

**CENTER FOR AMERICAN PROGRESS  
And  
AMERICAN ACTION FORUM**

**SECRETARY TIMOTHY F. GEITHNER ON A PRO-GROWTH  
STRATEGY ON TAX AND FISCAL POLICY**

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JOHN PODESTA: Good afternoon and welcome, everyone. I'm John Podesta. I'm the president of the Center for American Progress. In just a few minutes, we'll hear from Treasury Secretary Tim Geithner, who I'd like to thank very much for taking the time to come speak here today.

I'm also pleased that we've done something a little unorthodox and brought Doug Holtz-Eakin over to offer a divergent view on today's topic, the pending expiration of President Bush's tax cuts. This is our second joint event with Doug's new organization, the American Action Forum. And I would say that, given the toxic partisan climate in D.C. right now, both sides can claim credit for not trying to kill each other – at least yet!

But seriously, the leadership, I think, of both AAF and CAP believe that it's critical for our country to try to reestablish a serious and respectful dialogue between the center-left and the center-right. So welcome everyone and thank you once again, all of you, for joining us.

In my view, Congress has a golden opportunity this fall to kill two birds with one stone. It can and it should extend tax relief for strapped middle-class families while the country winds its way out of recession. It could also make a real dent in the long-term structural deficits by letting President Bush's tax cuts for those at the top expire.

But progressive and conservatives are shaping up for a fight over whether or not these high-end tax cuts, which affect the wealthiest 2 percent of households, should sunset as scheduled at the end of this year. We wholeheartedly say yes.

As a progressive who has expressed great concern over the long-term deficit outlook, allowing top rates to revert back to rates that existed when I served in the White House under President Clinton will take a meaningful \$700-billion bite out of the country's long-term budget deficit without impeding growth of the overall economy.

I think Doug will argue that despite the blow to fiscal discipline, extending high-income tax cuts will be critical for creating jobs and sustaining economic recovery. But in my view, again, neither economic analysis nor experience bears that argument out.

CBO ranked high-income cuts dead last on a range of practical investments that could help spur job creation. And the President's Council of Economic Advisors found that just one-third of the money saved from discontinuing tax cuts at the top would create twice as many jobs as if it were invested in preventing layoffs from teachers, police officers and firefighters.

And in that regard, I'm very glad that the Senate finally mustered the 61 votes that it put up on the board today that were necessary to provide needed relief to states to prevent the worst of these layoffs.

I think, of course, one other factor weighs heavily on our side of the argument. It's called history. We've provided you with a pamphlet that we produce here that goes through some of the numbers about what progressive economic policy produced. I'm not going to go through that, in the interest of time. But I would say that we do have eight years of history under progressive economic policy that produced strong job growth, strong wage growth and did so with tax rates that we're talking about moving back to.

But with that, I'd like to turn it over to Doug Holtz-Eakin for a few minutes before the secretary takes the podium. As you all know, Doug recently founded and serves as the president of the American Action Forum. He served as the director of the Congressional Budget Office and the chief economist of the Council of Economic Advisors. He was also the top economic advisor to the McCain presidential campaign. Doug, thanks for coming over today and the stage is yours. (Applause.)

DOUGLAS HOLTZ-EAKIN: I want to say thank you to the Center for American Progress for being cohost of this event and to everyone for coming today. Before turning to Secretary Geithner, I do want to do two things. The first is to introduce the American Action Forum, of which I am the president.

It is a center-right think tank dedicated to policy education, policy ideas, which are consistent with the principles that we feel have served this country so well: respect for individual freedoms, a reliance on the private sector, a small, efficient government that's targeted toward its unique abilities.

But more than anything else, we are dedicated to a debate over the substance of our policy ideas, the idea that there can be principled discussions about the differences that separate the center-right and the center-left. And it's in that spirit that we are here today with the Center for American Progress and hope to establish a genuinely productive dialogue about this and many other issues that face our country.

Time will not permit me to disagree fully with Mr. Podesta. (Laughter.) But let me briefly outline where we might begin the disagreement. First and foremost, it is essential to recognize that the deficits that we face in the next decade and beyond are deficits that are driven by spending problems, not insufficient tax revenues. All the projections done by either the administration's own budget or by the Congressional Budget Office show taxes rising to above historic levels of GDP.

And despite that, we face deficits that are a trillion dollars as far as the eye can see. In particular, the administration's budget embeds these policies and still ends up with a deficit in 2020 that is larger than the deficit we would expect next year. So this is not a solution to our deficit problems.

I also think it's imperative to look at this from two perspectives. Number one is growth. In this economy, we have households who are suffering the aftershocks of a severe financial crisis and a recession. They have badly damaged balance sheets. They are, in fact, doing the right thing in trying to repair those balance sheets. We've seen the savings rate rise. They are neither positioned, nor should be expected to power this economy forward in a substantial way. Governments are in a comparable position, both at the state local, local level and, indeed, our federal government.

That means, by process of elimination, we need to be focusing on the business community and on our net exports. The business community is, in this instance, really important to pay attention to small businesses. If you look at the data that came out today from the ADP employment report, they break out employment growth by size of business.

In their numbers, since employment began to rise there have been 189,000 new jobs created in the private sector. Ninety percent of them are in firms under 500 in size, 30 percent under 50 employees in size. We need to take care of small businesses. To raise taxes in the way that the administration is proposing is to tax heavily the \$500 billion of business income that is reported on individual tax returns.

This places at risk 20 to 30 million jobs in an economy that is desperately in need of employment. So from a growth perspective, in the near term, and from the fundamentals of long-term economic growth, raising taxes at this point in the way the administration's proposing is not going to be a step in the right direction.

And finally, I think we need to look at this from the perspective of tax reform. We have a tax system that is badly broken. The essence of tax reform is to have a broad base and low rates. Everything we do in tax policy should be viewed through the lens of, are we making a step toward tax reform?

To raise marginal rates and preserve an unnaturally narrow base is a step exactly in the wrong direction from tax reform, something I don't think this country should do. And so for those and many other reasons, I'm going to disagree in advance with the secretary and, after the fact, from Mr. Podesta.

But let me turn to the real business because we are delighted today to have the secretary of the Treasury, Timothy Geithner, join us. Mr. Geithner is a graduate of Dartmouth and the Johns Hopkins School of Advanced and International Studies. He is a longtime fixture in the policymaking community. He started in the Treasury in 1988 and has served under, I believe, five secretaries of the Treasury, including an important stint as the undersecretary for international affairs under Secretaries Rubin and Summers.

He has served at the International Monetary Fund for two years. And he held a very important post with one of the linchpins of our financial institutions as president and CEO of the Federal Reserve Bank of New York, where he was a voting member of the Federal Open Market Committee and one of the key figures in the valiant efforts that were made to combat the financial crisis that we've been through over the past several years.

But the main reason for his presence today is that on January 26, 2009, he became the 75<sup>th</sup> secretary of the United States Treasury and I am delighted to invite him to the podium today. Thank you. (Applause.)

SECRETARY TIMOTHY F. GEITHNER: Thanks to both of you. I agree with much of what each of you said, actually, including the use of the word “valiant.” (Laughter.) Thanks for having me here. I just want to complement both of you on what you do.

You’re engaged in this noble effort to raise the basic quality of public debate about economic policy, to give people better analysis, better ideas. That is very important. It won’t deliver, on its own, better judgments by your country’s leaders, but will raise the probability that you get better choices over time with institutions like yours engaged in this noble effort, again, at policy analysis ideas. So my compliments to you for doing that.

We face, as you know, some very important choices as a country in the next several months. And we need to make those choices carefully, guided by what will be best for the middle class and best for economic growth. Now, over the past two decades, Washington has given the country a useful lesson in the consequences of two very different approaches to economic policy and fiscal policy.

In the 1990s, sound, prudent, responsible fiscal policies led to large budget surpluses, along with significant investments in the middle class, which helped contribute to a period of very strong economic growth and job creation, led by the private sector, with broad-based gains in income for all Americans.

Washington then changed course, abandoned those basic disciplines of budgeting and borrowed to finance very expensive tax cuts skewed towards the most affluent and a substantial expansion of government programs, unpaid for. The result, of course, as you know, was a huge increase in our national debt, relatively slow job growth and stagnation in incomes for the middle class. Now, we are living today with the damage caused by those choices.

And as we start a new decade, we have compelling evidence of what works and what does not work for middle-class Americans and for Main Street businesses. The debate we now confront is whether to extend tax cuts for the middle class, which are due to expire at the end of this year, and whether to allow tax cuts for the top 2 percent of Americans, those with annual household incomes of at least \$250,000, to expire as scheduled.

This decision is about more than just the impact on our future deficits and debt, although that is critically important. It’s a decision that will impact economic growth and the faith of Americans in the fairness of our tax policies. Now, the president’s commitment is to restore policies that will help the middle class and lay a foundation for better long-term economic growth. The president believes and I believe that extending middle-class tax cuts is an essential part of that commitment and is essential to continued economic recovery.

These tax cuts mean roughly, on average, \$2,000 per year for a typical middle-class family. But given the size of our fiscal deficits and debt, those inherited deficits and debt burden, we have to provide that tax relief in a fiscally responsible way. And we believe the best way to do that is by allowing the tax rate for the top 2 percent to go back to levels last seen at the end of the 1990s, which, as you know, was a time of remarkable economic growth and economic strength.

Now, there are some who suggest that we should hold the tax cuts for the middle class hostage until Congress extends the tax cuts for the top 2 percent and permanently repeals the estate tax too. That would be a mistake, in my judgment. If the middle-class tax cuts are not extended, Americans will face a sharp increase in taxes and a sharp fall in disposable income.

This would be irresponsible and it would be unfair, especially given the fact that so many Americans are still suffering, through the effects of what we learned last week, in the GDP numbers, was the worst recession in postwar history. Allowing those tax cuts for 98 percent of Americans to expire would only slow recovery.

Now, others have suggested we delay by extending all the Bush tax cuts temporarily, for a year or two. But the world is likely to view any temporary extension of the income tax cuts for the top 2 percent as a prelude to a long-term or permanent extension. And that would hurt economic recovery as well, by undermining confidence that we're prepared to make a commitment today to bring down our future deficits.

Now, fiscal discipline and responsibility requires hard choices and we have to be prepared to make them. The president has proposed to terminate or reduce government programs that we do not need and cannot afford. He's proposed to freeze nonsecurity discretionary spending. And doing so will, by 2014, bring nonsecurity discretionary spending to its lowest level, as a share of the economy, since the 1960s.

This will require difficult choices and even painful cuts in government programs, an effort that we have undertaken in our past two budgets and an effort that Secretary Gates, in particular, has been leading at the Department of Defense.

Now, in the context of those efforts to establish discipline on expenditures, asking the top earners in our society to forego an extension of recent tax cuts has to be part of the compact to restore fiscal responsibility in Washington.

Some on the other side of the aisle insist on extending tax cuts for the top 2 percent of Americans as a condition for extending the middle-class tax cuts. But permanent extending the tax cuts for the top 2 percent would require us to borrow \$700 billion more over the next decade, adding significantly to an already unsustainable level of debt. That would be a mistake. But who would benefit from that mistake? Only, again, the top 2 percent of Americans who, today, earn on average roughly \$800,000 per year.

There are some who have argued against stimulus who now say that extending the tax cuts for the top 2 percent is just the form of stimulus that the economy needs today. But analysts

from the CBO, Congressional Budget Office, to Goldman Sachs recently concluded that extending tax cuts for the top 2 percent would be among the last effective forms of stimulus.

That's become the top 2 percent are the least likely to spend those tax cuts, certainly not in comparison to the 98 percent of Americans who make less than \$250,000 per year. While they would surely welcome extending tax cuts, it's not likely to change their spending habits. Extending the tax cuts for the top 2 percent for one year would require the United States to borrow an additional \$30 billion. The top 2 percent would save most of that increase in after-tax income.

Now, if we had an additional \$30 billion to spend to reinforce recovery, most economists would agree with the CBO that it would be better to direct that money to tax cuts for the middle class and to promote business investment. And even more effective, in terms of bang for the buck, to use those resources to provide additional support to states so that they can keep teachers in the classroom and police on the beat.

Now, over the past few weeks, some myths – old ones and new ones – have surfaced. There are some politicians who argue that tax cuts pay for themselves. That is a long-discredited idea. There is absolutely no evidence to support it. And conservative economists and policymakers today are embarrassed by that argument. They run away from it.

There is a second myth out there that by allowing the tax cuts for the top 2 percent to expire, we're going to hurt small businesses. Doug made this point. This is a political argument masquerading as substance. Letting the top-end tax cuts expire will affect less than 3 percent of small-business owners. Ninety-seven percent of small businesses in this country would not pay a penny more, due to letting these upper-income tax cuts to expire.

Now, some have argued that even if only a few percent of small-business owners make over \$250,000 per year, those people make up a substantial amount of what is called, under this definition, small business income. But this argument apparently counts anyone who receives any type of partnership or business income as if they were a small business.

By this standard, every partner in a major law firm and every principal in a major financial institution would count – or could count – as a separate small business. An executive who had board fees or speech fees would also count as a small-business owner under this overly broad definition.

If you actually want to help small businesses get needed tax relief as opposed to using them as a cover for supporting tax cuts for the most well-off, those people should be supporting Senate passage of the Small Business Jobs Act this week before they leave town.

This bill, the Small Business Jobs Act, along with important credit and lending initiatives, calls for zero-capital-gains taxes for long-term investments in certain small businesses and calls for a significant expansion of the ability of small and medium-sized businesses to write off new investments.

Now, the policies put in place by the previous administration prior to this great recession have left us with a terrible legacy of challenges. The legacy of the crisis is millions of unemployed Americans, idled factories across the country and national debt swollen by eight years of deficit spending and growing income inequality.

We live in one of the richest economies in the world, but one in eight Americans is on food stamps today. And America is a less-equal country today than it was 10 years ago, in part because of the tax cuts for the top 2 percent that were put in place in '01 and '03.

The most affluent 400 Americans in 2007 who earned an average of more than \$340 million that year paid only 17 percent of their income in taxes, a lower rate than many who consider themselves middle-class Americans.

Now, we are in the midst of – we have been for the last two-and-a-half years, at least – a very important debate about the best way forward for our economy, the appropriate role of government in the economy. And we may disagree about the role of government in promoting better health care or retirement security or public education for our citizens. And even where we share those objectives – and of course many of us do – we may disagree on how best to achieve them. But I believe there is no credible argument to be made that the purpose of government is to borrow from future generations of Americans to finance an extension of tax cuts for the top 2 percent.

The president believes, and I believe, that we should keep taxes as low as possible, consistent with funding the essential functions of government; that we have to pay for the programs we decide as citizens the government should provide, and that we have to do it in a way that both promotes economic growth and is fair.

We can't pretend that deficits don't matter. And it is encouraging today that we see more Republicans expressing concern about future deficits. Borrowing to finance tax cuts for the top 2 percent would be a \$700-billion fiscal mistake. It's not the prescription the economy needs right now. And the country can't afford it.

With that, I'm happy – look forward to having a little conversation. Thank you.  
(Applause.)

MR. PODESTA: I'll sit on the audience's right to confuse everyone. And in the interest of being a good host, Doug, I'll let you have the first question.

MR. HOLTZ-EAKIN: As I'm sure you're aware, the CBO looks each year at the president's budget and their analysis of the president's budget says that for the next 10 years, despite the fact that, that budget includes tax increases on those making more than \$200,000 or \$250,000, we never have a deficit that's under \$700 billion, we end the decade with a deficit of \$1.2 trillion; the debt-to-GDP ratio is at 90 percent. And in 2020, we are borrowing \$900 billion to pay interest on previous borrowing.

How do you reconcile your deep statement about – interest in deficit control when your own budgetary plans take those tax increases and spend them so much that we have a larger deficit in 2020 than we do in 2015?

SEC. GEITHNER: The CBO numbers and the OMB numbers both show that with the president's policies, we cut our deficit in half as a share of GDP over the next three to five years. CBO has estimates that leave us with a deficit slightly higher as a share of GDP five years out than the president's OMB's estimates. They're, I think, roughly 1 percent of GDP apart.

But they show appropriately that with – by allowing the recovery act things to expire, by making sure that we contain discretionary spending, by supporting this package we think is a fair, pro-growth, fiscally responsible package of tax policies, we can make dramatic reductions in reducing our long-term deficits as a share of GDP.

And for exactly the reasons that you're suggesting, Doug, which is that future growth depends on confidence in Americans – that we're going to have the will to bring those deficits down – that's why we think it's responsible and prudent to make sure we let the tax cuts for the top 2 percent expire as scheduled.

Again, if you don't do that, you're going to be adding another \$700 billion to future deficits and our debt burden and I think that will risk undermining confidence in our ability as a country to begin to dig our way out of this deep fiscal hole. So that's the rationale – you know that.

Now, we acknowledge that this program of pro-growth tax policies is not going to solve all the problems in the country. Even if Congress embraces and adopts the president's policies and submits to the discipline on spending that we propose, we're still going to have unsustainably high long-term deficits. We don't get them down far enough.

And for that reason, the president – taking a page out of President Reagan in the Social Security dimension – has brought together a bipartisan commission of men and women from Congress, both sides of the aisle – national experts in fiscal policy and economics – and asked them to step away from politics and try to figure out how to build a political coalition around changes in policies that'll get us the additional distance we need to do.

So I agree with you that it's really important and that's why, again, that's a good reason for why it's a prudent step today to let those top 2-percent cuts expire on schedule.

MR. PODESTA: Let me follow up on that from maybe an unusual perspective, which is I find it a little bit ironic that amongst centrist Democrats who have been the loudest over the last year in saying that the deficits are a problem that needs attention, have been the quickest to move towards letting these high-end tax cuts slide for a year or two.

And I won't ask you to speculate on their motivation – (chuckles) – but I will ask you to – what do you say to them about the effect – you've addressed it to some extent in the speech –

but to that audience, what do you say to them about the effect on growth from the policies that you laid out in the speech?

SEC. GEITHNER: Again, I would start by saying that you have to recognize that the best – the central obligation we face now is to make sure we get this economy moving again. Dig our way out of this hole, reinforce recovery; we're supporting economic growth. Not just short-term economic growth but long-term growth prospects. And you also have to recognize that we do not have unlimited resources. We have to make choices.

Governing is about recognizing that we have limited resources. And I do not believe that it is a prudent use of limited resources to, again, borrow huge amounts of money to make possible the extension of those tax cuts for the short term.

Now, if people think there's a good case now for more stimulus for the economy, then we should have the debate about what's the best form of stimulus. And again, I think it's fair to say that economists across a broad spectrum of the political spectrum of the economics profession would not rank those tax cuts for the top 2 percent anywhere close to the most powerful forms of stimulus.

And because we have limited resources, we've got to make sure that every judgment we make that takes a dollar of taxpayer resources, a dollar of limited borrowing authority to support the economy, we're using to support things that have a very high return.

And again, because – well, you know, the arguments; you know the economic arguments and lots of people make them better than me. I don't think there's a good argument to make that the best use of those resources is to extend those task cuts for the high end. We think there are lots of good alternative uses for them. And the Small Business Jobs bill has lots of good examples in there for that.

And again, what we're trying to do is to find things that have a very high return, that'll spark private investment, that'll have the highest contribution to raising employment at the lowest possible cost to the taxpayer.

MR. HOLTZ-EAKIN: So let's go to that debate, which is your closing phrase, this policy of raising marginal tax rates, raising taxes on dividends and capital gains is going to spark private investment.

I believe –

SEC. GEITHNER: Well, hold on, could I just start by that?

MR. HOLTZ-EAKIN: No, let me –

SEC. GEITHNER: What we're proposing to do is to say for 98 percent of Americans and for 97 percent of small-business owners that we leave their existing tax rates in place. But

we're also proposing it to make sure that tax rates that are important for investment – dividends in capital gains – don't rise beyond 20 percent.

We're also proposed to extend a variety of important tax cuts for businesses to spark investment. We're also proposing to make sure we're using tax resources to help make it easier for people to complete college in a very difficult economic environment. That mix of tax programs is – in our judgment, again – more pro-growth and more fiscally responsible.

So thank you for giving me a chance to make that case, again, Doug.

MR. HOLTZ-EAKIN: No, I, again, we're not talking about cutting anyone's taxes. The question is, whose taxes will we raise and for how long? That's the issue that's on the table. It has been framed by you and others as a stimulus issue when I believe deeply it should be framed as a growth issue.

We are past the point where the economy is falling. We have an economy that's growing. It's growing unacceptably slowly and the pain is being borne by millions of out-of-work Americans. So it is past the time for short-run sugar highs of stimulus. You yourself have acknowledged, I think, that the household sector is badly damaged, unlikely to spend. Keynesian stimulus is about stuffing money into households. A big chunk of the stimulus seemed to be given to state and local governments – again, unlikely to spend. Why not err on the side of caution and not raise any taxes on the business community, which is uniquely positioned to power us at this point in time?

And we can come back and have the argument about small business through the tax code, which I believe is more than political. But why is it being framed as stimulus when we should be past that and when even the framework doesn't match the problem we have?

SEC. GEITHNER: I think tax decisions are always about how you balance what's best for growth, what's fiscally responsible, what's fair. Those are the things you have to balance. And the choice we face is how best to balance those objectives.

And, again, I do not believe that, given the fact that we do live with limited resources – we don't have unlimited choices now. To take \$30 billion and the prospect of \$700 billion over 10 years and use that to, again, extend tax cuts that only go to 2 percent of the top-earners in the country is likely to have probably the weakest impact on activity as almost any of the alternative uses, including the tax code for those limited resources. So that's the case.

And, again, I think it's very hard. You know these arguments. I think it's very hard to make the argument that we can afford to add that additional debt burden over the 10-year period given the basic damage to confidence presented by those long-term deficits. And I don't think you get much positive impact on growth.

MR. HOLTZ-EAKIN: I just want to acknowledge, lest there be any confusion, you know I'm not a fan of the deficit outlook. I do think it's quite damaging and deeply unfair.

SEC. GEITHNER: And I commend you for – (inaudible, cross talk).

MR. HOLTZ: This is one of the most unfair things we'll see. But I never thought I'd see Congresses outspend the Republican Congresses I saw – and now we have. And that's where the problem is. (Chuckles.)

SEC. GEITHNER: Now, that's a very important point. So, again, it's just worth pointing this out. You know, the deficit that we started with, which is \$1.3 trillion, is a function of a lot of things that happened over time. It is the consequence of two recessions: one mild one and one deeply severe one. But it's also the consequence, as I said in my remarks, of a bunch of choices about how to govern and a bunch of choices to suspend and abandon basic disciplines like paygo and finance, very expensive expansion of entitlements and tax cuts.

Now, the recovery act contributed a very modest additional increment to that budget deficit to not have acted forcefully to break the back of that financial panic. I am very confident – and we have evidence to support that from Mark Zandi and Al Blinder recently – that we would have had much worse growth outcomes, much higher unemployment, much more business failure and much worse damage to our long-term fiscal position.

So I think we have done the best mix available of pro-growth policies to break the back of the financial panic, recognizing, of course, that those had to be temporary. And we need to make sure that start the process now of digging out of the long-term hole.

MR. PODESTA: We'll get to questions from the audience here in a second. But I think if the focus really is on growth, this was the centerpiece of the Bush economic program, were these high-end tax cuts that produced 2.3 million jobs before the recession. Nearly double that many were lost before he left office. We had growth that was half as strong as it was in the 1990s. Median household income declined for the first time since the 1960s by, actually, a whopping \$2100.

Wage growth nudged up only \$300 for women; it actually fell \$2,000 for men. So the expected growth of these high-end tax cuts, I think we've got, actually, a proven record on this. And it leads me to ask – I'm almost tempted to ask Doug: Why would anyone want to (embrace ?) extending – (laughter) – that record.

MR. HOLTZ-EAKIN: I'll ask him a question but attack you in the process. (Laughter.)

MR. PODESTA: We also – there's an issue that's sort of embedded in all of that, which is that we've talked a lot about the wage gap that began really growing again during – what do we call it? The “oughts” (ph)? – a wealth gap that continued to expand as it has over the last 30 years.

Is there now a recovery gap? Are people at the high end now – you know, we've seen the stock market bounce back; it's up 61 percent from its bottom. We've seen bonuses come back – at least the ones that get reported in the newspapers. Corporate profits are up 35 percent.

The people at the top really seem to have begun to experience the recovery as opposed to the middle class and particularly the long-term unemployed. Does the tax policy embedded in your approach get at this recovery gap that we're currently experiencing?

SEC. GEITHNER: Absolutely. You know, financial crises are brutal in part because the burden falls – and the pain and the damage falls – much more heavily on average Americans; not just on the poor. And they're going to be living with the consequences much longer than the rest of the economy. And although the overall economy has now been growing for a year, and although the overall averages show an increase in private-sector job creation, the beginnings of increasing income growth, those averages mask an economy that has parts that are really quite strong – really encouragingly strong like you see in high-tech.

You see the evidence of that in exports; you see private investment growing at a really quite strong rate. Again, despite some concerns in the business community about uncertainty, you see business investment in the second quarter was growing at a rate of I think roughly 17 percent.

That's good. But you also see large parts of the economy that were hit hardest by the crisis still facing probably the toughest economic environment Americans have seen in generations. You see that in construction; anybody in real estate, parts of the country that were at the epicenter of the housing crisis; and of course lots of small businesses across the country still facing a really difficult environment.

So, again, I think our challenge is to make sure we're providing support to the parts of the economy still in crisis. We're using our limited resources as carefully as we can to make sure we're getting the maximum impact on repairing that damage, getting job creation back where you need it.

Again, targeted support for small businesses to states and local governments is a very good, very essential policy. Now we're fighting very hard for that. But, again, we have to do all of that and still recognize that we've got some basic obligations to restore fiscal prudence and responsibility. And we can't do everything.

And I think one thing we learned about the last decade is it's – you know, deficits do matter; it's not free and it's important for people to recognize that you have to balance those things in a way that's more fair, better for growth, better for the middle class. So, absolutely, John.

MR. PODESTA: (Inaudible, off mike) – business investment. There are a lot of companies that are sitting on a lot of cash. What's it going to take to get them to hire people and to give them – is it going to be on the demand side with the middle class or – and is that the strategy embedded here?

SEC. GEITHNER: Yeah, I think that seems to be the necessary approach. But, again, we're very supportive of trying to do things to spark increase in demand and try to pull that investment off of the sidelines.

Why are firms today sitting on those large shares of cash today? It's really for two reasons, I think: One is, they did come into this crisis with very strong balance sheets. That's a good thing for the country. It's partly why growth came back more quickly. So that's a strength of the economy.

I think the other reason, really, the best way to explain it is just that the scars of this crisis were so deep, so traumatic that it's left people very tentative, much more tentative about how strong growth is going to be. And until they see that growth on a sustained basis they're still being very careful about how they put those investments to work.

But, again, the good thing is to say that private investment is growing at a really rapid rate now. And we hope we can sustain it. It's probably not going to be sustainable at quite that rate. But I think that's encouraging.

Okay, can I come back to one thing Doug said? – because I didn't – I don't think I did justice to it. Is that okay, Doug?

MR. HOLTZ-EAKIN: Oh, yeah. And then I'm going to disagree with about the past 10 minutes. (Laughter.)

SEC. GEITHNER: I said this in my remarks, but I think it's important to recognize that the policies the president has proposed for nonsecurity discretionary spending by the federal government, if adopted by the Congress, would leave nonsecurity discretionary spending at a remarkably low level as a share of the economy, lower than what prevailed during President Reagan's term and – I think I said in my remarks – lower than it's been since the 1960s.

So we are not proposing, do not believe in proposing a set of policies that don't recognize our responsibility and our burden for showing that we are willing to cut things that don't work and hold things to a – well, restore things to a much more modest share of GDP as a whole.

MR. PODESTA (?): I'd like to see you do that on the security side, too, but go ahead.

MR. HOLTZ-EAKIN: So, a couple of comments, which I won't even disguise as a question. The first is – I will say this lovingly – but there was a president other than President Obama who, when he had a large deficit, said, I will cut it in half by the end of my time and I will do it by freezing nonsecurity and non-homeland spending. And we've seen that movie before.

And I think that's why people are skeptical that any tax increases will be used for deficit reduction: because the track record on that front, quite frankly, collectively, in this town, is not very good. And those are exactly the goals the Bush administration laid out. It's as if there's a memo in a drawer.

SEC. GEITHNER: No, but what's different about this is – and this is important for people to recognize – is that our deficits today, like when we came into office, are roughly 10

percent of GDP. But half of that as a share of the economy is a combination of the temporary recovery act stuff – which will expire – and the effects on the deficit of the recession.

So even with –

MR. PODESTA: From lost tax receipts.

SEC. GEITHNER: Yeah, and from higher transfers, unemployment benefits that come in a recession. So even if nothing – I shouldn't say it quite this way – but say nothing happened in Washington for the next four years.

MR. PODESTA: Well, nothing is happening in Washington. (Laughter.) Today being – (inaudible, cross talk).

SEC. GEITHNER: That would not be good for the country. But if we suspended then you would see a very sharp reduction in the deficit as a share of the economy. Now, I completely agree with you, Doug. I think most people look at America over the last decade or so and they are not particularly confident that Washington is going to be able to show and deliver the kinds of choices on how you use limited resources that average American families are having to do today.

So I agree with that. That's a burden on all of us.

The president can't force that; we're proposing it. But we're going to live by the discipline we impose in the beginning to propose budgets that get us back to balanced, get us back to a sustainable position.

MR. HOLTZ-EAKIN: Quick question? Can I make one comment, question, first?

MR. PODESTA: Go ahead.

MR. HOLTZ-EAKIN: In running the horserace between the '90s and the first part of this decade, I think it would be fair for everyone to recognize that the '90s had a dot-com bubble which led to a recession. They were beneficiaries of a peace dividend from the fall of the Soviet Union. And the economy in this decade has suffered from tax at 9/11, corporate governance scandal, oil price shocks, two wars. And to tease out the effects of tax policy on economic growth; it's not fair to simply make the comparison.

And here's my last serious question for you –

(Cross talk.)

MR. HOLTZ-EAKIN: In 2008, we sent out checks.

SEC. GEITHNER: By the way, I agree with that. And I try to be careful not to say that – and I don't even –

MR. HOLTZ-EAKIN: No, that was an attack on him. You were good. (Laughter.)

MR. PODESTA: I'll leave it to the outcomes that are –

(Cross talk.)

MR. HOLTZ-EAKIN: Here is the serious question: In 2008 we sent out checks, the federal government, which is conceptually identical to extending temporarily middle-class tax cuts. Those checks did nothing to stimulate consumption, household spending, or the economy in the end. Why are you confident that this approach will work?

SEC. GEITHNER: Well, I'm not sure what you're arguing there. You're saying we should let the tax cuts for middle-class American expire?

MR. HOLTZ-EAKIN: The proposal is to extend them temporarily, which is the equivalent to having them and sending out a check to offset it. That did nothing.

SEC. GEITHNER: No, what we proposed is to – and it's probably worth stepping back for a second. The recovery act, which of course came alongside very powerful programs by the Federal Reserve – essential programs to restore liquidity as well as the efforts we made to recapitalize the financial system – had very substantial tax cuts, pretty necessary substantial support for states and investments in things that matter for long-term growth.

That package of measures, quick acting and some spread over two years, were very powerful, incredibly powerful in stopping the freefall in growth. I mean, just look at a – the graph of growth or equity prices or concern about the future of the world, the financial system, trade, finance. That turned when people saw Congress legislate that package and the things we did to help fix the financial system alongside the Fed. They were very effective.

Now, again, what we're proposing to do is to leave – let Americans understand that we are going to extend those tax cuts for 98 percent of Americans. In the president's first two budgets, we proposed to do that over that full 10-year window and to do it in a way that was responsible, consistent with the obligation we also have to bring down those deficits substantially as a share of GDP as the economy recovers. So that's why I think it's – for those two reasons, I think it's good policy.

But, again, you have to judge these things all against the alternatives. We're judging things against alternative choices. And again, to take the alternative path, which is to say we're going to borrow from the future to extend these tax cuts for top two percent, I do not think would be a prudent, responsible, or effective, or pro-growth use of limited resources.

MR. PODESTA: Take a question from the press. Identify yourself please.

Q: Mike Elk with In These Times. You just mentioned that the economy has been suffering for a variety of reasons. And you excluded mentioning trade. October 1<sup>st</sup> you have an

opportunity to label China a currency manipulator. What would be the criteria for labeling China a currency manipulator considering that since our last round of negotiations, they've only raised by about 1 percent?

SEC. GEITHNER: A very important question and I guess I'd just say a couple things as context. China is very important to the United States. Exports to China in the first four or five months of this year were growing roughly double the pace of exports to the rest of the world. So the growth you're seeing in China, the reforms you're seeing in China as they shift towards an economy more driven by domestic demand are providing very substantial benefits to American workers and American businesses. And you can see that just in the cold numbers.

Now, China, as you know, about six weeks ago, I think, took the essential step of restoring flexibility to exchange rate and making it clear that they're going to allow that exchange rate to appreciate in response to market forces over time. They're only at the beginning of that process. And what matters is how far and how fast they let it move. And of course, we like everybody else are watching that closely and everybody can watch how fast, how far they let it move.

Now, it's worth remembering that when they last let the exchange rate move in the period between '06 and '08, it moved 20 percent over a two-year period. It's very hard to judge from the initial movement, again, how far and how fast they're going to let it go. Again, what's important to us and I think to all of China's trading partners is they actually let it appreciate significantly in response to market forces.

MR. PODESTA: We've got one more here.

Q: Yeah, Kim Dixon with Reuters. The administration supports dividends going from 15 to 20 percent, but are you working with lawmakers on a way to pay for it, because budget rules prevent that from happening. And then, just a quick second question. Could you guys go back and forth a little bit on the small business issue again? Does Mr. Holtz-Eakin agree with the estimate by JCT that it's only 3 percent of small business that would be impacted by the letting the top two rates expire? Thanks.

SEC. GEITHNER: You're right that to extend the dividend, to keep dividend cuts from rising beyond 20 requires we find some resources to make that possible. And yes, we are working with Congress to find a way to do that.

The question is, why is it important to do that? Again, we're trying to figure out what's the best most pro-growth package of tax measures, most responsible set of measures. Again, what we think makes the most sense for the country is to make sure that 98 percent of Americans and 97 percent of small businesses see continuity in their tax rates and that we keep rates that are very important to capital investment, like capital gains and dividends, from rising beyond a level that I think would help with business investment.

But you're right to point out that under the rules adopted at the end of last year, we have to find a way to pay for that. And we're going to have to do that.

Q: (Inaudible.)

SEC. GEITHNER: I don't want to speak to how we do that. That's something we have to obviously work with the relevant members of Congress on how to do. But we think it's important we do that.

MR. PODESTA: For those in the audience who didn't get the basis of that question, the budget discipline that the Congress has reimposed, which I believe went off with – they abandoned in 2002 before the 2003 tax cuts but reimposed last year – requires paying for this particular increase in – to be able to not have that go back to ordinary income regs.

MR. HOLTZ-EAKIN: And the short answer is, I agree with the estimates of 2, 3 percent that have been done. But it doesn't matter how many tax returns go into the Treasury. What matters is the amount of economic activity that is affected by tax policy. And because of conscious attempts to integrate the business and personal income taxes, we have a trillion dollars of business income reported on individual returns.

MR. PODESTA: I do want to point out again that a lot of the, quote, unquote, “small businesses” on those returns are not what probably most people think of as small businesses but partnership income, people who have taken a corporate form that allows them to pay personal taxes. And it's not ordinary business income that is being accounted for, I think, in Doug's estimates.

SEC. GEITHNER: I mean, you just –

MR. HOLTZ-EAKIN: Can I just say something. And then, honest, I will defer to the secretary of Treasury. But I do want people to understand that my point on this is that there are traditional objectives of tax policy at play here. One of them is to integrate the business and personal income taxes so that all income is taxed at the appropriate rate for the individual who owns that income, whether it's directly through their wages or indirectly through business activity. The second is to have a tax code that does not discriminate unfairly among alternative forms of business, scales of business.

And to set out as an objective to draw a line that says you're small, you're large and treat them differently is at odds both with the integration issue and with the traditional goal of tax policy. As I said in my opening remarks, I believe we should be ruthlessly focused on pro-growth tax reform because we're going to need every ounce of growth we can get. Sorry.

MR. PODESTA: We might actually agree on some of that. Okay, do you want to respond?

SEC. GEITHNER: No, I mean, again, the question is does that objective of what would be ideal for evolution of tax policy over time justify leaving in place tax cuts that still go to a very, very small fraction of American businesses, given the fact that we have these competing, very important imperatives not just of growth but of fiscal responsibility. So that's the question.

I don't think we can elevate elegance in the near term at the expense of that basic objective. I think it would be an expensive mistake, as I said.

MR. PODESTA: I think we have time for one question – the gentleman on the aisle. And then, we're done.

Q: I'm Toshi Yogato (ph) with Asahi Shimbun, a Japanese newspaper. I have a question on the outlook of the U.S. economy. In the international market, there has been a growing concern about the – (inaudible) – of the U.S. economy. And Japanese yen is getting stronger and hit 15-year high yesterday. And also, Chinese renminbi hit record high yesterday. And Chairman Bernanke said the outlook is unusually uncertain and weaker private conception growth is fueling those concerns. What's your assessment and thoughts?

SEC. GEITHNER: The American economy is growing. It's growing at a moderate pace. It's been growing for 12 months. Some parts of the private sector are accelerating as you see in private investment. In fact, if you just put together spending by households and by businesses, you're seeing the rate of growth in spending accelerate not moderate as we get into this recovery.

But it is very important to recognize that we are still living with the scars of a very deep, traumatic financial crisis. They're going to last for some time. It's going to take us a long time to repair the damage caused by that crisis.

It is our responsibility, our obligation still to do as much as we can to help reinforce that recovery, to reinforce growth, make sure that you see growth extend to the parts of the economy that are still suffering the most, still suffering again the worst economic conditions they've seen in a generation. And again, that's why we're working so hard to help convince the Congress to move forward with additional incentives for small businesses, help get credit markets for small business going again, help states and local governments not just extend benefits for the unemployed.

There's a very good economic case for doing that. Obviously, you want to do that in a way that is responsible fiscally. But it is important we do that.

It is, I think, worth noting that we have really adjusted with amazing speed and force through this crisis. We have had a huge adjustment already in the housing market and the real estate market. You've seen a very substantial deleveraging necessary as the financial sector got itself back to a stronger financial position. You're seeing households have made substantial changes already in reducing their debt burden and saving a larger fraction of income. Those are very encouraging, very healthy adjustments.

The fact that business cut so savagely into payroll and investment in the peak of the panic because they were just, frankly, scared to death, has been just devastating for the basic sense of financial security, economic security of so many Americans. And again, that is going to take time to repair. But the American economy is in a much stronger position today to manage through these challenges ahead because of the actions we took to break the back of the financial crisis and to begin to repair the damage. And again, our job is to make sure that we're

reinforcing growth and making sure that we see growth extend to the very substantial parts of the American economy that are still suffering so much from the crisis.

MR. PODESTA: So please join Doug and me in thanking Secretary Geithner for his presentation and for being with us and for this conversation. (Applause.)

(END)