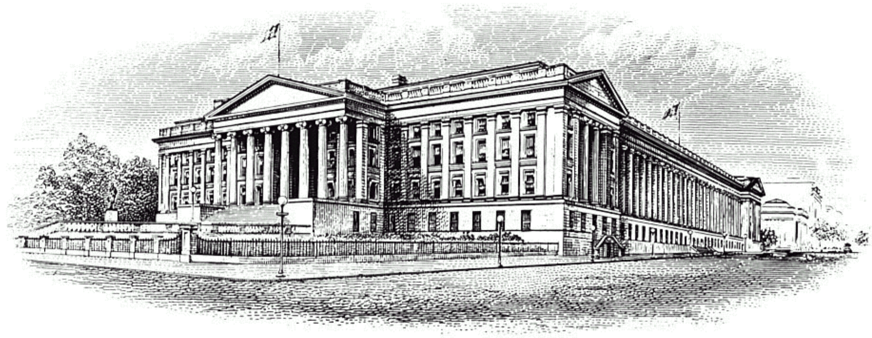

DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

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Under Secretary of Treasury for Domestic Finance
Senate Committee on Banking, Housing, and Urban Affairs
Subcommittee on Economic Policy

Chairman Bunning, Ranking Member Schumer, and other members of this subcommittee, I am pleased that you have chosen to hold this hearing on a top economic priority for our nation, both now and for decades to come: increasing investment.

For the immediate future, our challenge is to rebuild business appetite for taking risks on the future and thus for creating jobs. Looking farther into the 21st century, a major challenge for our society is to pay for the collective retirements of my generation and those that follow, while keeping commitments to current retirees and those near retirement. Over both horizons, the central task for government and for the private sector is boosting savings and investment. First, government must examine and remove legal and regulatory obstructions to savings and investment. The President has focused our attention on the need to reduce the biases against equity investment. Second, to bolster investor confidence, shareholders should demand and firms should do a better job of disclosing their key indicators of business and financial performance and prospects – the ones they actually use in managing their businesses.

Our key macroeconomic challenge today is to face the aftermath of the extraordinary events of the 1990s. Federal Reserve monetary policy, global economic integration, and telecommunications advances combined to fuel real prosperity and higher productivity, but investors' overestimation of their impact contributed to a stock market bubble. We continue to live with the consequences of these events and the destruction of trillions in household wealth as the bubble burst.

Business investment began slowing in 2000, causing demand for labor to soften. Let's be clear where jobs come from. New jobs come from investment -- the willingness of investors and entrepreneurs to put capital at risk in a business venture. The President has focused us precisely on that point: sharpening the incentives for investors and entrepreneurs to invest in the most productive ventures. And higher productivity means higher wages and a stronger economy for everyone.

The task before us is much the same throughout this new century: to enhance incentives for private sector savings and investment. We are going to pay for the retirement and health care of the baby boom generation one way or another. We can increase private savings and investment, or we will reach lower standards of living in the future than we would otherwise.

How can government and business achieve these goals now and in the future?

The President has clarified the main task for us in government: to remove the legal, tax, and regulatory distortions that discourage savings and investment.

There is no better example than the current double taxation of corporate dividends. No one defends this bias from first principles; and no other major industrial nation taxes profits at such a punitive effective rate. By taxing dividends twice, our tax code encourages companies to retain earnings instead of paying them to shareholders; to raise excessive levels of debt; and to dedicate some of America's leading minds to tax minimization instead of job creation. And by imposing a high marginal rate on profit, our tax code thins the vital blood of economic growth: risk capital.

We are encouraged by the good progress being made on the President's Jobs and Growth proposal, including progress toward lowering tax barriers to savings and investment. We are working with Congress to obtain the best package possible, as quickly as possible. The President has made clear that the sooner we get this done, the sooner we can create jobs and put people back to work.

Boosting savings and investment in America will also require restoring investor confidence. Congress passed Sarbanes-Oxley, and the SEC and Justice Department are successfully implementing its provisions to improve corporate governance. But companies too have responsibilities to lead – to provide investors with meaningful, high quality information. This is not principally a task for the government to achieve.

Our securities markets are extremely efficient at pricing and allocating capital on the basis of all available information. Unfortunately, important information is too often not available to shareholders. We will not restore our investor confidence until shareholders truly can see the companies in which they invest through the eyes of their agents in management, until they can see the real, economic leverage and the key indicators of business value that insiders can.

When investors have a picture of the real, economic leverage employed, regardless of the distractions of off- vs. on-balance sheet distinctions, attention will naturally turn to cash flow: to how management expects to pay down the leverage and still have some income left over for the shareholders. Exposing true leverage – contractually obligated net present value – is the only way that shareholders and creditors can judge true performance and can distinguish profit from business operations and from financial engineering.

Private sector leaders must transform the practice of corporate disclosure, to set a new class of best practices that will genuinely inform investors about the risk/reward prospects of the firms in which they invest. I wish that government could set best practices by fiat; I don't think it can. Only the private sector – corporate executives, lawyers, accountants, bankers, analysts, and money managers – can make it happen.

The President has urged us to focus on this top national economic priority: encouraging investment. Sharpening the tax incentives and improving corporate disclosure are crucial steps toward that goal – both to create jobs now and to generate the wealth later to pay for our collective retirement.

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