Remarks by David Malpass, Under Secretary for International Affairs, to the German Marshall Fund

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INTRODUCTION

I would like to thank the German Marshall Fund for inviting me today, and especially thank its President, Karen Donfried, for hosting this discussion. Since its founding in the early 1970s, the German Marshall Fund has been dedicated to the worthy objective of strengthening transatlantic dialogue. In line with this objective I would like to discuss the transatlantic economic and financial relationship today.

As we speak, President Trump is completing an important trip to NATO headquarters, the UK, and Helsinki. As is clear, the United States regards the transatlantic relationship as one of our most important in the world, but one that is facing deep challenges. One of my top priorities is building sound transatlantic relationships aimed at strengthening the U.S. economy and lowering regulatory barriers abroad for U.S. firms. I'd like to share my thoughts on some of the key issues, including observations from my recent trips to Ukraine, and to Basel related to the Financial Stability Board (or, the FSB).

European nations and the United States play key roles in global economic and financial fora. While we have differences, we cooperate in several areas in the G-7, G-20, IMF, World Bank, European Bank for Reconstruction and Development (EBRD), OECD, and FSB. I'd like to give you some detailed examples of both the challenges and the areas of cooperation, and then turn to the big picture goals of financial stability, robust capital markets, lower financial regulatory barriers, and stronger global growth.

MULTILATERAL INSTITUTIONS

We work across the Atlantic on an almost daily basis to foster better management of the international financial and regulatory organizations. This includes their size, structure and personnel, and the quality and effectiveness of their programs. We share common interests with Europe in the need for transparency in bilateral and multilateral debt, fairness in procurement, higher standards in the fight against corruption, bribery, money-laundering and terrorism, and concern over China's non-market policies and its aggressive expansion in developing countries.

Our ultimate goal for the international financial institutions is to allow people to achieve greater prosperity and a higher median income. This presents challenges in the European relationship because Europe's representatives in international organizations sometimes, perhaps often, favor an expansion of multilateralism and more government programs. This often conflicts with the goal of greater prosperity. The reality is that higher median incomes is mostly achieved through economic and political freedom and a supportive environment in terms of sound money, restraint in the size, power and taxation of central governments, and an appropriate regulatory framework that facilitates growth in median income. We don't have nearly enough instances of multilateralism aiding in this process, but many instances including several this year in which multilateral programs have contributed to turmoil.

We've worked with several European nations over the past year to agree on major reforms of the World Bank. Assuming endorsement by the Bank's Board of Governors, this will result in a capital increase that focuses on the implementation of a lending limit to stop the cycle of repeated capital increases; and on graduation of higher income borrowers so that a bigger percentage of the lending can go to lower-income countries. In particular, World Bank loans to higher-income borrowers such as China will be sharply reduced.

We're currently joining others in the G-7 to oppose the pay increase being proposed for the World Bank Executive Directors. As many of you know, the World Bank is run by a large staff of highly compensated administrators. In addition, the Bank has 25 resident Executive Directors, each with well-staffed offices and large representational and travel expenses. The result is an expensive overhead, which detracts materially from the mission of designing and funding effective development programs for poorer countries.

To name a few more areas of cooperation, we're working with European countries to reform the governance structure of the Korea-based Green Climate Fund; discourage the EBRD from expanding into sub-Saharan Africa; and narrow the OECD's activities and refocus it on its mission.

Now, let me spend a little more time on the FSB based in Basel, Switzerland. After years of often-costly expansion of its regulatory activities, we're working across the Atlantic to refocus the FSB on its core mandate of financial stability. There's agreement that it should become more transparent to external stakeholders and take full advantage of its foundation, which is consensus-based and membership-driven.

We recognize many past overreaches in multilateral regulatory activities. However, our engagement in international financial regulatory fora, including the FSB, is necessary to promoting three core U.S. objectives: 1) international financial stability; 2) consistency of international regulatory outcomes; and 3) improvement of regulations and the regulatory structure so that they do not stifle innovation or economic growth at home and abroad.

Treasury supports the FSB's recent decision to focus on evaluating the effects of the international financial regulatory reforms launched after the financial crisis – rather than setting new standards. We want the FSB to improve oversight, transparency, and stakeholder engagement, and are closely engaged in the ongoing review of the FSB's processes and procedural guidelines.

Ultimately, we and Europe would benefit from maintaining a level regulatory playing field across jurisdictions. It is imperative that regulations do not create unnecessary distortions that impede economic growth or the productive flow of capital. Regulations should achieve appropriately calibrated outcomes that maintain financial stability, but they do not need to be identical across jurisdictions, as some in Europe would contend. This imperative was discussed in detail at last month's meeting of the U.S.-EU Joint Financial Regulatory Forum.

BREXIT

This brings me to the issue of Brexit, Britain's exit from the European Union. Our interest post-Brexit is that the UK and EU become strong, fair economic partners for us, including faster growth, robust capital markets and open, balanced trading relationships. We are concerned that the Brexit process is giving European regulators an opportunity to move in harmful directions, including on financial regulation. In particular, the addition of non-prudential equivalence regulations and potential requirements to relocate markets or activities to the continent risk increased costs and market fragmentation. This would weaken Europe's already slow growth rates, and further polarize Europe's economic performance, to the detriment of Europe's weaker economies.

From the U.S. standpoint, a Brexit outcome that imposes regulatory requirements based on non-prudential considerations would harm U.S.-based financial firms and also hurt Europe, which we hope will become a better trading partner. We have urged officials in the UK and the

EU to reach an agreement that does not disrupt financial markets or cause reduced liquidity, dislocation, or market fragmentation. As with the international financial institutions, we will continue our active engagement on financial regulatory policy issues, but recognize sizeable challenges in the relationship.

WEAK CONTINENTAL ECONOMIC GROWTH

Brexit rightfully is on everyone's minds because it will fundamentally change the economies and laws of Europe and the transatlantic relationships. But it is not the only potential challenge. Before Brexit, Europe already faced slow growth, weak investment and dramatic demographic decline. The IMF released its World Economic Outlook this morning showing weaker prospects in many European countries even as the U.S. continues solid growth. Tax and regulatory reform have worked in the U.S. but are not widely embraced in Europe, leaving a sharp divergence in economic performance. This is especially true of small businesses, for which the U.S. climate has turned up but the European climate remained unfavorable.

It has been over eight years since the onset of the euro crisis, which threatened the exit of Greece from the euro. Since the crisis, Europe has slowly built government mechanisms to respond to future crises, but the core problem of slow growth is still severe. Italy's real GDP is smaller than it was in 2004 and Greece's smaller than 2000, showing the extent of the growth problem. The market movements that we saw at the end of May in response to Italian political developments underscore that macro vulnerabilities remain in the euro zone.

Europe could boost overall growth through policy reforms, but, with the exception of France's important labor reforms, there seem to be only isolated prospects for labor mobility, smaller, less intrusive government or lower tax rates. Not enough Europeans think of starting a small business, or, if they do, they often plan to launch outside the European Union.

STRENGTHENING EUROPE'S ECONOMIC AND PHYSICAL SECURITY

Even as Europe continues to struggle to strengthen the euro area's finances, leaders have voiced the clear merit in strengthening their cooperation in security and defense. President Trump reiterated at last week's NATO summit that all NATO members need to reach their stated commitment of spending 2 percent of GDP on defense by 2024, and then strive to do even more. Ultimately, a physically-secure Europe would be more financially secure as well.

Within the vein of increasing prosperity, let me touch on a topic related to European economic and energy security: the proposed Nord Stream II gas pipeline. The United States shares the concerns of many European partners that this project would undermine Europe's own energy diversification efforts, deepen Russian dominance in gas markets, and increase Russia's economic leverage over the continent. Nord Stream II, if built, could concentrate over 75 percent of Europe's gas imports through a single corridor transiting the Baltic Sea. It would be unwise for Europe to make itself even more vulnerable to Russian gas imports and provide Russia another tool to pressure or coerce European countries, including Ukraine. During my late June visit to Kyiv, several Ukrainian officials noted their concerns with the project and its potential to undermine Ukraine's independence. Nord Stream II could cost Ukraine up to $2 billion annually in transit revenues, severely undermining our efforts to help secure an independent and economically sustainable Ukraine.

Ukraine continues its long journey to reforming its economy and achieving faster growth. Progress has been made on improving the governance and profitability of Naftogaz, the state-owned gas company, and improving oversight and resilience of the financial sector. Just last week, the Rada strengthened the anti-corruption process. But, Ukraine's work – and the work of the U.S. and the EU in supporting reform efforts – is not complete. To grow, further progress is needed, including land reform, de-monopolization, natural gas price reforms, and further measures to counter corruption in the lending system.

CONCLUSION

The Trump Administration seeks to engage globally in ways that strengthen our economy and security, a key part of a stronger global economy. Our relationship with Europe figures prominently in this approach, and the challenges and opportunities in the transatlantic relationship will be an important factor in our participation at this week's G-20 ministerial in Buenos Aires.

Thank you for your interest today, and I look forward to a productive discussion.