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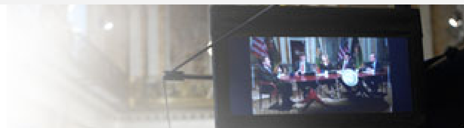

Written Testimony of Deputy Assistant Secretary Mark Sobel

12/16/2011

Written Testimony of Deputy Assistant Secretary Mark Sobel
Before the House Oversight and Government Reform Subcommittee
on TARP, Financial Services and Bailouts of Public and Private Programs

"What the Euro Crisis Means for Taxpayers and the U.S. Economy"

Introduction
Chairman McHenry, Ranking Member Quigley, thank you for this opportunity to discuss U.S. interests in European economic reform.

The European Economic Outlook is Weakening
Over the past year, economic and financial stresses in Europe have spread to some of Europe's largest economies, and the crisis now facing Europe is deeper and more entrenched. Sovereign bond yields have risen sharply in many countries. Many European financial institutions have faced difficulties in obtaining funding from markets and are de-leveraging in order to strengthen their capital adequacy. European equities have fallen by a quarter since April.

These developments have resulted in a sharp weakening in Europe's current growth performance and significant markdowns in growth projections for 2012. Growth in the euro area is projected by most analysts to be negative this quarter and into early 2012, with weak growth persisting in 2012. For example, the OECD, which earlier this year had projected annual average European growth in 2012 of 2.0 percent, just revised its estimate to 0.2 percent. Many private forecasters are more pessimistic.

Europe's problems are a serious risk for the U.S. outlook
In the United States, the pace of recovery has strengthened recently and most analysts expect continued moderate growth next year. But given Europe's strong trade and financial linkages with the rest of the world, other regions could feel the impact as well. Indeed, Europe's problems are a serious risk for the U.S. economic outlook.

- The European Union buys nearly 20 percent of U.S. goods exports ($242.6 billion in 2010) and over 30 percent of U.S. service exports ($170.2 billion). The European Union accounts for 63 percent of the stock of foreign direct investment (FDI) into the United States, at $1.5 trillion, and 56 percent of new investment in 2010. Therefore, when European growth slows, U.S. jobs, exports, and FDI inflows decline.

- Global financial markets are strongly interconnected. When European financial markets tighten, it can adversely impact U.S. banks' confidence and their willingness to lend and invest. That, in turn, can hurt American businesses and jobs, particularly in smaller firms that depend on credit from their banks to grow and innovate.

- When EU stocks decline, U.S. equity markets often do as well, hitting the savings and wealth of Americans.

To make these linkages more concrete, for instance, exports to the European Union represent over 24, 20 and 18 percent, respectively, of merchandise exports from New York, North Carolina, and Illinois. In each of these states, over 150,000 jobs – and over 250,000 in Illinois – are export-related. A decline in exports to Europe will inevitably adversely impact America.

Engaging Europe
First and foremost, Europe has an enormous self-interest in tackling its problems. The events of the last two years have highlighted the need for the currency union to have an adequate crisis response toolkit to respond to economic and financial stress, as well as stronger disciplines to assure long-term fiscal and external sustainability. As President Obama and Secretary Geithner have stated on numerous occasions, Europe clearly has the capacity and the resources to address its crisis.

Europe is making progress in putting in place reforms to create the conditions for future economic growth and to build a stronger architecture for fiscal union. The recent European Council agreement represents an important step forward. But more work remains to be done.

Our ties to Europe are deep and longstanding. The Transatlantic partnership is vital to our national security. Supporting Europe is not just a matter of diplomacy or friendship. Rather, it is a matter of vital national interest for the well-being of the American economy, for the wellbeing of American workers, for the wellbeing of American businesses, and for the wellbeing of American families and individuals saving for their future.

Therefore, we are heavily engaged with Europe through bilateral and multilateral channels.

Bilaterally, the President is actively engaged. There are extensive contacts with European leaders. Secretary Geithner has traveled to Europe 3 times in the last 3 months to engage with his counterparts. Over the past two years, we have offered our perspective about the dangers that the sovereign debt crisis poses for the global recovery. And we have shared the lessons from our own financial crisis, including the importance of responding to market challenges decisively and with overwhelming force.

Multilaterally, we are working closely with countries around the world to help promote a stronger and more balanced global economy. To do so, we have valuable international fora, particularly the G-20—which is the principal forum for international economic and financial cooperation with membership comprising 85 percent of the global economy—and the International Monetary Fund (IMF or Fund).

Recognizing the strong linkages among their economies, G-20 Leaders underscored at the London Summit in April 2009 their willingness to aggressively tackle and stabilize the global economy and financial system. Together, they undertook a massive and powerful cooperative effort. Later that year in Pittsburgh, with global economic conditions steadying and the recovery underway, Leaders agreed on a Framework for Strong, Sustainable and Balanced Growth that requires actions by all G-20 countries to address the global imbalances that preceded the crisis.

The world's ability to tackle its medium term challenges will require cooperative actions by all, but it surely also requires tackling and overcoming the near term challenges. This, in turn, underscores the significance of an effective European response to the euro area crisis. Last month in Cannes, France, G-20 Leaders focused heavily on the European crisis. The Cannes Summit Communiqué underscored the importance of strengthening European banks, building an effective European firewall to avoid contagion, and laying the foundations for robust economic governance reform in the euro area. Mexico will chair the G-20 in 2012, and it already has stressed that promoting a more effective European crisis response will be a top priority.

The IMF is a central institution of the international monetary system, and international monetary cooperation is as vital today as it was when the IMF was founded over sixty years ago. Throughout this time period, the Fund has served well the global community and U.S. economic interests. It helped Europe and Japan achieve sustained growth in the post-war period. After the demise of the Bretton Woods System, it helped the U.K. and Italy overcome their crises in the 1970s, resolve the Latin American debt crisis of the 1980s, support economic transition in Eastern Europe and the former Soviet Union in the 1990s, and was central to the response to the Asian and emerging market financial crisis late in the 1990s and earlier this decade.

As a civil servant with extensive experience on IMF policy issues, it has been a hallmark of my career to see the strong bipartisan support, in both the executive and legislative branches, for the Fund's role in the global economy. I have seen Secretaries Baker, Brady, Bentsen, Rubin, Summers, O'Neill, Snow, Paulson, and Geithner all stand squarely behind the IMF as it addressed the most critical financial and economic challenges of our times. Through this support, the United States has been able to exercise strong global leadership in responding to crises.

The Fund has not wavered in its belief in the central role of sound economic policies and reforms, but it has responded with flexibility to the needs of countries. Countries first and foremost bear the burden of adjustment. They must put their fiscal houses in order and live within their means. But the Fund can play a role in promoting more orderly adjustment by offering financing to support economic reforms, thereby providing some breathing space to countries in overcoming their problems in ways that are less disruptive.

When growth plummets in one country, especially a large country, it spills over onto others. In these circumstances, the Fund's support also helps mitigate the impact on innocent bystanders and the system as a whole. The global financial crisis in 2009 is a good example. Numerous emerging market economies, including many that had strengthened their performance over the prior decade and were engines of growth for the world economy, were hit by a massive outflow of capital that threatened to undermine their hard-won gains. The actions taken by national authorities in early 2009, coupled in particular with the announcement at the London Summit of new and significant support for the IMF, helped stem the capital outflows and steady the international financial system. This action was pivotal in promoting global recovery.

The IMF is a very good investment for the United States. The Fund helps promote global stability and lessen the fallout from events abroad to American workers and families. When the Fund lends, it does so subject to appropriate conditions and with safeguards to assure it is repaid. And its repayment record is outstanding. When the IMF draws on U.S. resources, the United States is exposed to the Fund's balance sheet - not the borrowing countries - and the Fund's balance sheet is rock solid. The Fund is regarded as the world's preferred creditor, meaning that the IMF's member countries acknowledge and agree that it gets repaid first.

The Role of the Fund in Europe

The crisis in Europe is severe, and it is impacting not only Europe, but the entire global economy. The challenge Europe faces, however, is completely within the capacity of the stronger European members to manage. As European countries act to develop critical economic reforms and to strengthen fiscal governance, Europe must also continue mobilizing the requisite resources to put in place a strong and credible firewall commensurate with the scale of the challenge. It must do so quickly, with force and determination.

The United States and our international partners stand with European leaders as they move to put in place decisive solutions. The IMF is important in providing external assessments of reform programs which have unparalleled credibility. The IMF cannot substitute for a strong and credible European firewall and response.

The IMF now has a substantial arsenal of financial resources – almost $400 billion. The Administration has been clear with our international partners that we have no intention of seeking additional funding for the IMF.

Conclusion

Our nation's economic recovery and job creation depend on a strong world economy and stable international financial markets. The global economy now faces deep challenges that threaten domestic and global growth and heighten financial instability. Foremost is the situation in Europe. Stresses that harm U.S.-European trade and propagate financial contagion from Europe adversely affect U.S. businesses, slow our recovery, and harm U.S. workers, jobs, and families. Let us work together, with our allies, and through our leadership in international fora and institutions, to overcome these challenges that put our recovery, and the world's, at risk.

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