Speech by Secretary Geithner - The United States and China, Cooperating for Recovery and Growth

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The United States and China, Cooperating for Recovery and Growth
Treasury Secretary Timothy F. Geithner
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It is a pleasure to be back in China and to join you here today at this great university.

I first came to China, and to Peking University, in the summer of 1981 as a college student studying Mandarin. I was here with a small group of graduate and undergraduate students from across the United States. I returned the next summer to Beijing Normal University.

We studied reasonably hard, and had the privilege of working with many talented professors, some of whom are here today. As we explored this city and traveled through Eastern China, we had the chance not just to understand more about your history and your aspirations, but also to begin to see the United States through your eyes.

Over the decades since, we have seen the beginnings of one of the most extraordinary economic transformations in history. China is thriving. Economic reform has brought exceptionally rapid and sustained growth in incomes. China's emergence as a major economic force more fully integrated into the world economy has brought substantial benefits to the United States and to economies around the world.

In recognition of our mutual interest in a positive, cooperative, and comprehensive relationship, President Hu Jintao and President Obama agreed in April to establish the Strategic and Economic Dialogue. Secretary Clinton and I will host Vice Premier Wang and State Councilor Dai in Washington this summer for our first meeting. I have the privilege of beginning the economic discussions with a series of meetings in Beijing today and tomorrow.

These meetings will give us a chance to discuss the risks and challenges on the economic front, to examine some of the longer term challenges we both face in laying the foundation for a more balanced and sustainable recovery, and to explore our common interest in international financial reform.

Current Challenges and Risks

The world economy is going through the most challenging economic and financial stress in generations.

The International Monetary Fund predicts that the world economy will shrink this year for the first time in more than six decades. The collapse of world trade is likely to be the worst since the end of World War II. The lost output, compared to the world economy's potential growth in a normal year, could be between three and four trillion dollars.

In the face of this challenge, China and the United States are working together to help shape a strong global strategy to contain the crisis and to lay the foundation for recovery. And these efforts, the combined effect of forceful policy actions here in China, in the United States, and in other major economies, have helped slow the pace of deterioration in growth, repair the financial system, and improve confidence.

In fact, what distinguishes the current crisis is not just its global scale and its acute severity, but the size and speed of the global response.

At the G-20 Leaders meeting in London in April, we agreed on an unprecedented program of coordinated policy actions to support growth, to stabilize and repair the financial system, to restore the flow of credit essential for trade and investment, to mobilize financial resources for emerging market economies through the international financial institutions, and to keep markets open for trade and investment.

That historic accord on a strategy for recovery was made possible in part by the policy actions already begun in China and the United States.

China moved quickly as the crisis intensified with a very forceful program of investments and financial measures to strengthen domestic demand.

In the United States, in the first weeks of the new Administration, we put in place a comprehensive program of tax incentives and investments - the largest peace time recovery effort since World War II - to help arrest the sharp fall in private demand. Alongside these fiscal measures, we acted to ease the housing crisis. And we have put in place a series of initiatives to bring more capital into the banking system and to restart the credit markets.

These actions have been reinforced by similar actions in countries around the world.

In contrast to the global crisis of the 1930s and to the major economic crises of the postwar period, the leaders of the world acted together. They acted quickly. They took steps to provide assistance to the most vulnerable economies, even as they faced exceptional financial needs at home. They worked to keep their markets open, rather than retreating into self-defeating measures of discrimination and protection.

And they have committed to make sure this program of initiatives is sustained until the foundation for recovery is firmly established, a commitment the IMF will monitor closely, and that we will be able to evaluate together when the G-20 Leaders meet again in the United States this fall.

We are starting to see some initial signs of improvement. The global recession seems to be losing force. In the United States, the pace of decline in economic activity has slowed. Households are saving more, but consumer confidence has improved, and spending is starting to recover. House prices are falling at a slower pace and the inventory of unsold homes has come down significantly. Orders for goods and services are somewhat stronger. The pace of deterioration in the labor market has slowed, and new claims for unemployment insurance have started to come down a bit.

The financial system is starting to heal. The clarity and disclosure provided by our capital assessment of major U.S. banks has helped improve market confidence in them, making it possible for banks that needed capital to raise it from private investors and to borrow without guarantees. The securities markets, including the asset backed securities markets that essentially stopped functioning late last year, have started to come back. The cost of credit has fallen substantially for businesses and for families as spreads and risk premia have narrowed.

These are important signs of stability, and assurance that we will succeed in averting financial collapse and global deflation, but they represent only the first steps in laying the foundation for recovery. The process of repair and adjustment is going to take time.

China, despite your own manifest challenges as a developing country, you are in an enviably strong position. But in most economies, the recession is still powerful and dangerous. Business and households in the United States, as in many countries, are still experiencing the most challenging economic and financial pressures in decades.

The plant closures, and company restructurings that the recession is causing are painful, and this process is not yet over. The fallout from these events has been brutally indiscriminant, affecting those with little or no responsibility for the events that now buffet them, as well as on some who played key roles in bringing about our troubles.

The extent of the damage to financial systems entails significant risk that the supply of credit will be constrained for some time. The constraints on banks in many major economies will make it hard for them to compensate fully for the damage done to the basic machinery of the securitization markets, including the loss of confidence in credit ratings. After a long period where financial institutions took on too much risk, we still face the possibility that banks and investors may take too little risk, even as the underlying economic conditions start to improve.

And, after a long period of falling saving and substantial growth in household borrowing relative to GDP, consumer spending in the United States will be restrained for some time relative to what is typically the case in recoveries.

These are necessary adjustments. They will entail a longer, slower process of recovery, with a very different pattern of future growth across countries than we have seen in the past several recoveries.

Laying the Foundation for Future Growth

As we address this immediate financial and economic crisis, it is important that we also lay the foundations for more balanced, sustained growth of the global economy once this recovery is firmly established.

A successful transition to a more balanced and stable global economy will require very substantial changes to economic policy and financial regulation around the world. But some of the most important of those changes will have to come in the United States and China. How successful we are in Washington and Beijing will be critically important to the economic fortunes of the rest of the world. The effectiveness of U.S. policies will depend in part on China's, and the effectiveness of yours on ours.

Although the United States and China start from very different positions, many of our domestic challenges are similar. In the United States, we are working to reform our health care system, to improve the quality of education, to rebuild our infrastructure, and to improve energy efficiency. These reforms are essential to boosting the productive capacity of our economy. These challenges are at the center of your reform priorities, too.

We are both working to reform our financial systems. In the United States, our challenge is to create a more stable and more resilient financial system, with stronger protections for consumer and investors. As we work to strengthen and redesign regulation to achieve these objectives, our challenge is to preserve the core strengths of our financial system, which are its exceptional capacity to adapt and innovate and to channel capital for investment in new technologies and innovative companies. You have the benefit of being able to learn from our shortcomings, which have proved so damaging in the present crisis, as well as from our strengths.

Our common challenge is to recognize that a more balanced and sustainable global recovery will require changes in the composition of growth in our two economies. Because of this, our policies have to be directed at very different outcomes.

In the United States, saving rates will have to increase, and the purchases of U.S. consumers cannot be as dominant a driver of growth as they have been in the past.

In China, as your leadership has recognized, growth that is sustainable growth will require a very substantial shift from external to domestic demand, from an investment and export intensive driven growth, to growth led by consumption. Strengthening domestic demand will also strengthen China's ability to weather fluctuations in global supply and demand.

If we are successful on these respective paths, public and private saving in the United States will increase as recovery strengthens, and as this happens, our current account deficit will come down. And in China, domestic demand will rise at a faster rate than overall GDP, led by a gradual shift to higher rates of consumption.

Globally, recovery will have come more from a shift by high saving economies to stronger domestic demand and less from the American consumer.

The policy framework for a successful transition to this outcome is starting to take shape.

In the United States, we are putting in place the foundations for restoring fiscal sustainability.

The President in his initial budget to Congress made it clear that, as soon as recovery is firmly established, we are going to have to bring our fiscal deficit down to a level that is sustainable over the medium term. This will mean bringing the imbalance between our fiscal resources and expenditures down to the point - roughly three percent of GDP -- where the overall level of public debt to GDP is definitively on a downward path. The temporary investments and tax incentives we put in place in the Recovery Act to strengthen private demand will have to expire, discretionary spending will have to fall back to a more modest level relative to GDP, and we will have to be very disciplined in limiting future commitments through the reintroduction of budget disciplines, such as pay-as-you go rules.

The President also looks forward to working with Congress to further reduce our long-run fiscal deficit.

And, critical to our long-term fiscal health, we have to put in place comprehensive health care reform that will bring down the growth in health care costs, costs that are the principal driver of our long run fiscal deficit.

The President has also proposed steps to encourage private saving, including through automatic enrollment in retirement savings accounts.

Alongside these fiscal actions, we have designed our policies to address the financial crisis to carefully minimize risk to the taxpayer and to allow for an orderly exit or unwinding as soon as conditions permit. Across the various financial facilities put in place by the Treasury, the Federal Reserve, and the FDIC, we have been careful to set the economic terms at a level so that demand for these facilities will fade as conditions normalize and risk premia recede. Banks have a strong incentive to replace public capital with private capital as soon as conditions permit.

Let me be clear - the United States is committed to a strong and stable international financial system. The Obama Administration fully recognizes that the United States has a special responsibility to play in this regard, and we fully appreciate that exercising this special responsibility begins at home. As we recover from this unprecedented crisis, we will cut our fiscal deficit, we will eliminate the extraordinary governmental support that we have put in place to overcome the crisis, we will continue to preserve the openness of our economy, and we will resolutely maintain the policy framework necessary for durable and lasting sustained non-inflationary growth.

In China, the challenge is fundamentally different, and at least as complex.

Critical to the success of your efforts to shift future growth to domestic demand are measures to raise household incomes and to reduce the need that households feel to save large amounts for precautionary reasons or to pay for major expenditures like education. This involves strengthening the social safety net with health care reform and more complete public retirement systems, enacting financial reforms to help expand access to credit for households, and providing products that allow households to insure against risk. These efforts can be funded through the increased collection of dividends from state-owned enterprises.

The structure of the Chinese economy will shift as domestic demand grows in importance, with a larger service sector, more emphasis on light industry, and less emphasis on heavy, capital intensive export and import-competing industries. The resulting growth will generate greater employment, and be less energy-intensive than the current structure of Chinese industry. Allowing the market, interest rates, and other prices to function to encourage the shift in production will be particularly important.

An important part of this strategy is the government's commitment to continue progress toward a more flexible exchange rate regime. Greater exchange rate flexibility will help reinforce the shift in the composition of growth, encourage resource shifts to support domestic demand, and provide greater ability for monetary policy to achieve sustained growth with low inflation in the future.

International Financial Reform

These are some of the most important domestic economic challenge we face, and these issues will be at the core of our agenda for economic cooperation.

But I think it is important to underscore that we also have a very strong interest in working together to strengthen the framework for international economic and financial cooperation.

Let me highlight three important areas.

At the G-20 Leaders meeting, we committed to a series of actions to help reform and strengthen the international financial architecture.

As part of this, we agreed to put in place a stronger framework of standards for supervision and regulation of the financial system. We expanded and strengthened the Financial Stability Forum, now renamed the Financial Stability Board. China and other major emerging economies are now full participants, alongside the major financial centers, in this critical institution for cooperation. We will have the chance together to help redesign global standards for capital requirements, stronger oversight of global markets like derivatives, better tools for resolving future financial crises, and measures to reduce the opportunities for regulatory arbitrage.

We also committed to an ambitious program of reform of the IMF and other international financial institutions. Our common objective is to reform the governance of these institutions to make them more representative of the shifting balance of economic and financial activity in the world, to strengthen their capacity to prevent future crisis, with stronger surveillance of macroeconomic, exchange rate, and financial policies, and to equip them with a stronger financial capacity to respond to future crises. We also committed to mobilize $500 billion in additional finance through the enlargement and membership expansion of the IMF's New Arrangements to Borrow in order to provide an insurance policy for the global financial system.

As part of this process of reform, the United States will fully support having China play a role in the principal cooperative arrangements that help shape the international system, a role that is commensurate with China's importance in the global economy.

I believe that a greater role for China is necessary for China, for the effectiveness of the international financial institutions themselves, and for the world economy.

China is already too important to the global economy not to have a full seat at the international table, helping to define the policies that are critical to the effective functioning of the international financial system.

Second, we must cooperate to assure that the global trade and investment environment remains open, and that opportunities continue to expand. As economies have become more open and more closely integrated, global economic growth has been stronger and more broad-based, bringing increasing numbers out of poverty, and turning developing nations into major emerging markets. The global commitment to trade liberalization and increasingly open investment played a critical role in this process - in the industrialized world, in East Asia, and, since 1978, in China. As we go through the severe stresses of this crisis, we must not turn our backs on open trade and investment - for ourselves and for those who have yet to experience the fruits of growth and development. The United States, China, and the other members of the G20 have committed to not resort to protectionist measures by raising trade and investment barriers and to work toward a successful conclusion to the Doha Development Round.

And third, one of the most critical long-term challenges that we both face is climate change. Individually and collectively, there is an urgent need to ensure that each and every country takes meaningful action to deal with this threat. Reducing land and forest degradation, conserving energy, and using clean technology are important objectives that complement both our efforts to achieve a new, sustainable pattern of growth and our goal of reducing greenhouse gas emissions. China and the United States already are working closely through the Strategic and Economic Dialogue in areas such as clean transportation, clean and efficient production of electricity, and the reduction of air and water pollution. We must continue these efforts for the sake of our natio ns and the planet.

Conclusion

In the last few years the frequency, intensity, and importance of U.S.-China economic engagements have multiplied. The U.S.-China Strategic and Economic Dialogue that President Obama and President Hu initiated in April is the next stage in that process. I look forward to welcoming Vice Premier Wang, State Councilor Dai and their colleagues to Washington to participate in the first meeting of the U.S.-China Strategic and Economic Dialogue.

Our engagement should be conducted with mutual respect for the traditions, values, and interests of China and the United States. We will make a joint effort in a concerted way " *tong xin xie li*". We should understand that we each have a very strong stake in the health and the success of each other's economy.

China and the United States individually, and together, are so important in the global economy and financial system that what we do has a direct impact on the stability and strength of the international economic system. Other nations have a legitimate interest in our policies and the ways in which we work together, and we each have an obligation to ensure that our policies and actions promote the health and stability of the global economy and financial system.

We come together because we have shared interests and responsibilities. We also have our own national interests. I will be a strong advocate for U.S. interests, just as I expect my counterparts to represent China's. China has benefited hugely from open trade and investment, and the ability to greatly increase its exports to the rest of the world. In turn, we expect increased opportunities to export to and invest in the Chinese economy.

We want China to succeed and prosper. Chinese growth and expanding Chinese demand is a tremendous opportunity for U.S. firms and workers, just as it is in China and the rest of the world.

Global problems will not be solved without U.S.-China cooperation. That goes for the entire range of issues that face our world from economic recovery and financial repair to climate change and energy policy.

I look forward to working with you cooperatively, and in a spirit of mutual respect.