

January 12, 2009

RFF Policy Leadership Forum

*How Markets Can Help Address
Climate Change and Other Major
Environmental Problems*

A Conversation with the Honorable Henry M. Paulson,
Jr., U.S. Secretary of the Treasury

1616 P St. NW
Washington, DC 20036
202-328-5000 www.rff.org



Resources for the Future Policy Leadership Forum

**How Markets Can Help Address Climate Change and Other
Major Environmental Problems**

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With:

PHILIP R. SHARP
PRESIDENT
RESOURCES FOR THE FUTURE

LAWRENCE H. LINDEN
CHAIR, BOARD OF DIRECTORS
RESOURCES FOR THE FUTURE

LINDEN: Good afternoon, and welcome the Policy Leadership Forum at Resources for the Future. My name is Larry Linden. I have the honor of being the chair of RFF's Board of Directors.

The Policy Leadership Forum is RFF's format for allowing leaders who set policy on natural resource and environment matters to address the Washington community.

Previous speakers have included presidential candidates and other Cabinet members and CEOs.

It is my great privilege to introduce our guest today. He is the Honorable Henry M. Paulson, the secretary of treasury.

Since he's recently become a household name...

(LAUGHTER)

... been on the cover of nearly every major magazine in the world, he hardly needs a formal introduction. I'll just note, he's a graduate of Dartmouth and Harvard Business School, worked in the White House in the '70s, joined Goldman Sachs and rose to become its chief executive officer.

He was selected by President Bush to become Secretary of the Treasury and was sworn in, July 2006.

At Goldman Sachs, he was sought after for his advice by clients as a young associate, and was viewed by myself and other executives with whom he worked there as extraordinarily smart, energetic, tough, and a seasoned colleague whom we were pleased to have as our leader.

When he accepted the post of treasury secretary, many Washington watchers wondered why would he give up such an important post in the private sector for the last years of administration, and particularly when the economy was doing well, it looked like there'd be relatively little to do, other than the probably impossible task of getting the Chinese government to reduce its support for its currency.

Well, I guess things turned out differently, and I guess you've been able to keep busy.

However, Secretary Paulson has always had other passions to which he's applied his many talents, and one of them has been the conservation of the natural world. He's a lifelong bird watcher and outdoorsman, and at the time of his appointment as Treasury Secretary, he was chair of the Nature Conservancy.

In these endeavors, he's been fortunate to have his wife Wendy, who's with us today, as his partner and colleague, and she's also a recognized leader in this community.

At Goldman Sachs, I was fortunate to work with him on the establishment of a large nature reserve in Tierra del Fuego, Chile, and then on the first environmental policy to be adopted by an investment bank. And with these actions, Goldman Sachs became a business community leader on environmental matters.

We've decided to conduct today's program as a conversation with Secretary Paulson on the topic of how markets can address climate change and other environmental problems.

RFF's own esteemed president, the also honorable Philip R. Sharp, will take the other side of the conversation. Phil is himself a distinguished public servant, having served as congressman from Indiana for 20 years. During this period he led the passage of several important pieces of energy and environmental legislation, including the acid rain control law that established the first working market in environmental credits. We have been fortunate to have Phil as our president of RFF for three-and-a-half years now.

We do expect to have time for some questions before the hour is up. In order to save time and to keep things efficient, we're going to observe the following procedures:

Please submit your questions in writing. I think you have the cards or papers at your chairs. For context, please include your name and affiliation.

Pass them up to the front row during the conversation, to Ray Kopp. The RFF staff will screen them for general interest. And please write legibly.

Now I will hand off the program to Phil Sharp and Secretary Paulson.

SHARP: Thank you very much, Larry.

And, Mr. Secretary, we're honored to have you here at Resources for the Future. And since Alexander Hamilton served first in your shoes, there have been a handful or fewer secretaries of the Treasury who have played a pivotal role in our economy or the history of our financial institutions.

And certainly, you are one of them, and you are there now. But as we set this up, that's not what the conversation is about today. What the conversation is about today is about the focus on other global challenges in the environment and, in particular, climate change.

And partly we want to engage you on the conversation about the part of the government that you lead and why they should be involved in this question.

When this conversation comes up in Washington, the Treasury Department is not the first thing that comes off the tongue, in terms of engagement on these issues. So, perhaps, you could give us a sense about the department's role and your role?

PAULSON: Yes, well, I think that the Treasury Department will need to play a very major role, going forward. And I think other finance ministries around the world will need to play a very major role.

I've spent a fair amount of time making sure we had the resources and the key people at Treasury, going forward, to do that. There is no way we are going to be able to solve the enormous problems that we have in front of us without the deployment of a great deal of new technology. And it's going to take challenging hundreds of billions of dollars of investment in capital from the private sector.

And that is something that the Treasury Department knows something about – will know something about in the future, and finance ministries all around the world know something about.

And what I've seen, in looking at this – there's the science, which is strong and overwhelming. There's the politics, but then there's the economics. And so, unless we can have the proper pricings and unless we can have the capital flows that are going to allow us to put in place the regulatory system that's going to allow for sustainable economic growth, we're not going to be successful.

And I've noticed that in doing some of the things we've done around the world and in putting together the clean technology fund, for instance, I've found that if you look at the foreign ministries, who are very much involved, they know how to do deals.

If you look at the development offices, they're very concerned about the social ramifications. But I think the economics is just so important, because unless we continue to have economic growth and sustainable economic growth, I don't see countries willing to make the kinds of decisions that are going to be necessary.

So, again, I see it as essential that finance ministries or the Department of Treasury has people in place that understand the economics, but also understand conservation and the environment.

SHARP: In the clean development fund, you had a major role in helping the World Bank to get this established, and as I understand it sought appropriations in the U.S. Congress of a couple billion dollars. I don't think we ever got it yet, did we?

PAULSON: This came about as the result of the president's proposal. He asked me to lead an effort globally. We have seven major nations that have committed to it, other than the United States.

We've got, you know, Australia, and Sweden, and France, and Germany, and the U.K., and Japan, but the purpose is to fund the development of cleaner technologies in the developing world.

SHARP: And so to help transfer technology and what not in terms of the size of this, you anticipate to really have an impact it's going to have to grow...

PAULSON: Well, it's got to be huge. Remember, the beauty of this – the reason it's housed at the World Bank, FDITC, because they know something about incenting the private capital, because the idea is to lever this investment many times over by just helping fund the delta between, you know, the technologies that might've been used and the cleanest technologies, and it encourages the private sector capital from coming in.

But I'd say – one thing I should've started off – by saying, one of the things that I am proud of having done, and we have a leader at Treasury, Billy Pizer, who you know came from Resources for the Future – who's leading what I see as a very strong office of energy and the environment.

And we've housed it in the international affairs office, but it's a virtual office. It draws in resources from economic policy and the general counsel's office, and tax policy. And so, we have all the normal things that Treasury have done in terms of, you know, the oversight of the environmental programs and the multi-lateral

development banks, and the, you know, Tropical Forest Conservation Act, but also climate.

And so, we now will have people that understand, not only the economics, but understand, you know, the policy and the conservation. And I will be, actually, surprised and disappointed if the office of Treasury isn't a leader; probably any leader in the government in terms of having more resources and knowledge than any other place.

SHARP: Well, certainly, it does have – I can testify to the high talent you've borrowed, stole from us – kind of proposition. We hated to lose Billy Pizer but we took it in a service view, that we've made a contribution to the well-being of the country.

But speaking about these – these the labor and the leverage private capital – obviously on the agenda – it was on the agenda in both presidential campaigns and both parties this fall – is what to do about a system in this country of regulation, and that is getting the price on carbon. And I wondered if you wanted – cared to say something about the value of us doing that, either through a tax or through a cap-and-trade market?

PAULSON: We need to first look at that globally, and then look at here, because one of the things that I believe that the current president has not received enough credit for, is how he has changed the debate when we look at climate globally. Because I do believe, now, that there is a growing awareness and acceptance for the fact that not just the major developed countries, but all of the major economies need to enter into commitments to mitigate greenhouse gas emissions.

Now, the developed world should be reducing those emissions and maybe the major developing countries, slowing the growth. But I think that has been key, number one.

Second, big emphasis on technology and development – developing new technologies and helping – in the developed world, having a special responsibility to help finance the point of these technologies.

And I would say the next thing, which I don't want to underestimate, is looking at the trade area, because – when I started discussions with many developing nations, they would – when I first got here – would start off by saying, "Well, you all polluted what you developed so now somehow we have the right to do so," ignoring the fact that we now know much more knowledge about the harm that comes from the pollution and we have technologies that are available today that weren't available when we were going through our development phase.

And so the idea that there are still tariffs on these environmental technologies and environmental services and that we've got – developing countries that aren't using them and charging tariffs seem morally and economically wrong.

So I think that this has been something that the president has emphasized, and I think this will – this will stand the – the test of time.

Now, in terms of – of getting the technologies developed – and, again, I think anything we do, there's an understanding that it needs to be global. Otherwise, all we're going to do is just export our carbon emissions to the developing world. And of course a ton of emissions are every bit as bad coming from India or China as – as from the U.S.

So, again, I think it takes a global solution. Obviously, we need to be a leader as the largest and most advanced economy. And I'm not going to break new ground here today opining on, you know, a few days from going out the door, opining on what the right regulatory regime is.

But what I – what I will say, I'm a big believer in price signals, and I'm a big believer in the fact you can do things incrementally and gradually. And as long as the private sector sees the signal, understands it, and sees where it's headed, this will then lead to all kinds of development of new technologies. And I believe there could be different regulatory regimes to send those signals, but, obviously, that's really the key.

SHARP: But getting that price out there is one of the central features. many economists have been saying that, but we begin to hear more and more voices of the American system is saying, well, we've got the Clean Air Act, we've got regulatory authorities that don't necessarily need to get to this.

PAULSON: Well, there's different – there's different ways of sending advice signals. And of course, we've had price signals that we've had experience with cap-and-trade in this country for some time.

If you look at, for instance, sulfur dioxide – one of the things we spent a fair amount of time with – working with the Chinese on is letting them – because they've got a very serious problem with SO_x and NO_x, and letting them understand how – the cap-and-trade system there has really helped us regulate the emission of those pollutants.

SHARP: Let's talk more about that international approach that you have been engaged with already; we'll come to China in a moment. But in terms – you've mentioned the major economies and meetings that were scheduled this year and that you participated in, and I was wondering if you can give us any – just speak a little bit more – to the value you saw those were in and whether that is a smart on-

going approach. Obviously, we've got the United Nations negotiations that will go on no matter what.

PAULSON: Well, the president's view was, obviously, the UNCCC takes primacy. The idea was not to displace that, but the idea was that we are not going to – to have any hope of solving the climate problem.

You need to be realistic and you need to see that what we're looking at is – this is not – this is a 20, 30-year game, and it's about making – developing and making major investments in technology and doing it globally.

And unless the major countries, the major developing economies participate, there's – there's no hope. And so, if you just say, you don't have to participate, we'll never get there.

And so, as the president approached it, there were – the 18 countries that accounted for 80 percent of the emissions were at the table. And so this is just – this is just consistent with, and supportive of, what's going on at the U.N., rather than – than being otherwise.

SHARP: Is it your presumption this would be a good approach to continue, obviously?

PAULSON: Yes, I think it's a good approach to continue. And I think the other thing that's just a very important approach to continue is the emphasis on reducing and eliminating tariffs for environmental goods and services.

It is just extraordinarily stupid and counterproductive to charge tariffs for those products and services. And so, I think that's got to be a very early step.

SHARP: Do you see that as a potential place to do that negotiation? Or where – or have you thought through that possibility?

PAULSON: Well, I think that negotiation could be done. I know Sue Schwab has been a leader, you know, as USTR and working that through, so that can be part of the – of what happens with trade negotiations.

But I think you need to focus on this everywhere. And whenever you talk about dealing with the problem and when major developed countries – developing countries are arguing that they need to go slower, et cetera, you should be saying to them, then why are you charging tariffs on these products that you so desperately need, to be able deploy new technologies. And why can't we work together to eliminate those? So I think we need to hit this, you know, from all sides.

SHARP: Well, another side of that issue, as you know, has come up in the discussions on Capitol Hill about how to get other nations, especially China, India,

perhaps, to engage on emissions reduction, and that is by using trade threats, using border adjustment issues with them. What do you want to say to that?

PAULSON: Well, I strongly oppose that, and just for those who have – that aren't as familiar with the issue, the argument would go that if – if one country has stronger emissions, stronger environmental policies, regulatory framework than another, rather than just taking and exporting your carbon emissions, that the one way to protect yourself is to charge a tax when products were produced under a more relaxed regime – coming to the country, you charge a tax on that.

I think that's a dangerous path to go down. I think protectionism generally is, and I think that is a big reason to have there be a global solution and have there be a regime that developing and developed countries enter into, and one that recognizes the fact that developing countries have a different set of capacities and economic capabilities and that they should not be – have the same strictures that you might find in a developed country, but that they should all be participating.

SHARP: Perhaps, in that vein, we might turn to China because, as I understand it, on behalf of the president, you lead the strategic economic dialogue with China and you brought environment into that dialogue, and I'm wondering if you want to speak about both what you did and what that potential is?

PAULSON: Well, it's a huge potential, because I believe one of the things we did was strategic (inaudible) dialogue, was started very long-term, government-to-government dialogue on all of the major issues, from health care, to energy and the environment, to product safety, to the currency, the trade – and we dealt with the most pressing short-term issues and the most important long-term issues.

And, of course, when you deal with energy and the environment, we're not going to solve either one of these issues unless China and the U.S. are involved. And – and so, there's a lot of room for – to make progress.

And what we did was we came up with a 10-year framework where we said, "Let's engage the private sector. Let's engage academia in addition to the government." And then we segmented it. And so we segmented it into five areas.

So we have energy efficiency as one of the major issues. We have electricity generation as another big – and transmission, another big area. We have clean water, clean air, transportation, and then wetlands preservation.

And in each one of these, we're tackling some of the most fundamental long-term issues and – and some short-term things. And we're getting people involved, like we – one of the things that was most fun for me is on the last trip to China, we signed MOUs on a number of these eco-partnerships where we're getting people involved.

We had people in the city of Denver and Chongqing sign an MOU you that had to do with the deployment of electric cars, plug-in hybrids, and development of the city grid you know to facilitate that.

We had a situation where you read about the town in Kansas was destroyed by, you know, by the tornado in Greensburg, Kansas. And there was a town in – in Sichuan that was destroyed by the earthquake. And they each are building – rebuilding, using green principles. And so they signed an MOU, and they're working together.

So there's a lot of very interesting ideas from the private sector, from academia. And then with the government, we're – we're working things.

I'll give you one example – for instance, helping China developed the protocols and the infrastructure to – to trade you know the credits with the "socks and knocks" because what you'll find is they have the same concerns we have about global warming. But they are also dealing with some very immediate problems in terms of people dying from some of the – some of the pollutants – you know sulfur dioxide and so on, and that some of the steps they take to – to solve that problem will also help ultimately deal with climate, and particularly some of the things that they can do with regard to energy efficiency and how energy is priced.

SHARP: In the process of those conversations, did climate come up in those conversations?

PAULSON: It came up a lot. I would say that one of the more interesting trips I took was – I think it was in August 2007, where I went to Chenghai and the Chenghai plateau, which is where the – the top Chinese expert on climate was – was there with us and someone from the National Science Foundation in China.

And there, you see a real example of what's happening in terms of global warming. You see a – you know, the biggest lake slowly drying up. On this very high plateau, you've got the source of the seven big rivers of China. The Yellow River no longer flows continuously.

But the Chinese scientists explain to me that the temperature on this plateau was increasing by one degree a year and that in 25 or 30 years, you wouldn't have the glaciers there anymore. And they even gave me their theories of – of weather patterns, because that's where the jet streams emanate, and they could trace storms in Oklahoma or heavy rain in – in the U.K. to what was happening there.

So they're – they're very focused on it, and they're focused on some of the shorter-term issues, which deal with natural disasters, to the longer-term issues.

SHARP: Did you find as a consequence that you – how would you assess the openness to the Chinese government about trying to take actions to reduce emissions?

PAULSON: Well, I – I think they're very open and very focused on it. But they have enormous challenges in terms of you know the – their energy usage, you know the growth rate.

I think just in terms of just enforcements of their – of their laws, which they have in many other areas, given the rate of growth, and so they've got some real challenges. But they understand them, and they're focused on them.

SHARP: And could you say anything about what you detect are their expectations about us on this issue? For example, going first, getting – demonstrating that we – you hear in our conversation at home the – the argument that we have to go first and not – it's not likely to get any action from them until we do.

PAULSON: I think this is something that everyone needs to focus on. There's no doubt about it. And they're very constructive, so they're looking to learn from some of the things where we've already gone first.

And you know our – our EPA and their SEPA – had very few enforcement people, and they're you know – so there's a lot they're already looking to learn, but you're right. This has to be something that's done globally.

And even with – I think there's a lot of work that needs to be done. One thing that – that I could see when I was at Goldman Sachs and I see now is right now when you look at some of the voluntary trading systems and – and with – with carbon credits, you realize how important it's going to be; to come up with a system ultimately that has got credibility or is verifiable, that when someone pays to – to avoid it, you know a ton of carbon emissions, they know that they're really getting a ton of carbon emissions avoided.

And I just think there's a whole lot of things that are going to need to be worked out over time, but it's got to be globally. And again, all you're going to get for me at this juncture is that we need clear price signals and that are predictable. And it has to be gradual, because I think it's very important that we continue to have economic growth. And so I'm a big believer in that.

SHARP: Well, thank you. I was going to try to push you a little harder, but I can see we're not going to get many new policy statements here.

PAULSON: You can – you can push. I haven't slept in two-and-a-half years. You're not going to get me in the last couple of days.

(LAUGHTER)

SHARP: I have no doubt. You have faced far too – far tougher questioners. I have no doubt of that – and a few more probably in the remaining days of your tour of duty here.

Well, let me ask you on that – on that example of the – the model of using the SED, the strategic economic dialogue with China, whether you think that's a useful thing in the climate context and a more narrow set of issues that the U.S. government might be doing with India, with Brazil, with a few of the others, as opposed to just using the larger groupings for the negotiations.

PAULSON: I think you do as much as you can. In other words, the I think the reason we put the time and effort into what we did with China is because we're talking about the two largest economies.

And with almost any issue that you look at, whether it's in the national security, whether it's in the economic area, our ability to achieve progress is going to be directly related to the ability to work with – with China.

So this is just a very important relationship, and so also because economic issues are so important here, that if we get that right, a lot of other things will follow from it.

And then, of course, we knew to look at emissions and you look at energy usage, again this is – this makes a lot of sense in terms of having that bilateral. But I think a lot of this is going to have to be done multilaterally.

And I don't think you have – you get something done multilaterally unless there is a lot of – the U.S. is the leader, and so unless the U.S. is engaging on a bilateral basis directly with all of the major economies, we're not going to have the kind of multilateral success you'd like to have.

And I don't think that we're going to have that kind of success we need to have at the U.N. unless we – we have the major economies in the right spot.

SHARP: let me turn to some of the questions now. In quickly looking through them, I can see that a number of people have identified that they hold troubled assets, and they are wanting to petition under the TARP for everything, but we'll skip over those here this morning.

(LAUGHTER)

PAULSON: OK.

SHARP: The first question is one that we started to pursue, and I think we – you've already given us the answer, but it's probably not. It wouldn't be the most transparent way to use a tax as opposed to a cap-and-trade system to get a price on carbon.

PAULSON: I – you know let me just say that I want something that's fair, credible, efficient, transparent . . .

(LAUGHTER)

PAULSON: . . . and all of those things. And – and I would say to you that there are – there are – depending on how this is done, it's a distinction without a difference, because under various regulatory schemes and – and regimes, you can – you can get something that achieves a very similar result.

SHARP: If you want more documentation on that point, you can go to our Web site, and Billy Pizer, who used to be with us and now with you, and others helped write on that subject.

Well, let me turn then. All economists seem to adopt the criteria you have put forth here as a general proposition about how to measure these – these policies.

Let me turn to a question from Meghan McNamara with the Exchange Monitor. And she asks how much of a stimulus should be devoted to energy policy and where?

PAULSON: Well, you know that's for – that's for the next team you know, and I think clearly that that's for them to – to speak to. But you know energy policy is extraordinarily important, and energy infrastructure, energy policy – that's something that I think everybody agrees on.

SHARP: From Frank Loy, who is a member of our board of directors, there's a question. And he – he, you know, says, well, since you have just articulated that – that the border adjustment were tariffs is not the appropriate way to go, do you see any other techniques for trying to protect the American industries that face international competition, if we – if we engage in this?

PAULSON: Yes, that's what I tried to say, Frank, that I think this will probably go to a border adjustment on carbon. Where there is a danger, it will go there unless we have a – a global system, where we have the commitments made by major developing and developing – developed countries are transparent, meaningful, clear.

And again, my point is not that the big developing countries should need to go as far as we go, but they need to clearly make commitments that – that everyone understands. I think if they do that, then we can avoid the kinds of environmental tariffs you are – you were talking about, which I think is something we should seek to avoid. I mean reasonable people can disagree on that, but I'm not a big proponent of tariffs.

SHARP: Can you imagine the international negotiation, however – the so-called post-KR or whatever it is incorporating some kind of provision as a discipline mechanism within the international agreement?

PAULSON: I can imagine a lot of things as they incorporate it. I can imagine things that I would not like to see. And consequently, what I would rather push for would be eliminating tariffs on environmental goods and services and having the major developed and developing countries agreed to a set of global commitments that's fair and everyone understands.

SHARP: From Jill Blockhus with the Nature Conservancy, she's asking, in the context of possible federal legislation coming up, whether you think climate change should be dealt with in isolation or should be dealt with in conjunction with energy policy and economic development policy.

PAULSON: Well, I think you've clearly got to look at it all together, and that I could just tell you, whether you like it or not, unless this economy is growing and the global economy is growing, there's nothing we're going to do that's going to be environmentally sustainable for the long term, because that's just a necessity.

And you're certainly not going to solve the environmental issues without solving the energy issues, or – they're part and parcel of the same. And so they – they need to be dealt with together. And that is why I see so clearly that the Treasury Department has got to have a very major role.

SHARP: A question from Richard Aiken with CECA Solutions. How effective do you feel the federal loan guarantee programs – there are several of them obviously – but such as the DOE advanced vehicle technology manufacturing loan guarantee – how successful do you think the loan guarantee is as a tech need to try to advance technology?

PAULSON: Well, it is one very good technique. And as opposed to different times to pricing, those you're picking with – you know you're picking winners, and I would say this, the credit crisis broke out in its current form – that I saw very few problems when I got close to them seems smaller as opposed to larger, because once I got here, I saw things that were analytically simple were politically complex.

And if they were big issues, they weren't solved for a reason. They weren't solved because they're politically complex, or they're analytically complex. So the more I thought about these issues, I found very little good news. But one place where I found good news was spending time at DOE, spending time with some great scientists, and seeing that in so many areas that looked like there were breakthrough tech knowledge these that were two, three, four or five years away.

And so I think if you want to be an optimist – and, of course, you've got to be an optimist in this – is that what you understand is that on the one hand we're not

going to solve these problems without the development and deployment of new technologies, that you will also find that those new technologies can and will be developed and deployed if we have the proper policies, price signals, and the regulatory regime.

SHARP: Are there any other sort of policy techniques that you – this was a question about one technique, the loan guarantee that used especially obviously pricing carbon in general as a possibility.

PAULSON: Well, there's the price signals generally, obviously loan guarantees. There's just money expended for basic you know research and development. And I think there's been – and I think that money in – in this administration has spent a lot, a lot more than has been done previously to develop and deploy new technology, – and so we've seen the guarantee programs in nuclear and other areas. And those are all reasonable and important policies.

SHARP: The question – I'm having a little trouble reading his writing – but Michael Zwerin, I believe, from the Wildlife Alliance, is asking about if there's anything that your department can do to help with the international negotiation to be sure to involve the smaller developing countries that are in particular in the forest carbon market.

I think the concern here is the more sophisticated among the tropical forest nations might crowd out the others. And so how can we make sure this is broad-based.

PAULSON: I think he's right. And one thing I did not talk about, because I – but we've been very active with – with the Tropical Forest Conservation Act and with debt for nature swaps. And there's a lot that's being done and worked on right now with avoided before station.

And again, I think you're right. that question could be expanded to just a multitude of other topics, because one of the challenges I've had the treasury, when we look at economic development or helping countries develop tax systems or a local domestic currency market or get a – a bond rating to tap the – the sovereign debt market or any of that, is there's just a huge use for resources that we have at Treasury.

And being able to do something with some of the smaller, less sophisticated companies – countries is critical. And one of the issues that I've had in Treasury, and I think we as a nation have, as we are very stingy when it comes to appropriating and spending money for use outside of the U.S., for a country as wealthy and as large as we have. And the president has been very aggressive and forward leaning in doing things in Africa and Latin America and dealing with malaria and AIDS and a whole variety of issues.

But when you look at what we spend relative to our other budget, it's relatively small. And so that's one of the issues we've had at Treasury continually is in getting

a bigger budget and more resources to deal with some of these less sophisticated, smaller countries.

SHARP: Well, it also sounds like from our previous discussion that one of your main focuses and concerns has been trying to build the institutional capacity of the department before you leave so it's capable to engage on some of these.

PAULSON: Right, and we've built it in a number of areas. But one thing I do know, thanks to the great addition coming from your organization, we will have a strong office in place, and my successor will inherit much more than I had when I took over.

SHARP: Well, I can't help but the possibility here to mention, too, that on the forestry carbon – deforestation issue – we have several prominent analysts involved right now in trying to figure out how you might create a market that could help see to it that we finance in those areas.

PAULSON: Well, we could spend the rest of this time talking about that, because one of the things we worked on with this 10-year framework with China is the illegal logging.

And we signed an MOU there, because here we have the United States the largest importer of finished wood products and China the largest importer of logs and exporter of wood products. And so working on that, there is an awful lot that could be done in terms of the whole avoiding deforestation area.

And as you said, you know techniques, but also I think ways to verification. And – and I think there's a lot that can be done terms of enforcement and verification.

SHARP: Mr. Secretary, we have probably time for only one more question. And this one is from Dick Smith with U.S. Geological Survey. And he's saying aside from the climate, are there other environmental issues were markets and price signals would be a better guide solution than some of the more regulatory approaches?

PAULSON: Let me tell you something. In almost every area, I'm a believer in price signals. And so – and let me tell you when we look at the environmental issues we face, I wish it were just quiet. So let's just take a look at water. And – and so there's a whole series of – and one of the things that we are – that we are also working on with China is conserving wetlands. And even there, where I think it's primarily regulatory, part of getting people to understand the value of doing something is to be able to put a – put a value on these resources.

And – where we've worked with China – and I had the honor to work with the Nature Conservancy in China before coming to Treasury on conservation projects – again, you talk about price signals, being able to let people understand the – what this means in terms of tourism, particularly if you have development limited and

doing it in a way which it really protects the – the natural resources. So I think price signals are very important generally.

SHARP: Well, that leads me to one more sort of personal note. As Larry Linden mentioned in his opening remarks – prior to your getting into the government, you spent a lot of time on conservation and environmental issues in a personal way. And on leaving now, do you have anything you could tell us about your plans? If you want to announce where you're going, this should be an appropriate audience to do that.

PAULSON: Well, all I can say is I'm going to take some time and plan the next step. And Wendy is not just the partner, but the leader here, and she's the one that got me involved with every conservation organization I've been involved with. I've worked with her closely, and so the two of us I think we'll figure out together what the next steps will be and as it relates to conservation and the environment. And whatever I do, that will be some important part of my overall activities.

SHARP: Mr. Secretary, we are honored and pleased to have you here, and we want to thank you for your service to the nation.

PAULSON: Thank you.