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THE STATE OF THE GLOBAL ECONOMY: A CONVERSATION WITH SECRETARY OF THE TREASURY TIM GEITHNER

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Introduction:

KEMAL DERVIS
Vice President and Director, Global Economy and Development
The Brookings Institution

Moderator:

DAVID IGNATIUS
Columnist
The Washington Post

Featured Speaker:

TIM GEITHNER
U.S. Secretary of the Treasury

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P R O C E E D I N G S

MR. DERVIS: Good morning, everyone. It's a great privilege, honor, and pleasure to welcome, on behalf of Brookings, Secretary Geithner this morning, and also David Ignatius from the *Washington Post*, and all of you.

Welcome at an interesting moment when the IMF and World Bank spring meetings are going to take place in just a few days at a moment of the world economy where there is some good news, particularly in the United States. But still, a lot of soft spots. Still Europe is a big worry, and in some of the emerging markets we see a market slowdown also. So, I think we're not out of the woods in terms of the world economy. And it will be, I hope, fascinating I'm sure, fascinating to listen to the exchange between David and Secretary Geithner. And then you'll be invited, of course, all to come in.

Mr. Geithner is the 75th Secretary of the Treasury of the United States. Before serving at the Treasury, Mr. Geithner served as the President and Chief Executive of the Federal Reserve Bank of New York. In that capacity, he served as the vice-chairman and a permanent member of the Federal Open Market Committee, the group responsible for monetary policy. Secretary Geithner had a long career at the Treasury but also worked at the IMF, directing the Policy Development and Review

Department, so he has very strong both international and national experience, bringing it together. Secretary Geithner studied international economics and East Asian studies at Dartmouth and SAIS.

The event will take place in the form of a conversation with David Ignatius from the *Washington Post* whom many of you, I'm sure, or maybe all of you know; he writes twice a week for an affairs column and contributes to post-partisan blog. David has also written eight spy novels, the most famous of which is probably *Body of Lies*, which in 2008 was made into a Hollywood film starring Leonardo DiCaprio and Russell Crowe. I told him before the meeting that I was really very jealous of that.

Ignatius joined the *Post* in 1986. In 1990 he became Foreign Editor, in '93 Assistant Managing Editor for *Business News*. He began writing his column in '98 and continued even during his three years as Executive Director of the *International Herald Tribune* in Paris. Earlier in his career Ignatius worked at the *Wall Street Journal* covering a large area of topics. He studied political theory and economics at Harvard and Cambridge. So, welcome again, many thanks, and up to you.

MR. IGNATIUS: I'm always happy to be linked to Leonardo DiCaprio in any public setting. Mr. Secretary, as Kemal says, we have the IMF and World Bank convening here. There's great curiosity about the world economy but I want to start with the U.S. economy and ask you about the growth picture. The IMF's latest forecast is for growth this year of 2.1 percent. Consensus estimates all seem to be under 2.5 percent. We had signs of faster growth in last year's third quarter but then slowing, and I'd like to ask you the basic question I think everybody has which is what's going on? What's your mental snapshot of the U.S. economy right now?

SECRETARY GEITHNER: Well, the U.S. economy is gradually healing, gradually getting stronger. Growth has averaged about 2.5 percent since the recovery began, slower than the average of recoveries in the post-war period. Why has it been so moderate? Really, the following reasons: one is the basic reality that when you're digging out of a financial crisis caused by too much borrowing, too much leverage, and the economy built too many houses, you face a lot of headwinds as you work through those imbalances and that makes growth slower than it would normally be. Because people are bringing down debt, saving more, spending less, and they're naturally more cautious in that context. That's very important to understand, and the paradox in that is that the weakness that induces temporarily should be a source of strength going forward. And as you know and many people have written, we're much further along in that adjustment process than are many countries, so we've brought down risk in the financial sector quite dramatically. You know, we're four years into the adjustment in housing, and even individuals are bringing down their debt levels quite a bit. So, that's good.

We also got hit by a series of pretty substantial external shocks in 2010 and '11. Europe's crisis, Japan and oil; those are large enough to bring down the rate of growth quite significantly in the United States. And then we had, of course, the debt limit drama of last summer which was very damaging to consumer confidence at a time when the world was very fragile.

Those are the main reasons why recovery has been more moderate than you might have thought, just thinking about an economy coming out of this crisis. But we're making quite a bit of progress. We're in a much stronger position than we were six months, a year, eighteen months, two years ago.

And if you look at the basic indicators of economic strength in the United States, what's encouraging about it is that the strength is pretty broad based. You see it in manufacturing, in high-tech, agriculture, energy. Private investment growth has been pretty strong, actually. Even job creation in the private sector has been relatively strong since the re-start, and export growth is pretty good, and productivity measure is pretty encouraging.

Where there's weakness, still, in housing and construction, it's understandable. Necessary as we work though these imbalances, so I think we should find that pretty encouraging.

Again, just to finish this, still some risks and uncertainty ahead. Obviously, Europe's going through a very long protracted difficult set of challenges. Although oil prices to date didn't look like they've had a materially significant negative effect on overall growth so far, there's still a lot of uncertainty around oil markets. And as everybody is sort of becoming aware, if you look forward to the end of the year in the United States, you face the expiry of a substantial number of tax cuts, the potential impact of a large automatic kind of spending. Another debt limit debate, and it will be a big test of Washington. Big test of the capacity of this country to govern itself in how Washington deals with those challenges. And, you know, hopefully, we use it as an opportunity to make another significant step toward long-term fiscal reform at that time.

But the engine of the American economy, the engine of the private sector, is humming along. And obviously the more we can do to reinforce that and, you know, we're just going to keep looking for opportunities with Congress to try to get Congress to approve additional measures that would strengthen the pace which we're growing and therefore bring the unemployment rate down more rapidly than it's coming.

MR. IGNATIUS: You and I were talking the other night informally about the famous Cain's definition of an economy that's growing robustly. The animal spirits of investors who see a chance to make money next quarter and so invest. And then you get this viscous cycle, and we see a restraint in investor behavior. Yes, investment numbers are up, but I'm wondering if you could just speak a little bit to the concern many people have that we're in a new normal. That the animal spirits are going to be less animalistic for a while. People are going to accustom themselves to lower risks, lower rates of return. It's just a different kind of economy. Do you think that's a correct picture?

SECRETARY GEITHNER: Well, I think there's something to that but I think it's overdone in the context of the United States. Again, remember the forces that produced the growth of the previous decade coming up to the crisis were really unsustainable, untenable. And that created a set of expectations about future performance in the financial sector and other sectors of the economy that was not plausibly sustainable over time.

So, there's been a bit of gravity in expectations as people think about what it's going to take for us to grow in a more balanced and sustained way going forward. You know, we can't have an economy where we expect growth to come from sustained borrowing by individuals relative to income to finance over-investment in housing. Not a plausible long-term strategy.

So, again, I think the broad adjustment you're seeing in the U.S. economy we should find encouraging. You know, it's more investment and export led. It's coming with an improvement in private savings rates, even the beginnings of improvement in public savings. Public fiscal debt is coming down. That's encouraging. People are bringing down their debt burdens. The financial sector is much more stable. And, you know, we have a resilient, very dynamic American economy. You can see that, again, across the broad strength you're seeing.

And I think if you look ahead, you know, the world is, I think, still at the early stage of what's going to be a very long period of pretty substantial rates of growth in the emerging world and the most populous parts of world. And we are better positioned than most developed economies to take advantage of that. And that's partly why you're seeing the strength you see today, again, in agriculture, in manufacturing, and hi-tech in the United States.

MR. IGNATIUS: Let me ask you about the year-end set of interlocking crises that you mentioned. In the newspapers we've been referring to that as Taxmageddon with our usual restraint. But there are a lot of uncertainties that are out there. And you could argue that the

President, by introducing the idea of the Buffett Tax, 30 percent minimum tax for millionaires, is adding to that sense of uncertainty as we head toward year-end. I want to ask you to address that question. Is it just unlikely that we'll see some firming of business confidence until these issues are resolved which probably will be after our presidential election? And on the question of the Buffett Tax, a lot of people have wondered why the President hasn't looked instead toward more comprehensive tax reform? A lot wrong with the U.S. tax system. You could argue that equity is part of what's wrong, but why this limited approach to a big problem?

MR. GEITHER: Good questions and thanks for raising them. You know, among the challenges we face as a country -- they're not the only challenge we face -- is trying to find a way to build political consensus around a balanced mix of tax reforms and spending savings to restore sustainability to our fiscal position. As I said, it's not the only challenge we face. It's not the most urgent challenge we face, but it'll be critical going forward.

And at the end of the year we have this huge incentive, huge opportunity to try to get people to come together and, again, make some progress in that direction. For that to happen, you're going to need some additional revenues through tax reform alongside some significant savings across all parts of government; health care, all the other things that dominate the spending picture of the government. But they have to happen together because I think it's untenable to ask people to bear the burden of the significant savings that are going to have to come -- across the government which can affect all parts of the American economy and middle class families unless that's accompanied by some shift towards a modestly higher burden of taxation on the most fortunate Americans. I just don't see how you justify it economically. I don't know how you do it politically unless you have that combined package. So, as part of that process, what we've been trying to do is lay the foundations for the debate that's going to have to come on tax reform.

Now, the President has proposed very detailed, very comprehensive tax changes. Letting the Bush tax cuts expire for the top 2 percent of Americans, and a significant limitation in the ability of that 2 percent of Americans to take advantage of deductions and exclusions in the tax code. We think that's the necessary and essential element of tax reform alongside changes on the business side that would lower the rates and broaden the base and clean up all the corporate wealth on tax code. Create strong incentives for investment.

So, the two basic centerpieces of reform that are going to have to happen are ways to restore a greater degree of proclivity in tax code with a modest increase in the effect of tax rates of the most fortunate Americans. That's what the Buffett Rule tries to do by making it clear that, as many Republicans have said, that you need to limit the deductions and exclusions in the tax code which disproportionately benefit rich Americans. You want to have that alongside a comprehensive business tax system which would lower rates, broaden the base, and improve incentives for investing in the United States.

And what we're trying to do is, again, lay the broader foundation for those reforms, so that when we're better positioned at the end of this year to set up a process that would move in that direction. But those should be alongside of, not a substitute for, a broader set of savings on the spending side.

Just one last point on this. All of the bipartisan proposals for fiscal reform share with the President's, a basic judgment that you need to have spending savings alongside some modest increase in revenues. So, everybody has looked at this, whether it's Bowles/Simpson, the Senate Six, Rivlin-Domenici, or the whole range of other non-partisan or bipartisan efforts out there, they've all come to the same basic judgment that there's no plausible way politically, and no really sensible way economically to try to restore fiscal sustainability without that. And tax reform should be part of that, but it requires some spending savings, too.

MR. IGNATIUS: So, just to clarify for our audience, am I right in understanding you to be saying that the President would be interested at year-end in a broad discussion about tax reform as you address the series of questions that you mentioned?

SECRETARY GEITHNER: Oh, absolutely. And again, I think tax reform is coming. It’s inevitable. It’s necessary. It’s all about the shape of it. And, you know, we’re going to have to make another substantial contribution on the spending side, too. And those things should proceed in parallel, and we’re going to have to find some way to put in place a framework for doing those things at the end of the year.

MR. IGNATIUS: So, let me shift now to --

SECRETARY GEITHNER: Can I say just one more thing?

MR. IGNATIUS: Yes.

SECRETARY GEITHNER: Because it's important. I think the important thing about the uncertainty that people see ahead at the end of the year and I would just say that I don't think there's any plausible argument today in the behavior of businesses and the broad behavior of the American economy. Wherein financial markets you can see much evidence really and any evidence of that uncertainty about the ultimate resolution of our fiscal problems materially affecting economic growth or behavior. I don't -- it just doesn’t exist today. No evidence -- it might come in the future, but not today. But I was going to say the big source of uncertainty around this and I think what people can do to provide a little more reassurance and balance and context is that -- or around the debt limit and the potential scope of changes on the tax side, to some extent the pace of the declining deficit.

So, let me just say that the three things that would be reassuring and helpful for markets to hear from politicians in Washington are the following: one is that Congress will pass the debt limit without all the drama and politics and damage that Republicans and Congress imposed on the country last summer. Two, it's important to recognize that the tax proposals we're debating would affect 2 percent of American individual tax payers, 2 percent. They would involve a modest increase in the effective tax written on those Americans. About 3 percent of small businesses affected, very small fraction of the American economy affected by those changes. And the third thing is, and this is very important too, is to recognize that when you restore fiscal sustainability like this, you've got to do it in a way which is calibrated to the strength of growth and recovery. Because if you cut too quickly, if you try to bring about too precipitous a withdrawal of fiscal stimulus in that context, then the risk is you do damage to recovery and you undermine the objectives you're trying lay forward. So, those three things are important for you to recognize. And if people in Washington can emphasize a commitment to those basic three tenets, then that will help reduce some of the uncertainty around what might happen at the end of the year.

MR. IGNATIUS: I want to turn now to Europe, which is a source of great interest and some concern is the IMF and the World Bank gather for their meetings. Olivier Blanchard, the IMF economist in his latest analysis, just out in the last few days, notes the problem of investors demanding fiscal consolidation, fiscal cuts, and then getting upset at the slower growth that results from those cuts. It's kind of a trap that if you do what you're required to do then people are upset with you. And I want to ask you more broadly, looking at the situation in Europe and the risk of very lowered declining growth, what do you think, what's the United States think, is an appropriate response beyond what's being done now?

SECRETARY GEITHNER: Well, excellent question. I think it's the centerpiece of the policy choices you face now, going forward. You know, they have put in place a stronger set of tools for managing this crisis, stronger set of financial tools, stronger firewall if you look at the combined force of the ECB and what the governments have put together in terms of these funds, better tools, and they have governments that are doing some very tough things on the reform side. And I think the governments of Europe were helping support those reforms, have a lot more confidence in the governments for example in Spain and Italy now with what they're trying to do, which is good. But it's very important to get that balance right between, just to say it more simply, growth and austerity. And what you want to do is avoid a situation where since there's a risk of a prolonged period of economic disappointment and weakness on the growth side in many of those countries. You want to avoid getting in a situation where, since economic weakness produces in the short-term, larger deficits than you had hoped for, you don't want to have to offset that increase in the deficits with immediate difficult cuts and spending or taxes right away.

The best way to do it is to respond to those with some gradually phased in, medium term plans for reform. If you try to do it all upfront, then the risk is, again, you're undermining the prospects for some stability and growth, some recovery growth, and you may end up undermining and setting back the cause of reform. In addition to that, of course, as you've heard from all these debates, it's very important there be a clean and unequivocal commitment by the Central Bank and the broader fiscals in Europe that they're going to provide the financial commitments necessary for those governments to be able to borrow at sustainable interest rates and for those banking systems to be able to fund and to function. And those two things are critically important for this very difficult and very protractile process of reform to have any chance of traction.

And again, just to emphasize what the governments of Italy and Spain are doing are very difficult. They're very tough, but I think they're quite promising in many ways. Because you're seeing them kind of confront, not just the sustainability problems on the fiscal side, and not just the problems in the financial sectors, but they're trying to put in place a set of reforms in the labor markets and over the broader business community that'll make it easier for them to grow in the future, easier to start a business, for example, and to hire people. And those things are important and promising, but very difficult, tough long road, very fragile, very tough politically and it's important that they get a little reinforcement along the way.

MR. IGNATIUS: We seem to go week by week in our monitoring of the European crisis. And so, in that context, I'm interested in what you're hearing as you talk over these last days with European finance ministers and with ECB chief, Mario Draghi, about what's happening in these economies.

SECRETARY GEITHNER: Well, again, I would say that the really most important change that you've seen over the last six months is, I would say the governments of Germany and France and the ECB, have a lot of confidence in what the new governments of Italy and Spain are doing. That's very important because without that it's very hard to get anything to come together and that's very important.

And the other thing they've done is, as I've said, they've put in place a better set of tools. They're in the early process still of building the architecture of a set of things that will make the monetary unit work in the long run. But they're in a much better position in terms of this mix of financial tools than they were just six months ago or so. And those are very important things and the combined effects of those actions have been to calm significantly the tensions of markets that you saw periodically in 2010 and 11. But, you know, you can see every day of course the recognition. This is going to be a long difficult protractile process, politically very difficult. And it's going to just require some reinforcement, sustained effort over time.

MR. IGNATIUS: And so, to sum up, am I right in taking from what you've said, a sense that Europe has turned the corner in terms of the severe liquidity problems that were evident several months ago?

SECRETARY GEITHNER: Well, I think what they've done is they've done a better job of reassuring the world that they're going to take the risk of catastrophic failure out of the plausible range of outcomes, out of the markets in some sense. Catastrophic failure meaning, you know, cascading defaults by governments or systematic collapse of financial systems or the dismembering of the euro. They've worked very hard to take those catastrophic risks out of the market. That's absolutely essential, necessary. Nothing is possible without that reassurance. They're going to have to keep working hard to do that. And even when they achieve that, they're still left with formidable -- a very difficult set of reform challenges. But even there they've got a better set of tools in place to help reinforce those reforms.

MR. IGNATIUS: Let me ask a final question from me and then we're going to turn to the audience for your questions. And I'd like to ask you about the final big piece of the global economy and that's China, two things of particular interest now. First, the Chinese announced last weekend they were widening the band within which the RMB can move and I'm wondering whether and to what extent that addresses longstanding U.S. concerns about the value of the yuan and the way in which it's allowed to trade. And then, more generally, there's a growing discussion about whether the Chinese economy is slowing; it seems to be from looking at the latest figures. And if it's slowing, whether it's heading for what we call a soft landing, soft decline, or whether the concerns that your analysts have, that you have, that there could be somewhat more trouble ahead for the Chinese economy.

SECRETARY GEITHNER: Good question. I think the cumulative effect of what China's done on the exchange rate side, on the external side, is very significant and very promising. So, let's just review what they've done. They've allowed the dollar to -- the remedy to depreciate against the dollar in real terms about 14 percent since June 2010. If you look back relative to 2005, it's more like 45 percent, pretty significant adjustment in real terms.

They have begun to significantly loosen the comprehensive set of controls they have in place on capital movements and they build on people to use the RMB borrow and lend in RMB. They have widened the band to allow the market forces to play a greater role in setting the exchange rate. They have been, at least over the last six months or so, intervening significantly less. Their current account surplus has come down dramatically and the expected surplus going forward has come down really quite significantly, too.

So, those are important and promising and I think they signal a continued commitment by the Chinese authorities. Even though, they're going through this political transition to this broad change in growth strategy towards a growth strategy less dependent on external demand, more reliant on the market, more focused on domestic demand and that's encouraging. Obviously, they've got a long way to go in that process, including on the exchange rate, not at the end of that process.

On the growth front, it's a good question and I don't claim any particular feel for it right now. I think that it's absolutely true the growth has slowed, particularly in the early parts of the first quarter. But I think most people look at China -- and most people in China with a feel for this are really quite confident that you're going to see this economy growing, you know, in the range of 7 to 8.5, 9 percent over the medium term. And I think that's a realistic forecast as long as Europe is still making some progress and working through its crisis.

MR. IGNATIUS: And again, to clarify, you used some very positive language in describing Chinese moves on the currency front, very, very significant, very promising you said, which leads me to ask, if the Chinese continue to do this series of incremental steps that are having a significant broad effect, is that sufficient to meet the longstanding U.S. demand that the Chinese allow their currency to trade more freely?

SECRETARY GEITHNER: It just means we're on the right path. You know, none of us know --

MR. IGNATIUS: Right. But if they keep on that path, are they going to get to where we want them to be?

SECRETARY GEITHNER: Well, depends on how long they stay on that path. I mean, I think that you don't know with certainty how far that process should go and that's an assessment. People have to make a ruling basis over time. What you can tell about the reality today is that they’ve moved some distance. They're planning to still move further. I think they recognize they have to go further. I think all the available evidence suggests they have to go further on the exchange rate and I think, again, the key thing -- you know, we like to remind people that nations act in their interest and their own perceived interest. And I think China has made the basic judgment that it is essential to the long-term interest of China, economical interest of China, that they create an exchange rate that gives it the independence to run economic policy in China to suit Chinese conditions, not American conditions or European conditions, Chinese conditions. And that requires the gradual loosening of this link to the dollar and that's why they're embarking this path. And, as I said, you know, again, significant and promising but they're not at the end of this process, a reform.

MR. IGNATIUS: So, I want to go to the audience for questions. This is the Treasury Press Corp's best chance to pound their secretary with questions before the meetings take place. So, if there's anybody from the Press Corp, I want to make sure to recognize them, but hands in general. I see a hand back there. Yes, please?

MR. TALLEY: Ian Talley, Dow Jones. I'm not sure about the hounding, but given -- the EU used recent efforts to temporarily raise its firewall, there seems to be a dam-breaking on raising IMF funds at least in a limited way. What specifically, besides pacing fiscal consolidation and more LTROs, are you going to press Europe for to encourage their prospects?

SECRETARY GEITHNER: Well, again, I would say looking forward -- but these are choices Europeans have to make. Looking for what the challenges are ahead. The challenges are obvious. They are to put in place this set of policies reinforced by financial assistance. It'll provide a better foundation for growth over time. They have to put in place the institutional frame to allow monitoring to work. And that means a better developed mechanism for fiscal discipline and fiscal transfers and a means of more integrated unified capacity to run a financial system. Those are very important. They're starting to build that architecture, those reforms, but that's still ahead of them. But, you know, they're very much aware of these challenges and I think they've -- again, I think they've made a very credible commitment to do what it takes to make this process work. And they obviously have -- they absolutely have the will and the ability -- financial ability, economic ability -- to make it work.

And, of course, no one can feel more strongly about that than the Europeans themselves, because they have such a huge interest, strategic interest, in making this broader endeavor of economic union, monetary union, work.

MR. IGNATIUS: Other questions? Yes, please.

MR. FEINBERG: Hi. My name is Michael Feinberg. I'm a student at the George Washington University.

I had a question about mortgage write-downs, if the administration is considering any additional programs? And if you believe that they would have a significant effect on the broader economy?

Thank you.

SECRETARY GEITHNER: The housing market is, you know, still very tough in the United States, still a long way to go to work through the big overhang you're seeing in housing.

And we think the most promising way is to help facilitate that processes are, one, to help Americans who have income and can afford to stay in their home to stay in their home, get a modification of the mortgage that allows them to do that; to help more Americans refinance and take advantage of, you know, historically low mortgage rates even if they're deeply under water; and to move this very large stock of unoccupied homes -- the legacy of the crisis -- to move that into the rental market where there's a lot of demand, of course, and a lot of shortages.

There are many other things we can do, but those seem to be the core of what's happening.

And as part of the first of those, which is to give people a chance to face a more sustainable, affordable set of mortgage obligations, we think there's a case, in some circumstances, for making principal reduction a part of that. We've done that in the programs we run at the Treasury. We've seen quite a lot of that in the markets, as banks and investors make the same judgment themselves that it's in their interest, over time, to do that. And we're working, as you know -- as you must know -- with Fannie and Freddie and their oversight bodies to make the economic and the financial case to them that this would be a useful part of what they're trying to. And it would probably -- almost certainly improve -- overall returns to the taxpayer in those companies.

The number of families who would benefit from that are significant -- not overwhelmingly large, but significant. And our basic approach on housing is that we're going to keep at it until we see a much more durable set of improvements coming.

And any place we think there's a way we can help facilitate that process -- help more people stay in their homes, help facilitate transition to other forms of housing, help repair and heal the damage -- we're going to keep doing that as long as we have the authority to do it.

I should say that there's a bill being considered in the House today that would end the Government's authority in the housing market, which would be very damaging. I mean, to right now, at this time, with the economy where it is, with unemployment where it is, with housing where it is, with the scars and the damage and the legacy of the crisis still so damaging and so apparent to many Americans -- to stop the Government from having the ability to help ease the transition in this cause would be very damaging to recovery. And there's no plausible economic or financial case for doing it.

MR. IGNATIUS: Since you've mention the "U-word," "unemployment," I really ought to ask you, given the growth forecasts that we're looking at for the rest of this year -- and, as I mentioned earlier, the IMF is projecting 2.1 percent for the year for the U.S., and consensus forecasts range between that and 2.5 -- what does that imply for the likely rate of unemployment through the year?

I mean, put a different way, that doesn't imply much improvement in the likely rate of unemployment through this year, does it?

SECRETARY GEITHNER: You know, I don't ever talk about forecasts. But if you look at what the IMF and the broader community of private forecasters say about the U.S. economy now, they see an economy that's growing between 2 and 3 percent. And where it comes out in that range will determine the pace at which you see more people get back to work, and the pace at which unemployment comes down.

For unemployment to come down at a significant pace, you need to be growing, you know, significantly above 2-1/2, 2-1/2 percent. If the world conspires against that, and some mix of oil, or Iran, or Europe slow the momentum here again, as it did before, then you'll be at the weaker end of that range.

But, still, again, just to try to emphasize what's promising -- again, we're in a much stronger position to deal with even those challenges, those uncertainties, than we were even six months or a year ago. And, you know, most things you can look at and measure in the U.S. economy today suggest more resilience, even though, you know, we've got a lot of challenges still ahead of us.

MR. IGNATIUS: There was a gentleman behind you, and then you, sir. Yes -- Fred.

MR. BERGSTEN: Fred Bergsten from the Peterson Institute for International Economics.

Tim, I think it's fair to say the major operational question at the IMF meetings this weekend will be possible augmentation of IMF resources to build an additional firewall to help cushion possible effects from Europe.

Two aspects of that: You have taken, I think, a strong position that the U.S. itself will not contribute to that augmentation of IMF resources. I happen to think you're exactly right. This is a liquidity issue, and the funding ought to be provided by surplus and creditor countries. The U.S. is a big debtor country, has their own deficit problems. So it's quite appropriate, I think, not to contribute -- I think you're right on that.

But the second issue is the creation of the firewall itself, the increased IMF facility, and how big it ought to be.

And, there, I've been puzzled, because I think it's fair to say you have not been very enthusiastic about that. In some senses, you've even discouraged creation of a very large, very rapidly available set of additional resources. And I'm puzzled about that. I would have thought you would go after the surplus, creditor countries -- China, Japan, oil exporters, many others -- to put up as much money as possible to support what the Europeans are doing, in order to try to avoid the spillover to our own economy and others.

So, would you kind of explain why you're not out there leading the charge to put together an additional big firewall to support what the Europeans are doing themselves?

SECRETARY GEITHNER: Okay, good questions. So let me try to explain our basic strategy in this case.

There are two things the world is doing for Europe now which are very important. One is, we are -- and we are very supportive of the IMF playing a significant role in reinforcing the reform process in Europe. It's a supplementary role to the European financial role. It's not the dominant financial role that's appropriate in that case, but it's a significant financial role in that context.

We've been very supportive of that, and will continue to be.

The second thing that's been happening, which is, I think, as significant in this case, and something only the United States can do, is the Federal Reserve, as it did in '08 and '09, has given the Europeans unlimited access to dollar swap lines, at a critical moment where funding concerns in European banks which have very large external assets funded in dollars were under a lot of pressure. That's something only we could do. We did it early, a very, very powerful, substantial scale. And the Feds indicated that they will leave that framework in place as long as it makes sense for them to do that.

Now, the IMF is in a very good position -- I think you're can see based on the commitments you're going to see people talk about this week -- to demonstrate to the world that it can, although it has $400 billion in available resources today, a very substantial pool of money relative to, I think, any other time in the IMF's history, it has the ability to raise additional finance from other countries very, very quickly if it needs to do that.

And I think that's good. Because that will prove to the world that there is a substantial capacity that can reinforce what the Europeans are doing, and help cushion, if necessary, the effects of any European trauma on the rest of the world. And were very -- we're actually very supportive of that process, and will be very supportive of it this week.

Now, what we have been -- just to be honest about it, and be direct about it, what we did not want to see is people look to the IMF as a way to substitute for a more forceful European response. We didn't think that would be tenable, not fair, not really realistic or plausible were we to agree to do that.

And so, where you've seen the United States -- and this is true for China, and Japan, and the other major emerging economies -- a little reluctant to move ahead of Europe, it's because of that basic recognition that, you know, Europe is a relatively rich continent. It absolutely has the financial resources to manage this problem. It's got to play the dominant financial role. And we wanted to see them put a more forceful commitment behind that basic reality, financial reality, before the IMF came in and said, okay, they'll do what's necessary to help make sure they can reinforce and supplement that role, and cushion the effects on the rest of the world.

So that's the rationale for our strategy.

One last point -- the economics of a swap line that the Fed provides the European Central Bank, and the national central banks, and the economics of a country that lends money bilaterally to the IMF, are not very different. Because, you know, when you lend money to the IMF, you have a liquid, interest-bearing claim on the Fund which you can draw on, if necessary. It has the characteristics of a swap, in some ways.

We're the only ones providing assistance directly to Europe. Other countries are not willing to do it directly, they're only doing it through the IMF, in that context. And, of course, what the IMF does is backed up by the United States in significant effect.

So, it's a mistake to look at this and suggest that the United States is holding back from, and standing apart from, this broad effort. We have been, as you know, central to the broader effort by the world to help reinforce what Europe is doing. And we're doing it in ways that are most effective for what Europe needs right now -- available early, and in very substantial force.

And those swap lines have made a very important role in dampening and cushioning the effects of Europe's crisis on the rest of the world, because it diminishes the need for European banks to dramatically reduce their external assets very quickly, which would have put a lot more downward pressure on the global economy.

MR. IGNATIUS: Ambassador Fujisaki, please.

AMBASSADOR FUJISAKI: Now, this is not a question to the Secretary, just to comment on Fred Bergsten's point.

As you know very well, we have just announced $60 billion contribution of the IMF, as we have done in 2008 after Wall Street crash. We were the first one to come to the assistance, too, of the IMF.

Thank you very much.

MR. IGNATIUS: Thank you, Ambassador.

Yes, sir -- in the third row.

MR. MOODY: Jim Moody.

We're all aware of how the discussion of the deficit have been a force of its own on Capitol Hill, and a lot of very shallow things have been announced about the deficit that show very little understanding. And I don't think the public has been given a good education on it, either.

Obviously, what is the right size of the deficit, or what is an acceptable size of the deficit has not been a clear public discussion at all.

On the one hand, we don't want the deficit to get too big, but using the analogy of the home credit-card bill is totally wrong. We're a reserve currency country, and we're lucky to have that. And the deficit, in some sense, is a matter of foreign trade. We're providing liquidity -- I'm sorry, we're providing parking of value, and that's valuable, per se, to park safely something for someone while they don't need it right now. And, in turn, for that we're getting liquidity that we wouldn't otherwise have.

So it's an international trade issue, in some sense. Both sides benefit.

So the proper size of the deficit is not zero. But how big should it be? And what is the span within it which is a -- it's an extremely productive element of our economy, and yet it's being demonized constantly in the most radical terms. And the press never seems to explain the fact it's an international trade concept. The question is, what are the limits?

And that public debate doesn't take place on Capitol Hill. It does not take place in the press. We need this, as a country, to have a rational discussion about what is, what are the limits, up and down, of the proper size of the deficit?

SECRETARY GEITHNER: You're lamenting the quality of public debate in the United States about economic policy (laughter), which you're right to do.

In terms of the fiscal deficit, the minimal acceptable anchor for fiscal policy should be the following.

You need to reduce the deficit to a level where the debt stops growing as a share of the economy and can start to come down. And for a country like the United States, that means we have to have a deficit that's slightly below 3 percent of GDP, and we have to hold it over that level. You know, we're slightly above 8 percent of GDP now. We have to bring it down slightly below 3. And we have to do that in a timeframe whereby the debt stabilizes at a level that's acceptable and stops coming down.

So, again, if you look at the path we've laid out for the country on CBO's metrics, metrics scoring, the President's policies would reduce the deficit to below 3 percent of GDP in, I think, 2016, hold it there over the rest of the decade.

And what that means is that debt held by the public would stabilize in the 70s -- 70 percent range as a share of GDP, high 70s, and then gradually start to come down over town.

Now, if we were to do that, and to achieve that, that would be a very consequential step. It would still leave us, in the outer decades, with what are still unsustainable rates of growth in health-care spending for retirees, where we've made some significant steps, in the Affordable

Care Act, to bring down the rate of growth in cost. But, obviously, we'll have to do more over time.

And, again, that's why I think the right way to think about the fiscal challenges ahead is, first, put that in perspective. Don't put it ahead of everything else we face. Recognize you have deal with them -- to do them sensibly, you have to deal with them in a way that's balanced, which has a mix of spending savings, tax reform, and it preserves room for us to invest in the things that are important for us to grow, make sure we're not eroding what's still a very thin safety net in the United States. You know, poverty in the United States is alarmingly high. It's worth reminding Americans that even before the crisis, 20 percent of American kids were born under the poverty line, families under the poverty line. And 40 percent of American children born -- again, before the crisis -- born to families that qualify for Medicaid.

So, the case for balance in fiscal reform, you know, it's not just an economic case or a political reality, but there's a very important moral question, and pragmatic economic question, about how you preserve room to make investments to grow in the long run -- like infrastructure, and education innovation -- and how you make sure you're protecting critical aspects of the safety net, not just for low-income Americans, but for middle-class retirees going forward.

And that's why we think there needs to be a more balanced approach to fiscal reform over time.

MR. IGNATIUS: The gentleman in the first row, and then, madam.

MR. KODEI: Hata Kodei, from Hitachi.

I'd like to ask you your thoughts about the TPP. The U.S. now has played a key role in TPP negotiation.

When it was formed, how do you think it will get impact to the U.S. economy?

SECRETARY GEITHNER: Well, I think the two promising things that have happened on the trade front over the last couple years which are really important are, one, we were able to negotiated and get Congress to pass a series of trade agreements with Korea and Colombia and Panama that had been pending, as you know, for a long period of time. And the U.S. had essentially frozen in its capacity to negotiate export-expanding trade agreements for the American economy.

And getting those agreements done is very important, because without that, why would any country be willing to take seriously an American commitment to negotiate? So that helps.

And the second is that we've seen, you know, a lot of support in Asia for this trans-Pacific partnership. You know, it's obviously going to be for a long period of time the most rapidly growing part of the global economy. We have huge economic interests in being part of that expansion. And we think we can use that agreement to set higher standards in the trade area for a number of economies that, itself, we hope will provide an incentive and anchor for reform, economic reforms, in the region.

So, you know, it's overwhelmingly good economic policy. And it's good strategic policy, too, for the United States. And we're hopeful that, you know, by the end of this year we'll be able to put in place the basic foundation of that agreement.

MR. IGNATIUS: Madam, in the fourth row -- yes, please.

MS. DONALDSON: Hi, I'm Nancy Donaldson, from the ILO.

And, so I want to go back to David's point about unemployment, but from a global perspective.

President Obama, at the Summit of the Americas, over the weekend talked about the importance of coming together and really tackling the issue of global unemployment issues. And I know that this administration has brought those issues to the Congress, as well.

We know that, in addition to the IMF and World Bank meetings, that the G20 finance ministers are meeting in the next couple of days. And I just wanted to ask you if you anticipate, on the agenda, having some discussion about global recovery that promotes job creation, and that that kind of growth has an emphasis?

SECRETARY GEITHNER: Very good point. And, of course. So let me just say, from the U.S. perspective, the dominant, overwhelming imperative for the global economy now -- as it has been for the last three years or so -- is to lay a foundation for strong growth across the world. There are other challenges, too, but that has to be central to the agenda, of course.

Now, you know, for that to happen, and for that to translate into broad-based gains in income and better opportunity for Americans, and better employment outcomes, you need to see growth complemented by things like better education outcomes, better education opportunities, better training opportunities.

You know, I think if you -- you know, the world economy has gone through several periods in history where you had dramatic increase in economic integration, dramatic changes in technology. And where those translated in the long periods of growth in incomes, average incomes, and, you know, broader economic opportunity, it was because those big changes in the dynamics of economic growth were accompanied by things like universal access to primary education, or things like the basic elements of the safety net to provide retirement security or health care security, things like that.

So, again, one reason why this debate about fiscal -- about growth, the balance between growth and austerity, and the debate about the shape of fiscal for the United States is so important is to recognize that you've got to make sure you're creating better conditions for economic growth, for better outcomes in terms of opportunity, and better prospects for broad-based income gains. And that should dominate the economic agenda in the United States and countries around the world for a long period to come.

And, again, that's why this debate we're going have in the United States is so important. It's why the shape and the context of these fiscal reforms are going to be so important.

MR. IGNATIUS: I want to ask a last question. This gentleman here has had his hand up.

And I would just ask the audience, when Secretary Geithner finishes his answer, if you could remain seated while he leaves the auditorium. Thanks.

SPEAKER: Thank you for your comments, sir.

I wanted to follow up on your opening comment that you said that debt levels in the U.S. were down. I would also like to follow up on Mr. Feinberg's, I believe, question about mortgages.

When you were talking about the Treasury and mortgage debt, you talked about what you hoped would transpire going forward in the short term. But you also said there were other things that your research department was looking at.

The IMF research department has looked at the issue of debt restructuring. And your Treasury Department has looked at it. Do you feel, besides mortgage debt, that credit-card debt, personal debt, student-loan debt needs to be addressed -- perhaps after the Buffett rule is taken care of? After tax reform?

But is there anything more precise you could say about beefing up aggregate demand, both in the U.S. with spillover effects in the global economy?

Thank you.

SECRETARY GEITHNER: On demand -- let's start with demand. Good way to end your question.

What, you know, we think the most useful thing that the Congress could do right now for the American economy is pass a long-term infrastructure bill, with substantially high levels of investment over time. That would be good for aggregate demand in the short run, good for employment generation, good for long-term growth potential. That's one example.

If they authorize the Ex-Im Bank for a period of time, you'd have continued assurance of pretty carefully designed support for American exports, a world where lots of countries subsidize exports.

Those are two good examples.

Helping Americans refinance, take advantage of lower interest rates is another thing that's sort of good. It's like -- it acts as a tax cut.

You know, just under our programs, for example, on the mortgage side, the typical modification is $500 a month in lower monthly payments. A million Americans have mortgage modifications that meet that test. That's a pretty substantial boost to income. If you can provide broader-based refinancing opportunities for Americans, including those that are under water, you can have similarly powerful effects like that.

Those are things that would be good for demand.

On the mortgage side, as I said, there's a pretty good financial case, pretty good economic case for adding to the tool kit of what the GSCs are doing -- target forms of principal reduction -- alongside their existing modification programs. So we're very much in favor that, and are trying to work towards that.

If you'd look at the other aspects of the broader consumer debt market in the United States you referred to, I think the right emphasis of reform in the United States is on things that improve the ability of individuals to borrow responsibly. So, for example, in the private loan market, student loan market, we'd like to see -- and the CFPB is working on this, Consumer Financial Protection Bureau is working on this -- to see, we'd like to see better disclosure, and better protections, so that Americans who are trying to, you know, pay for their education, borrow to do that, are not more vulnerable to making bad decisions in that context.

There's a huge opportunity for sensible reforms like that, and improved disclosure, across the broader individual credit markets. And so we'll be working towards those things.

Nice to see you all. Thanks for coming.

MR. IGNATIUS: Thank you very much, Mr. Secretary.

(Applause)

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