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Secretary of Treasury Timothy F. Geithner Remarks at the Brookings Institution *As Prepared for Delivery*

This weekend, finance officials from around the world will gather in Washington, along with the senior management of the International Monetary Fund and World Bank. The G-20 Finance Ministers and Central Bank Governors meet in Korea later this month, followed by the G-20 Heads of State in November.

I want to outline our objectives for these meetings.

A period of unprecedented international cooperation

Two years ago, the world economy was in the grip of an economic crisis on a scale not seen since the Great Depression.

The United States and its partners in other leading economies, in an unprecedented feat of peacetime economic cooperation, joined forces to launch a powerful, dramatic response.

Together, we put in place a powerful program of financial support – classic fiscal measures of tax cuts and investment, combined with monetary policy actions by central banks, and a variety of creative actions to stabilize our financial systems – to bring the global economy out of freefall and on a path to growth.

We mobilized hundreds of billions of dollars in financial support for and through the international financial institutions for investments in emerging and developing economies.

We committed to keep markets open to trade and investment, and together we honored that commitment in the face of strong political pressure.

We came together to embrace a common framework for reform of the global financial system.

We passed sweeping reforms of the U.S. financial system, and the world's central banks and supervisors reached agreement just two weeks ago on a very tough set of global standards for capital to limit leverage in the major global financial institutions.

These decisions required considerable trust and political resolve. And they have been effective in restarting economic growth and stabilizing financial markets. Global trade is now almost back to pre-crisis levels.

Each of our economies is stronger today than would otherwise have been possible, because of the effectiveness of this joint strategy. And the financial reforms now underway will substantially reduce the risk of damage from future financial crises.

The Growth Challenge

What are the main challenges ahead?

The most important policy question we confront together is how to strengthen the pace of growth and repair, and how to do so in a way that provides the basis for a more balanced and therefore more sustainable global economic recovery.

This is not a challenge that is best resolved by nations acting independently. In the heat of the crisis, we all recognized that our actions would be more powerful if we acted together. Even though the most dangerous part of the crisis is behind us, we are still in a place where we can achieve better overall growth outcomes if we make policy in a cooperative framework.

I want to offer a few suggestions on the policy challenges ahead in three areas: growth, exchange rate cooperation, and reform of the architecture of economic cooperation.

First, on economic growth. The IMF forecasts the world economy will grow at a respectable annual rate of around four percent in 2011. Growth is very strong in many of the major emerging economies. In the major advanced economies, however, output and employment are still substantially below the pre-crisis levels, and the pace of recovery has been slower, with economic growth now running at a pace that is close to potential growth rates and not rapid enough to repair quickly the substantial economic damage remaining from the crisis.

Economic recoveries that follow financial crises are typically slower than those that follow other types of recessions. This is because of the headwinds to growth that are generated by the necessary adjustments in asset prices and in reducing financial leverage. As financial institutions

rebuild their balance sheets and households reduce debt and raise savings, spending is slower to recover. Firms, cautious after being burned by the financial panic, are less willing to invest and to hire because of uncertainty about future strength in demand for their products.

Different economies face different challenges and different constraints on the scope for economic policy to strengthen growth. However, concern about the near-term limits to more growth-oriented economic policies are greatly exaggerated. Most of us still have the capacity to take additional actions that would improve both short-run and long-run growth prospects.

The greatest risk to the world economy today is that the largest economies underachieve on growth. We need to continue providing well-targeted support for the recovery in the near term even as we put in place plans to help ensure fiscal sustainability over the longer term.

And for the recovery to be sustainable, there must also be a change in the pattern of global growth. For too long, many countries oriented their economies toward producing for export rather than consuming at home, counting on the United States to import many more of their goods and services than they bought of ours.

The United States will do its part to achieve this adjustment. Private savings have increased significantly, and, as the recovery strengthens, we will bring down our fiscal deficits to a sustainable level.

But as America saves more, countries overly reliant on exports to us for their own growth will need to change their policies, or else global growth will slow and all of us will be worse off. Countries that chronically run large surpluses need to undertake policies that will boost their domestic demand.

The flexibility each major economy has to provide a greater catalyst to growth in the near term or to slow the pace of near-term fiscal restraint depends on the size of its long-term fiscal problems and the credibility of its plans to address those problems over the medium term. Even if the risks to a sustained global recovery look relatively low, it makes sense for policy makers in the major economies to continue to focus on strengthening growth, rather than risking a premature shift to restraint.

That brings me to the second policy challenge: we believe it is very important to see more progress by the major emerging economies to more flexible, more market-oriented exchange rate systems. This is particularly important for those countries whose currencies are significantly undervalued.

This is a problem because when large economies with undervalued exchange rates act to keep the currency from appreciating, that encourages other countries to do the same.

This sets off a damaging dynamic, described first by my former colleague Ted Truman, as “competitive non appreciation.” Over time, more and more countries face stronger pressure to lean against the market forces pushing up the value of their currencies. The collective impact of

this behavior risks either causing inflation and asset bubbles in emerging economies, or else depressing consumption growth and intensifying short-term distortions in favor of exports.

This is a multilateral problem. It is unfair to countries that were already running more flexible regimes and let their currencies appreciate. And it requires a cooperative approach to solve, because emerging economies individually will be less likely to move, unless they are confident other countries would move with them.

This problem exposes once again the need for an effective multilateral mechanism to encourage economies running current account surpluses to abandon export-oriented policies, let their currencies appreciate, and strengthen domestic demand. This is a necessary complement to the adjustments being undertaken by countries running current account deficits. A cooperative rebalancing of policy in this direction would be better for overall growth.

This issue was well-known to the group of economists who gathered in Bretton Woods, New Hampshire, to refashion the war-ravaged global financial system in 1944. The Articles of Agreement of the IMF, drafted at that conference, contain a now-obscure paragraph calling on the Fund to issue reports on countries with “scarce currencies”—what today we would call countries running persistent surpluses—“setting forth the causes of the scarcity and containing recommendations designed to bring it to an end.” That clause now reads like a relic of a bygone monetary era. But the problem it was drafted to address—the threat to global financial stability posed by persistent, large surpluses—is as salient today as it was then.

This brings me to a third issue on the international agenda, the reform of the architecture of economic cooperation.

When the world’s leaders met in London in April of 2009 and then in Pittsburgh in September that year to set a strategy for confronting the crisis, they agreed to begin work on a new “Framework” for global growth and to reform the architecture for cooperation.

The Framework, called the “Framework for Strong, Sustainable and Balanced Growth,” was designed to create stronger incentives for rebalancing growth, as the world recovered from the crisis, with higher savings in countries like the United States, complemented by reforms to strengthen domestic demand in surplus countries like China, other emerging economies, Germany, and Japan.

Alongside this “Framework” we agreed to give emerging economies a greater stake in the most important institutions for economic and financial cooperation, to increase the resources available to the international financial institutions, and to make the G-20 the centerpiece of cooperation, replacing the role traditionally played by the G-7.

We agreed to pursue these two paths in parallel. Each involved a change in the rights and responsibilities of the major economies, both emerging and advanced.

We have made some progress on the “Framework,” but that achievement is at risk of being undermined by the limited extent of progress toward more domestic demand-led growth in the

surplus countries and by the extent of foreign exchange intervention as countries with undervalued currencies lean against the pressures for appreciation.

On the governance front, we are now making progress toward agreement on a very important set of reforms to create a stronger IMF. These changes would strengthen the financial position of the Fund, allow it to respond more quickly and forcefully to future crises, and give the fastest growing emerging economies greater weight in the institution and a greater share of seats on the Board.

We want to make sure these changes go far enough in rebalancing rights and responsibilities of the members of the institutions. And for this reason, an agreement to modernize the governance of the IMF needs to be accompanied by more progress in encouraging countries, particularly the surplus countries, to pursue more market-oriented exchange rate policies and policies that will reduce reliance on exports and strengthen domestic demand.

We will be exploring with the other major economies some suggestions on how best to advance these objectives.

I want to conclude by emphasizing that we recognize the special responsibility of the United States for contributing to a more stable global financial system and a more balanced and sustainable pattern of growth.

We have moved aggressively to do our part to help bring the world out of crisis. We are working very hard to repair our financial system, to fix what was broken, and to reduce the future risk of financial crises here at home. We have seen a very significant increase in private savings by households. Our external deficit has fallen sharply, and we are financing at home a much larger share of the fiscal deficits we inherited.

We still have a lot of challenges ahead of us to strengthen growth and to restore fiscal sustainability. And we expect to work closely with Congress in the months ahead on how best to move forward.