Secretary of the Treasury Timothy F. Geithner
Written Testimony before the Senate Foreign Relations Committee

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Chairman Kerry, Ranking Member Lugar, Members of the Committee, thank you for inviting me to testify.

You asked me to talk about the global economic outlook and how we can advance U.S. economic interests, working through international institutions such as the multilateral development banks.

The global economy is now expanding after the profound crisis of the last three years, but the recovery is advancing at different speeds. The IMF forecasts that emerging markets will grow by 6.5 percent this year, while it expects growth in Europe and Japan to be 1.5 percent.

The U.S. recovery stands in between, with growth gathering momentum and inflation risks modest, but with unemployment still unacceptably high. Consumers and businesses are now expressing more optimism about the future, suggesting momentum that will sustain growth in the coming months. Private sector analysts have raised their near-term forecasts and are projecting stronger growth in 2011 and 2012. However, we still face very substantial economic challenges. Millions of Americans remain out of work, and families across the country are still struggling to make up for losses in their savings and in the value of their homes.

The global recovery faces several major challenges and risks in the near term. A few observations on each:

First, we are witnessing historic changes in North Africa, and we are engaging with the economic authorities in the region and with the multilateral development banks to address pressing economic needs and chart a future that better meets the economic as well as political aspirations of the citizens in this region. Alongside the measures announced by Secretary Clinton, we will work closely with the World Bank, the African Development Bank and other governments to support investments and economic reforms that will promote private-sector job creation in North Africa.

Regarding Libya, last Friday, President Obama took decisive steps to hold the Qadhafi regime accountable for its continued use of violence against unarmed civilians and its human rights abuses and to safeguard the assets of the people of Libya. The President issued an Executive Order freezing the assets of Muammar Qadhafi and four of his children, as well as the Government of Libya and its agencies, including the Central Bank of Libya and the Libyan Investment Authority – the country's sovereign wealth fund. Thus far, at least $30 billion in Government of Libya assets under U.S. jurisdiction have been frozen as a result of the Executive Order issued by the President. Under the International Emergency Powers Act, this is the largest amount of assets frozen under any U.S. sanctions program to date.

Second, in Europe, leaders are undertaking the difficult task of designing a financing mechanism that can help support the very challenging, multi-year programs of fiscal and financial reform that are underway in several of the member states. They are making progress. It is important that European leaders continue to make clear that they will do whatever necessary to make sure that the affected countries and their banks have the financing they need to enable those programs to succeed.

Third, the largest emerging market economies are facing the usual pressures associated with strong growth. Inflation is accelerating. The prospect of future growth is naturally attracting foreign investment, putting upward pressure on exchange rates. Emerging market economies with flexible exchange rates have seen substantial appreciation. The upward pressure on those exchange rates is being accentuated by the fact that other major emerging markets are holding their exchange rates at undervalued levels and tightly limiting capital inflows, which serves to exacerbate price pressures within their own economies and shift the burden of adjustment to others.

Fourth, rising global commodity prices – including for food and oil – are causing hardship in many parts of the world. The IMF estimates that commodity prices, in the aggregate, increased 25 percent in 2010. This is having a serious impact on inflation and the living standards of the lowest income groups in emerging markets, where food and fuel tend to comprise a larger share of consumption. In the United States, rising gasoline prices have left consumers with less money to spend, but underlying inflation across all goods and services is still modest.

Developments in the Middle East have generated concern about potential disruption to the supply of oil, and this has put upward pressure on oil prices. We are monitoring this situation closely. But it is important to note that there is considerable spare oil production capacity globally, and we and other major economies possess substantial strategic reserves of oil. If necessary, those reserves could be mobilized to help mitigate the effect of a severe, sustained supply disruption.

An effective global response to higher food prices requires increasing long-term investments in agriculture in low-income countries, through mechanisms such as the Global Agriculture and Food Security Program, the multilateral pillar of the President's Feed the Future Initiative. This program is designed to raise agricultural productivity and improve rural infrastructure to help farmers connect to markets.

We also support measures to limit the potential for commodity market abuse and price manipulation through increased transparency and oversight of commodity markets and the associated derivatives markets. And these pressures on global commodity prices will be reduced as the rapidly growing emerging economies act to tighten policy.

Fifth, the durability of the expansion will depend in part on the ability of advanced economies, including the United States, to deliver credible multi-year reforms to restore fiscal sustainability. G-20 Leaders committed in Toronto last June to halve fiscal deficits by 2013 and to stabilize debt-to-GDP ratios by 2016.

Beyond these immediate challenges, we are working to make global growth more sustainable in the future, to build the foundations of a more stable financial system, to expand opportunities for trade, and to provide the support for reforms in developing and emerging economies that contribute to our own economic and security interests.

First, we are pursuing a number of reforms to the international monetary system. The world needs a better set of incentives for governments to promote external sustainability and reduce the risk of the re-emergence of large trade and current account imbalances. In the G-20, we are moving gradually to build consensus on ways to measure external imbalances and identify their causes. The IMF will have a key role in this process, providing independent and public assessments of the impact of each country's policies on global economic stability and growth.

A central component of this effort has to be the development of stronger norms for exchange rate policies that will help accommodate changes in the global economy. There is broad consensus that the major economies – not just Europe, Japan, and the United States, but also the large emerging economies – need to allow their exchange rates to adjust in response to market forces.

Our bilateral and multilateral discussions with China have already yielded some progress. Since June 2010, China's authorities have allowed their currency to appreciate against the dollar at a pace of about 6 percent a year in nominal terms, and more than 10 percent a year in real terms, given faster inflation in China than in the United States.

Nonetheless, China's currency remains substantially undervalued, and its real effective exchange rate – the best measure to judge its currency against all of its trading partners – has not moved much in this latest period of exchange rate reform.

Related to this, we need a stronger consensus on policies that can help emerging economies manage the risks that can come with large flows of capital. These economies have considerable investment needs, and many are seeing substantial inflows of foreign capital.

The challenge is to reduce the risk that these flows contribute to excess growth in credit or asset prices and leave the domestic financial system vulnerable to exchange rate risk. This requires carefully designed prudential measures in the financial sector, as a complement to the classic mix of monetary and fiscal restraint and flexibility in the nominal exchange rate.

Second, a more stable international monetary system requires stronger oversight of the major global financial institutions and markets. The United States has demonstrated its leadership in this effort with the enactment of the Dodd-Frank Act and its financial reform last year. We have agreed with our international counterparts to impose tougher restraints on financial institutions' risk taking and leverage, to bring oversight to the derivatives markets, and to improve our capacity to contain the damage caused by the failure of large financial institutions.

This is a complicated undertaking, and we need to be very careful to make sure we create a more level playing field across countries so that financial activity does not migrate to jurisdictions where standards are weaker or less rigorously applied. We also need to provide participants with as much clarity as we can about the reforms so that the markets have time and opportunity to adjust to them.

Third, to promote growth at home we must continue to open markets overseas so that U.S. businesses can compete on a level playing field and U.S. workers can prosper. Working with Congress and with a broad range of stakeholders, we are pursuing our trade agenda on three fronts—multilaterally through the Doha Round, regionally through the innovative Trans-Pacific Partnership negotiations, and bilaterally through free trade agreements (FTAs) with Korea, Colombia, and Panama. Our goal is to conclude and implement enforceable, high-standard agreements that directly benefit our workers, our farmers, and our businesses.

Our FTA with Korea does just that. It is a good deal. It will enhance the competitiveness of U.S. businesses in the world's 12th largest economy. It will support at least 70,000 American jobs. It will add an estimated $10-12 billion to U.S. GDP, increase goods exports to Korea by $10-11 billion annually, and provide access to Korea's growing $560 billion services market. It sends a strong signal of U.S. leadership and commitment to the East Asian region. And it serves our national security interests as the United States and Korea work together to ensure peace and security in the region.

The Administration intends to submit the agreement to Congress soon for its consideration and will work with you to get it implemented. If enacted quickly, this agreement can have an immediate impact on opening markets, stimulating U.S. growth, and supporting jobs here at home. The President also directed his team to address the outstanding issues regarding the Colombia and Panama FTAs with the objective of bringing those agreements to Congress for consideration as soon as the issues are resolved.

Fourth, we must work to support economic reforms in emerging markets and developing economies, which contribute not only to our own long-term economic prosperity but also to our national security. As Secretary Gates has observed, "Development and security are inextricably linked."

Our investments in the multilateral development banks (MDBs) are a critical and cost-effective component of the United States' global economic leadership. Our leadership in the MDBs helps ensure that these institutions support vital U.S. interests around the world – promoting our national security objectives, preventing and mitigating financial instability, creating markets for clean energy technology, and contributing to economic growth here at home. Through their use of open and fair bidding processes for procurement and investment opportunities, our investments in the MDBs have a direct impact on jobs here at home. In exchange for our financial commitment, we leverage our leadership to advance policy reforms that increase the effectiveness of the MDBs themselves and that fight corruption and ensure best practices on the ground. In Africa, for instance, the alternative to MDB financing is low-cost financing from China – presenting recipient nations with the choice between MDB funding that makes hard asks of them for transparency and reform, and Chinese funding that comes with few conditions except for the enhanced political influence that flows to the lender.

Our investments must also include supporting a global solution to the long-term security risks posed by climate change through reduced emissions, increased resilience, and prevention of economic losses from climate-related disasters. Population displacement, declines in global food supply, and major water shortages are all expensive destabilizing long-term global impacts that can be cost-effectively addressed now through prudent policies and investments by all countries.

The MDBs leverage the maximum impact for every U.S. taxpayer dollar. We expect that the MDBs cumulatively will make $95 billion in financing commitments globally in 2012. In comparison, the entire U.S. foreign assistance budget request is $61 billion for FY 2012, of which the Treasury Department has requested $3.3 billion for the MDBs. In other words, Treasury's $3.3 billion request leverages $95 billion in MDB activity supportive of U.S. global interests, or over 50 percent more than the U.S. government's international affairs budget.

The cuts to Treasury's international programs that we saw in the House legislation would mark an unprecedented abandonment of U.S. commitments to institutions that play a critical role in promoting our national security and economic interests around the world. With these cuts, we would effectively be ceding the leadership and influence we have valued in vital institutions like the World Bank for more than 60 years, in Republican and Democratic administrations alike. And we would be doing it at the very time our leadership matters most.

Ultimately, our capacity to retain our global economic leadership rests on the strength and stability of the U.S. economy. Most of the key reforms we need to build a more robust and resilient global economy are in our own hands.

The President has outlined a broad strategy to help strengthen economic growth with investments in education, innovation, and the nation's infrastructure. Alongside those investments, we must reform the nation's finances to restore fiscal responsibility. Our deficits are too high and they are unsustainable. Left unaddressed, these deficits will hurt economic growth and make us weaker as a nation.

The President's Budget presents a detailed plan to reduce spending and deficits, cutting the inherited deficit in half as a share of the economy by the end of the President's first term. The Budget includes proposals that will shrink deficits by more than $1 trillion over the next decade, essentially stabilizing the national debt held by the public as a share of the economy starting in 2013.

Meaningful deficit reduction requires serious cuts to government spending. The Budget proposes a five-year freeze of non-security discretionary spending at its 2010 nominal level, reducing the deficit by more than $400 billion over the next decade, and bringing the level of non-security discretionary spending to its lowest share of our economy since the Eisenhower Administration.

But it is not enough to spend less; government must also spend more wisely. The President's Budget sharply restrains overall spending, while also investing in important areas where the government has a clear role to provide public goods that promote future economic growth and competitiveness: education, innovation, and infrastructure.

- An educated and skilled workforce is critical for the United States to compete in the global economy. The need for additional investment in education is striking: America has fallen to ninth among advanced countries in the proportion of young people with a college degree. The Budget proposes targeted investments in education to help us regain our competitive edge.

- Investments in research and development (R&D) produce the technological advancements that contribute to productivity growth and improvements in U.S. living standards. The President believes that government has an important role to play in promoting technological progress, just as it has historically, and the Budget includes R&D investments for this year to support basic research and clean energy.

- Infrastructure is critical to economic growth and competitiveness. In addition to a $50 billion up-front investment in transportation infrastructure to create jobs in occupations that have been hit hard by the recession, the Budget lays out a long-term plan for sustained, targeted investments in the most effective infrastructure programs and projects.

The President's plan provides a balanced strategy for reducing spending and reducing future deficits while preserving the room for the investments that are critical for future economic growth.

These are the most important steps we can take today to ensure that the U.S. economy remains strong and vital in the years and decades ahead. Fundamentally, a robust economy at home is the single most important contribution we can make to continued U.S. economic leadership and to the global economy as a whole.

Thank you.