's self-interest nor in the interest of the world economy. With a still rigid exchange rate, China lacks effective monetary policy tools to avoid the boom-bust cycles it has experienced in the past. This is particularly important now that investment in China appears to be reaccelerating, increasing the risk of a hard landing.

For the last 3 years, the Treasury Department has made engagement with China one of its top priorities. This intensive engagement has first and foremost concentrated on exchange rate flexibility, but also on the other steps necessary to shift the sources of growth toward domestic demand and consumption, reform the financial sector and to build the foreign exchange market infrastructure. While the economic face of China changes rapidly each day, we are not satisfied with the progress made on China's exchange rate regime and we will monitor closely China's progress every step of the way. It is important for China to understand that its exchange rate regime is not simply a bilateral United States-China issue, but a multilateral issue. Chinese exchange rate practices affect the entire world. The IMF is the world's only multilateral institution with a mandate to consider exchange rates. Managing Director Rodrigo De Rato has called for strengthening IMF exchange rate surveillance in his medium-term strategy. Further, at the recent IMF/World Bank spring meetings, he developed a new mechanism for multilateral consultations to broaden the global discussion of imbalances. The IMF must take this mandate for leadership by encouraging real reform in the Chinese currency regime.

In conclusion, the entire international community must work together cooperatively to address global imbalances, but it is a matter of extreme urgency that China act immediately to increase the flexibility of its exchange rate regime before real harm is done to its own economy, to its Asian neighbors, and to the global financial system.