SENATE FINANCE COMMITTEE
QUESTIONS FOR THE RECORD

United States Senate

Committee on Finance

Hearing on the Nomination of Neal S. Wolin to be Deputy Secretary of the Treasury

Neal S. Wolin

May 8, 2009

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<u>Questions from Chairman Baucus</u>

<u>Question 1</u>:

Executive compensation is an issue of great importance. We fought hard to include executive compensation limits in the TARP, and I expect Treasury to fully enforce these limits. Will you commit to enforcing these executive compensation limits? What are your thoughts generally on the current limitations, and how do you think Treasury should handle this issue going forward?

I agree that executive compensation is an issue of great importance. Taxpayers deserve to know that their tax dollars are being used prudently and specifically for the purpose of fueling economic recovery and not lavish executive pay packages. In addressing the issue of executive compensation, I believe that we should be guided both by the provisions of the American Recovery and Reinvestment Act (Recovery Act) and by the compelling principles outlined by the President: that executive compensation be based on long-term performance, that it be transparent, and that it be fully aligned with the interests of the U.S. taxpayers. The Department of the Treasury is committed to enforcing the limits on executive compensation imposed by the Emergency Economic Stabilization Act of 2008, as well as those established in the Recovery Act. Treasury is currently drafting an Interim Final Rule to implement the executive compensation provisions of the Recovery Act. If confirmed, I give you my commitment to enforce these provisions.

Going forward, it will be important for the Treasury to communicate clearly to the American public and the private sector that the government will hold companies accountable for how they use taxpayer assistance. I look forward to working on this issue and balancing these policy goals.

<u>Question 2</u>:

I have been very pleased with the work Neil Barofsky has done as Special Inspector General. He has one of the greatest oversight challenges in the history of the federal government. I would like your commitment to work with the Special IG, to cooperate with his office and, frankly, to use him to help senior management at the Treasury Department run the TARP program. Do I have this commitment?

You have my commitment to work with the Special Inspector General for TARP and to cooperate fully with his office. The work performed by the Special Inspector General for TARP is important to ensuring that Treasury's financial stability programs are transparent and accountable, and that they best serve the public interest.

<u>Question 3</u>:

Mr. Wolin, in what direction do you see Secretary Geithner steering the U.S.-China economic relationship? Toward what goals is he heading bilaterally and multilaterally? What role will you play in this process? How do you see this Committee's role? In thinking about our relationship with China, what lessons do the past eight years offer you?

As Secretary Geithner has said, the United States and China share a major interest in a stable, well-functioning and smooth international financial system.

Secretary Geithner and the Obama Administration are committed to a positive, cooperative, and comprehensive bilateral relationship with China. The United States and China should work closely, bilaterally and through the G20 process, to ensure sustained efforts of the scale required to bring about global recovery and financial stability.

Looking back on the last eight years, it is now clear that Chinese growth was far too dependent on exports, and on demand from US consumers. This cannot be the basis for sustained Chinese growth in the future. Going forward, it is critical that China adopt effective policies to spur growth through domestic demand, rather than continuing to rely on exports. This means raising Chinese household incomes, strengthening social safety nets, and encouraging the development of their service sector. It also means carrying out China's commitment to move toward a flexible, market-determined exchange rate for the Renminbi, which, despite the progress that has been made, remains undervalued.

If confirmed, I plan to work with Secretary Geithner and Treasury to engage extensively with China to bring about a shift toward growth driven by China's own domestic demand, and the U.S.- China Strategic and Economic Dialogue will be one mechanism for advancing this goal. I believe that it is important that Congress have an opportunity to contribute to the U.S. – China Strategic and Economic Dialogue. I will work with my colleagues at Treasury to encourage the Chinese delegation to meet with Congress while they are in Washington. If confirmed, I look forward to working with the U.S. – China relationship.

Question 4:

In April, I and fourteen other Senators sent a letter to Secretary Geithner to express our frustration about Treasury's decision to uphold Bush Administration policies which seriously hamper sales of U.S. agriculture goods to Cuba. It took more than a month to get a response. That level of responsiveness is unacceptable. This is an issue about which I, and several others on this committee, feel very strongly. Can you commit to me that you will be more responsive about these important issues?

Chairman Baucus, I understand your concerns. If confirmed, I commit to working with my colleagues at Treasury to ensure that Treasury responds to Congressional correspondence in a timely and appropriate manner.

Question 5:

What are the most serious problems at the IRS and how will you fix them? The IRS is working with old computer systems, some going back to the 1960s. To what extent do you see this as a serious problem? What role do you think information technology should play in tax administration?

The success of the voluntary tax system is based in large part on taxpayers' faith in the fairness of the system. I regard the tax gap as a serious problem facing our nation's tax system. Improved information technology can help to close that gap, as can greater information reporting and increased enforcement. If confirmed, I will consult with Internal Revenue Service (IRS) Commissioner Shulman on ideas for improving both tax collections and taxpayer service, recognizing that such improvements likely will require significant and sustained investments in both the IRS' information technology systems and its personnel. I look forward to working with the Committee on improving the technology systems in order to help to narrow both the international and domestic tax gap.

Question 6:

60% of individual returns are prepared by paid preparers. Do you support standard preparer competency standards in order to improve the quality of the returns they file?

I believe that paid preparers should provide knowledgeable, professional, and honest service that results in high quality tax returns. It is my understanding that, to ensure high quality work by preparers, the IRS has at its disposal a variety of mechanisms, including education, outreach, and, if necessary, disciplinary actions. Improving the quality of returns is a clear benefit to both taxpayers and the IRS. The benefits and burdens of imposing competency standards must be weighed before making a determination whether to do so. The costs of administering the standards system could fall on the IRS and thus on taxpayers. An introduction of standards across the industry also could result in increased costs to both preparers and their customers. If confirmed, I look forward to learning more about this issue and to working with IRS Commissioner Shulman and this Committee to ensure that taxpayers' interests are protected.

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Questions from Ranking Member Grassley

Question 1:

The *Tax Increase Prevention and Reconciliation Act of 2005* included a provision to impose 3% withholding on all payments made to government contractors in order to combat widespread abuse of the Federal tax system among government contractors as documented by the Government Accountability Office. Originally slated to apply to payments made after December 31, 2010, under current law this provision will apply to payments made after December 31, 2011, as a result of a delay in implementation contained in the *American Recovery and Reinvestment Act of 2009*. The House version of the Stimulus Bill called for this provision to be permanently repealed.

Do you think implementation of the 3% withholding provision applying to government contractors ought to be delayed or repealed completely?
If you believe the 3% withholding ought to be repealed, do you think the government ought to pursue the billions of dollars GAO estimates thousands of contractors doing business with the government owe in tax debts?

I understand that this provision was enacted in order to improve tax compliance by government contractors. The tax gap is a serious problem, and government contractors, like everybody else, should pay their taxes. In general, withholding and information reporting are effective mechanisms to close the tax gap. However, the burdens of such mechanisms must be weighed against the benefits, especially when the burdens may be placed on state and local governments, as is the case with respect to the 3 percent withholding provision. It is my understanding that to ensure tax compliance by government contractors, the federal government currently utilizes a variety of other mechanisms, from up-front registration with the Central Contractor Registry to back-end collection through the Federal Payment Levy Program. The President's Budget proposes increased information reporting with respect to government contractors and improvements in the Levy Program. If confirmed, I look forward to working with this Committee on this important issue.

Question 2:

The US has the second highest statutory marginal tax rate of OECD countries. Which do you think is more important in keeping US multinational corporations competitive: The effective tax rate, or the highest marginal tax rate? That is, is it more important that the total amount of tax paid by a corporation as a percentage

of its adjusted gross income is low, or is it more important that the tax rate paid on its last dollar earned is low?

While the U.S. statutory corporate tax rate is high relative to other industrialized countries, our corporate tax laws include a variety of incentives, including relatively generous depreciation allowances, such that the effective marginal corporate tax rate is about average when compared to other members of the Organization for Economic Co-Operation and Development. Statutory tax rates provide an incomplete picture of the corporate tax burden because they do not reflect the corporate tax base. That is, statutory tax rates do not reflect, for example, the effects of allowances such as depreciation. The effective marginal tax rate combines statutory corporate tax rates, depreciation allowances, and other features of the tax system into a single measure of the share of an investment's economic income needed to cover taxes over the lifetime of the investment. Both measures are important, as is the effective average tax rate, which is the tax paid as a percentage of income and which some think is important in determining a corporation's investment decisions, including investment location. Compared to the statutory rate, the effective marginal tax rate gives a more accurate picture of the incentive for corporations to invest at the margin, and thus to grow and compete successfully.

Question 3:

When Secretary Geithner and I met in my office and when he appeared before this committee as Treasury Secretary nominee in January, I started our dialogue by referring to an op-ed in the August 14, 2008 edition of the Wall Street Journal. That op-ed was written by then-Senator Obama's senior economic advisors, Drs. Furman and Goolsbee. They indicated that an Obama Administration would seek to keep the revenue base at or close to historic averages of GDP. At that point, CBO reported that, over the past 40 years, taxes as a percent of GDP averaged 18.3 percent.

At the hearing, Secretary Geithner indicated that, in general, he agreed with Drs. Furman and Goolsbee's target. Now, the budget before us stays very close to that average in the first five years, but trends about one-half point above that average in the last five years, though it peaks at 19.5% in the last year.

Do you disagree with those, including some in the Democratic Congressional Leadership, who argue the only path to fiscal discipline to maintain record levels of Federal taxation as a percentage of the economy?
Do you recognize that there is a downside to future economic growth if we return to record levels of Federal taxation?

The effect of taxes on the economy is a very important and complicated issue. The President's Budget reduces taxes for 95 percent of working families, and the Budget does not project revenue increases until 2011, when nearly all economic forecasters believe we will have moved beyond the current period of recession and into a period of growth. The Obama Administration believes that at that point – when our economy is back on track –

it will be critical to focus on restoring fiscal discipline and reducing the deficit. At that time, the Administration proposes setting tax rates at the level that prevailed at the end of the 1990s, when the economy did very well – and when we ran a balanced budget, even budget surpluses. Once the economy recovers, it will be important to find the right balance between revenues and spending in order to restore fiscal responsibility and discipline. If confirmed, I look forward to working with this Committee to try to find that balance.

The Administration believes that an unchecked rise in federal debt – the result of not restoring fiscal discipline – would pose a threat to the U.S. economy in the longer term. The consequences of a long-term substantial rise in the federal debt would be very troublesome. Federal borrowing would crowd out private investment, it would raise interest rates, and, in the long run, reduce productivity growth, which would reduce our long-run rise in the average standard of living. If revenue increases are used to lower the deficit, the economy will benefit because government borrowing will not crowd out private sector investment as much and interest rates will be lower.

Question 4:

According to the Congressional Budget Office, the effective individual income tax rate for American households in the lowest quintile was -6.6 percent in 2006 while the rate for households in the second quintile was -0.8 percent. This mean that many "taxpayers" are actually getting more out of the system than they pay in. According to their 2009 Survey of U.S. Attitudes on Taxes, Government Spending, and Wealth Distributions, the Tax Foundation found that 66 percent of adults believe that everyone should be required to pay some minimum amount of tax to help fund the government.

Do you believe that the concept of fairness dictates that all tax filers pay at least a small amount in income taxes paid for the specific purpose of funding the government?

As a result of successful programs such as the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit, some working families receive refunds from the IRS in excess of their federal income tax liability – although it should be kept in mind that such families are often paying payroll and other taxes as well. Programs such as the EITC, and now the Making Work Pay Tax Credit, have provided powerful incentives for the less financially advantaged to improve their lives through work, which is to their benefit and the benefit of our society as a whole. If confirmed, I look forward to working with this Committee on the important issues these programs raise.

Question 5:

Mr. Wolin, you may be aware that the IRS recently killed a program where they used private debt collectors to collect delinquent tax debt. I have expressed my disappointment in the sham cost effectiveness study to Secretary Geithner and

Commissioner Shulman and have asked for a strategic plan to reduce the amount of delinquent tax debt which, according to a GAO report last year is almost $300 billion – over $100 billion of which was deemed to be collectible. Commissioner Shulman has encouraged taxpayers to file their returns this year even if they couldn't pay the taxes they owed. This is good since millions have been impacted by the economic crisis.

However, IRS must be sure to not lose track of these folks so that they are encouraged to pay those taxes if and when they do get money. And IRS must do all it can to close the tax gap and crack down on tax cheats. This should be a priority before raising taxes on anyone. What recommendations do you have to improve tax collections?

I understand that the IRS has been engaged in modernizing its information technology systems and it must continue to do so. More effective use of upgraded information technology can help the IRS in its core mission of tax collection and taxpayer service. If confirmed, I look forward to working with Commissioner Shulman and this Committee on this important issue.

Question 6:

Mr. Wolin, Secretary Geithner announced the results of the stress tests yesterday. Little is known about Treasury's role in conducting those stress tests. Can you tell us what you know about how those were conducted?

I would also like your opinion on why the taxpayers aren't at increased risk if the banks convert the preferred shares that Treasury obtained under TARP to common shares. Is this merely an accounting gimmick that will not result in any net increase in the capital available to these institutions? (ie. preferred shares are listed as a liability on their balance sheets while common stock will be listed as an asset)

If the senior preferred shares are converted to common stock, does this put the American taxpayer at a much higher risk of not being repaid?

Under TARP, Treasury put in place measures to protect American taxpayers. Senior preferred shares provide protection to taxpayers because they pay regular dividends and other shareholders are subordinate to the shares held by the government. This insures the taxpayer is first in line to recoup money should the company enter bankruptcy and have to liquidate assets. Additionally, the contracts signed by TARP recipients require them to pay dividends on the preferred shares held by the government before paying dividends to anyone else, and restricts the institutions from raising dividends for other stockholders without first paying dividends on the senior preferred shares. The EESA specifically directs Treasury to institute measures to protect American taxpayers. What type of measures could be put in place if the preferred shares are converted to common stock?

If the preferred shares are converted to common stock, will the government have voting rights in the institution? If the answer is yes, will the government exercise that right and if so how will the government determine how to vote its shares?

The stress tests were designed and conducted by the Federal Reserve and other federal bank supervisors. These forward-looking assessments focused on the largest financial firms to ensure that they maintain adequate capital buffers to withstand losses in a more adverse economic environment. By focusing on individual banks, this approach allowed the analysis to take into account the unique exposures that individual banks face as well their individual prospects for generating earnings.

Treasury was not involved in the administration of the assessments. At various points throughout the process, the supervisors did inform Treasury of how they intended to conduct the test. Treasury was involved in the design of the post-stress test process including the requirement that each institution develop a "capital plan," given the role Treasury's Capital Assistance Program would play in helping banks meet their capital buffer need if they are unable to meet that need through the private market.

The conversion of senior preferred shares to common stock, if this were to occur, does not necessarily put American taxpayers at a higher risk of not being repaid. As a general principle, whether conversion benefits a shareholder depends primarily upon the exchange rate in the particular conversion. Although converting from preferred shares to common shares may involve the forfeiture of regular dividends, it can also allow the shareholder to capture the full equity upside in an institution. Treasury will carefully examine each case in which we are asked to exchange preferred shares for common shares and will ensure the taxpayers' interest is protected. With regard to the exchange of Capital Purchase Program shares, Treasury will look for private capital to be raised or other capital securities to be exchanged at the same time as any exchange by Treasury.

Whether the Treasury owns common or preferred stock, important taxpayer protections are embedded in the programs. In all cases, the Special Inspector General for TARP has the authority to investigate fraud and abuse at a TARP recipient. Additionally, institutions receiving TARP funding will not be able to pay dividends and will be subject to strict executive compensation restrictions.

Finally, in the event that financial institutions need significant government assistance in terms of the quantity or composition of capital, Treasury, in consultation with the institution's supervisors, will evaluate whether the existing board and management are strong enough to restore the firm to viability without government assistance.

Where Treasury does take common equity, it will seek to return the company to purely private ownership as quickly as possible, and will be guided by the basic principle that the best way to serve the interest of shareholders and taxpayers is to exert its influence only on core governance issues and not on day-by-day operations.

<u>Question 7</u>:

It has been reported that former TARP administrator Neel Kashkari said it may take three to five years for our economy to recover from the financial crisis and recession.

How long do you expect recovery to take? If it takes 3 to 5 years for our economy to recover, does that mean the measures being taken by the Treasury Department now are not having much of an impact?

Does the Treasury Department have a timeline of improvements expected in the economy as a result of the TARP program, and other initiatives?

Economic forecasting is an imprecise science, and recent events in the financial sector, which are outside the bounds of historical experience over the past 50 years, have added even more uncertainty. Given the wide range of outcomes, there is no specific time table for improvements; all forecasts should be considered as indicating the possible general trend of developments. As Secretary Geithner has said, the actual course of the economy will move in fits and starts.

Still, most forecasters predict that the economy will begin growing again in the second half of 2009, and many, including both the Congressional Budget Office and the Administration forecasts, suggest the economy will grow by nearly 3 percent or more in 2010.

The actions the Obama Administration has taken to jumpstart the economy through the Recovery Act , to open credit channels, provide capital to encourage lending, and to help homeowners, are a key reason the economy is expected to improve. The effects of these programs are just beginning to be felt; withholding reductions were fully in place on April 1, and the Office of Management and Budget estimates that about $15 billion of Recovery Act spending was actually paid out in April, although spending is rapidly ramping up.

<u>Question 8</u>:

Mr. Wolin, I introduced a bill to require hedge funds to be registered so we at least know how many and who they are. Do you support requiring registration of hedge funds?

As Secretary Geithner testified in March, the Administration's policy is that all advisers to hedge funds (and other private pools of capital, including private equity funds and venture capital funds) whose assets under management exceed a certain threshold should be required to register with the SEC. If confirmed, I will work closely with Congress to pass legislation that would mandate registration of hedge fund advisers as part of a comprehensive package of financial regulatory reform.

Another area ripe for regulation is credit default swaps. Given your experience in the insurance industry, do you believe these financial instruments should be regulated like insurance products or commodities or something else?

We need a robust and effective regulatory system for all over the-counter derivatives, including credit default swaps. Credit default swaps have some insurance-like characteristics similar to the bond insurance protection written by mono-line financial guarantee insurers. Credit default swaps also have a close relationship to corporate bonds and other securities, and they were used by some banks to manage their bank capital requirements and to structure asset securitizations. Given these various characteristics of credit default swaps, multi-agency regulatory cooperation is appropriate. One critical aspect of a robust and effective regulatory system is that derivative instruments be subject to consistent and appropriate regulation, regardless of how the instruments are labeled (commodities, securities, banking products, insurance). Appropriate and consistent federal regulation can best be accomplished by a combination of amendments to the Commodity Exchange Act, the securities laws, and banking regulations.

The chairwoman of the Securities and Exchange Commission has been active in promoting the regulation of credit rating agencies. Do you agree that these agencies should be regulated?

Systematic mistakes by rating agencies on structured securities were a substantial contributor to the current crisis. Moreover, over-reliance by investors on flawed and misleading credit ratings contributed to the breakdown of market discipline.

While rating agencies have revamped many of their processes in recognition of these failures, this is not enough. The Administration supports strengthened regulation of credit rating agencies to improve transparency of ratings methodologies and the risks that ratings measure, to better enable market discipline on agencies, and to strengthen policies and procedures to manage and disclose conflicts.

What should Treasury's role be in regulating these entities and instruments?

Through its role as Chair of the President's Working Group on Financial Markets, Treasury can play an important role by working with regulators to strengthen and align regulation under existing statutory authority, developing policy proposals in coordination with regulators, and working with Congress to pass appropriate legislation in these areas.

<u>Question 9</u>:

With the billions of taxpayer money that has been given to the auto companies, I am perplexed by recent reports that General Motors has announced it will be shifting more of its production overseas, rather than in the United States. What is Treasury doing to make sure American jobs are protected since General Motors would no longer exist if Treasury had not showered billions of U.S. taxpayer money on it?

The President and his Auto Task Force are focused on helping General Motors and Chrysler restructure to achieve financial viability in a way that preserves as many American jobs as possible. General Motors is currently in the process of finalizing its restructuring plan and is in an active and constructive dialogue with the United Auto Workers in which CEO Fritz Henderson made clear that all options are on the table. The President's Auto Task Force will continue to engage in this process to ensure that General Motors' final viability plan is good for American workers and the American economy.

<u>Question 10</u>:

As a result of the *American Recovery and Reinvestment Act of 2009*, economic recovery checks are being sent out to people with the purpose of providing a boost to those who do not qualify for the "Making Work Pay" tax credit. Though taxpayers are ineligible to benefit from both the full "Making Work Pay" tax credit and the $250 economic recovery payment, it has been reported that economic recovery payments will go to many people who are also benefitting from the full amount of the "Making Work Pay" credit. These individuals will apparently be required to repay the $250 to the IRS at tax time next year. Is this accurate, and if so, how did it come about? How many taxpayers are affected, and how much money will have to be returned to the Treasury? How is the Treasury Department and the IRS informing taxpayers of this situation? Why wasn't the legislation more thoroughly reviewed to prevent this situation from occurring?

Section 1001 of the Recovery Act allows a Making Work Pay tax credit for eligible individuals based on earned income. The Recovery Act also requires, in section 2201, that the Secretary of the Treasury disburse a one-time economic recovery payment of $250 in 2009 to the following individuals:

- Retirees, disabled individuals, and Supplemental Security Income (SSI) recipients receiving benefits from the Social Security Administration;
- Disabled veterans receiving benefits from the Department of Veterans Affairs; and
- Railroad Retirement beneficiaries.

Although the Making Work Pay tax credit generally benefits workers while economic recovery payments generally benefit pensioners, there may be some overlap between these groups of individuals; for example, pensioners who continue to work.

Consequently, section 1001 of the Recovery Act explicitly states that the credit "shall be reduced by the amount of any payments received by the taxpayer during such taxable year under section 2201." Through numerous public statements, Treasury has informed taxpayers of this legislative requirement. For example, the IRS web-site explains that any economic recovery payment "will be a reduction to any Making Work Pay credit for which the recipient qualifies." My understanding is that Treasury does not have an estimate of the number of taxpayers affected or the dollar amounts involved.

Question 11:

The National Federal of Independent Business has been conducting a monthly survey of small business for 35 years. The April "Small Business Economic Trends" survey found that small business hiring plans are at their lowest level in the whole 35 year history of the survey. The likelihood of small business owners has never been worse. Additionally, I frequently hear from small business that, despite the enactment of the $700 billion TARP program, credit is no easier to obtain. Given that most people think of small businesses as the engine that drives our economy, can the TARP program possibly be considered at all successful if those businesses are still not able to access credit?

There is no doubt that this financial crisis has prevented many small businesses with good credit histories and a record of making their payments on time from accessing the capital they need to make payroll and maintain or expand their operations. A major goal of Treasury's efforts to stabilize the financial system, restart secondary markets, and ensure banks have the capital necessary to lend, is to get credit flowing again to the small businesses that have always been critical to job creation in our country.

Treasury has – working very closely with the Small Business Administration (SBA) – already started implementing a strategy to reverse the steep drop-off in SBA lending and activity in the SBA secondary markets. Treasury put forward an overall strategy that included temporarily eliminating fees for 7(a) borrowers and increasing loan guarantees to 90 percent, in combination with an aggressive effort to get secondary markets flowing again. The temporary fee elimination and the increase in loan guarantees have been instituted as part of the Recovery Act, and it is my understanding that a new $15 billion initiative to unlock secondary markets will be operational shortly.

There is already some evidence that lending conditions may be improving for small businesses. Average weekly loan volumes for the SBA's 7(a) program have increased by 28 percent compared to the period from January to mid-March. But President Obama and Secretary Geithner recognize that many businesses are still struggling to get loans – and in particular, to maintain their lines of credit. If confirmed, I am committed to working with my colleagues at Treasury to focus on new ways to increase the availability of credit to small business owners across the country.

Are you worried that the current administrations stated preference to raise taxes on filers with more than $250,000 in annual income will hurt the ability of small

businesses to hire additional workers and retain current workers? Secretary Geithner and other in the Administration have said that only 2% of small businesses will be affected by the tax hikes on the top two rates contained in the President's budget. What is the source for that statement? Is this 2% figure accurate? The Joint Committee on Taxation states that 55 percent of the revenues raised by hiking the tax rate on the top two rates comes from flow-through business income. Do you acknowledge that even though a relatively small percentage of small businesses are affected by these tax hikes, that the larger small businesses, which are most likely to make more than $250,000, and therefore are most likely to have their taxes increased, involve more jobs? In other words, in terms of job creation and retention, do you see a distinction between an S corporation manufacturing business with 450 employees that makes $450,000 in income and a part-time sole proprietorship with no employees that makes $5,000 in income? All other things equal, will increasing taxes on these small businesses increase or decrease employment for these businesses?

The President believes that small businesses are critical engines of job creation and economic growth, and he is committed to ensuring that small businesses have the support they need to compete in an increasingly global economy. In keeping with that commitment, the Administration has proposed a series of tax cuts for small businesses, both in the Recovery Act and in the President's Budget, including providing capital gains tax cuts for small business owners, expanding the Net Operating Loss carryback provision for small businesses, and expanding bonus depreciation to help small businesses make new investments. As a result of these proposals, the vast majority of small business owners will receive tax cuts, including from the Making Work Pay tax credit.

It is the case that the President's Budget is allowing marginal tax rates for those with income over $250,000 to essentially return to the level they were at in the 1990s (with a lower dividend rate), a period in which there was significant small business creation and very strong job growth among small businesses. My understanding is that this change will affect less than 2 percent of small business owners. That number is based on a count of those taxpayers who have income from sources associated with small businesses, such as partnerships, S corporations, and sole proprietorships, and has been confirmed by the Treasury and by independent sources. Moreover, 81 percent of taxpayers in the top two brackets with flow-though income who will pay higher taxes because of an increase in the top bracket rates have adjusted gross income greater than $500,000.

President Obama and Secretary Geithner appreciate the importance of job growth for both small entrepreneurs and quickly-expanding small businesses. Obviously, resources devoted in any year to wages and benefits of employees are a business expense and not subject to tax. It is the Administration's goal to create an environment in which every small business has the opportunity to succeed, and, if confirmed, I will be very interested in working with the Committee to explore additional ways to support small businesses.

<u>Question 12</u>:

One of the Administration's key selling points for the American Recovery and Reinvestment Act was its potential to save or create between 3 million and 4 million jobs. On January 10, 2009, Christina Romer and Jared Bernstein asserted, "In light of the substantial quarter-to-quarter variation in the estimates of job creation, we believe a reasonable range for 2010Q4 is 3.3 to 4.1 million jobs created." On February 9, 2009, President Obama emphasized that "the single most important part of this Economic Recovery and Reinvestment Plan is the fact that it will save or create up to 4 million jobs, because that's what America needs most right now." The Administration's assumption is that 90% of those jobs would be created in the private sector. However, on March 10, 2009, in a closed door meeting with House Speaker Nancy Pelosi and Democratic House leaders, Mark Zandi of Moody's.com and Allan Sinai of Decision Economics, Inc. estimated that the stimulus bill would save or create only 2.5 million jobs in the first two years.
The Administration's job creation forecast was based on its assumption (articulated in the President's Budget) that the unemployment rate would peak at 8.2% in the second and third quarters of 2009. With reports today that the unemployment rate has jumped to 8.9%, what, if any, revisions would you make to the Administration's estimated number of private-sector jobs created or saved by 2010 as a result of the American Recovery and Reinvestment Act?
Precisely how is the administration determining whether a job has been "saved"?

The Administration's assessments of GDP growth from the Recovery Act are based on the responses of well-respected, mainstream models of the U.S. economy. The estimates of jobs created or saved are based on a conservative rule of thumb about how jobs would respond. That was a deliberate choice, to avoid over-predicting job gains. As mentioned earlier, economic forecasts are inherently uncertain.

Estimating the Recovery Act's effect on jobs created and saved depends not only on how much stimulus is applied to the economy, but also on how quickly the stimulus affects spending. Forecasters who estimate smaller job gains may have different views about how fast stimulus funds can be applied to the economy. The Administration has accelerated both the tax cuts and the spending from the Recovery Act relative to what many economists thought was possible when these measures were being discussed. Tax cuts were in place as of April 1 (some even earlier), one-time $250 payments to Social Security recipients are going out this month, and program-related outlays are ramping up, and were up to nearly $30 billion as of early May.

While the Administration will revise its economic forecast later this summer, as part of the established process of the Mid-Session Budget Review, the estimates of the jobs saved or created would not change significantly with a different starting point. It is my understanding that the estimate of 3.5 million jobs created or saved is relative to a baseline that does not include the Recovery Act and that if the economy without the Recovery Act were to be worse than the baseline, the approach used by the

Administration would, to first approximation, still estimate that 3.5 million jobs will be created or saved.

<u>Delegation of Customs Authority</u>

<u>Question 13</u>:

Are you aware of the role that the Department of the Treasury has in customs affairs?

I am aware of the role that the Treasury has in customs affairs. When I last served at Treasury, the Department represented approximately 40 percent of the total law enforcement officers of the Federal Government. Since that time, while Customs was transferred from Treasury to the Department of Homeland Security (DHS), Treasury retained legal authority for "customs revenue functions," which include those matters involving collection of revenue and regulation of trade for economic purposes. I understand that Treasury has delegated authority of day-to-day operations to DHS but retains sole authority to approve regulations and reviews certain classes of regulations. Treasury also plays a role in the future direction of Customs commercial operations through its role as chair of the Interagency Board of Directors for the International Trade Data System (ITDS).

<u>Question 14</u>:

How well do you think the delegation of customs authority by the Department of the Treasury to the Department of Homeland Security is currently working? Do you have any recommendations for improving the current system?

While I am not deeply familiar with this issue, my understanding is that cooperation on customs revenue functions has been fairly effective overall but that there is room for improvement. If confirmed, I look forward to working with you and your staff to discuss this issue further and would welcome any recommendations that you may have.

<u>Relationship with the Department of Homeland Security</u>

<u>Question 15</u>:

What is the optimal relationship between the Department of the Treasury, the Department of Homeland Security (particularly U.S. Customs and Border Protection), and the Office of the United States Trade Representative, with respect to the development and administration of our domestic customs laws and regulations, as well as our international obligations with respect to customs matters?

The optimal relationship among these agencies is one of partnership and close cooperation. I understand that Treasury staff is in regular contact with both the Department of Homeland Security and the Office of the U.S. Trade Representative. If confirmed as Deputy Secretary, I will take inter-agency coordination very seriously, and I look forward to strengthening cooperation and partnership as appropriate.

Question 16:

Can there be better coordination among the Department of the Treasury and the Department of Homeland Security, U.S. Customs and Border Protection, and the Office of the United States Trade Representative, with respect to customs matters? If so, how?

If confirmed as Deputy Secretary, I will take inter-agency coordination very seriously, and I look forward to strengthening cooperation and partnership wherever needed. I also look forward to learning more about any potential challenges or obstacles to optimal coordination and, if confirmed, I would welcome any recommendations that you or your staff might have.

Question 17:

If confirmed, will you commit to strive to improve the coordination and cooperation among the four bureaucracies? Is there anything that the Finance Committee can do to help to improve these working relationships?

If confirmed, I commit to strive to improve coordination and cooperation. Further, If confirmed, Treasury staff and I will work with the Finance Committee in seeking to improve these working relationships.

ITDS

Question 18:

Are you aware of the importance of the International Trade Data System? Do you believe that sufficient resources have been dedicated to the development of the International Trade Data System among the participating government agencies? Are you aware of any particular agencies that have not dedicated sufficient resources?

My understanding is that the ITDS was designed to eliminate redundant trade formalities and achieve significant efficiencies in trade processing by replacing the current practice where traders report separately to individual agencies (often on paper) with a single electronic filing and distribution to the appropriate agencies.

I understand that a status report of each agencies' situation and recommendations for accelerating implementation of ITDS was presented in the ITDS Report to Congress of October 2008. I am not aware of the current resources available to the agencies. If confirmed as Deputy Secretary, I look forward to learning more about this issue and to working with the Committee.

<u>Staffing</u>

<u>Question 19</u>:

Do you have any concerns that current staffing levels at U.S. Customs and Border Protection are not sufficient to administer fully the customs authority delegated by the Department of the Treasury to the Department of Homeland Security?

While I look forward to examining this issue more fully if I am confirmed, I do not at present have sufficient knowledge of staffing levels at the agencies. If confirmed, I will review the administration of the customs revenue functions to ensure that the authority delegated by Treasury can be effectively administered.

FINANCE COMMITTEE QUESTIONS FOR THE RECORD
United States Senate
Committee on Finance
Nominations Hearing for Neal S. Wolin
May 8, 2009

<u>Questions From Senator Cornyn</u>

The Administration has accepted applications from private sector companies and individuals seeking selection as fund managers under the planned Public-Private Investment Partnership (PPIP). Under the PPIP, Treasury and private investors will enter into partnerships to purchase troubled mortgage-backed securities from the various financial institutions that hold these toxic or legacy assets in an effort to free up the credit market and get these institutions to start lending again.

However, the program has faced questions from a variety of organizations, especially about the requirement that potential fund managers already have a minimum of $10 billion in toxic securities under management. Although Treasury appears to have backed off this criterion to an extent, the lack of overall transparency in the selection process has led many organizations and Members of Congress on both sides of the aisle to wonder whether or not the Department already has in mind a shortlist of firms they will select.

For example, The Wall Street Journal stated in an April 1 editorial, "None of this bodes well for the bank rescue. The purpose is to create new buyers for these toxic securities, a process that, in Treasury's own words, will lead to better 'price discovery.' The best way to accomplish that is with highly competitive bidding that includes any player with a solid track record in handling distressed assets. The weaker asset-holding banks are already wary of selling into this program, worried that low bids will result in big losses that will further hurt their balance sheets. They will be even less likely to take part if only a handful of managers, who have every incentive to keep prices low, are doing the bidding."

<u>Question 1</u>:

First, I notice that the PPIP application does not request a description of all assets currently, or historically, under management. A broader assessment of the manager's current assets under management might provide a better reflection of an institution's readiness to manage specific asset categories, such as Residential Mortgage-backed Securities (RMBS) or Commercial Mortgage-backed Securities (CMBS). What are your views on Treasury conducting a wider assessment?

It is my understanding that Treasury's goal in selecting managers is to identify those who will best enable the program to succeed. As you suggest, this will require a broad and thorough assessment of the capabilities of both the applicant institutions and the specific managers who will be working on the Securities Public-Private Investment Fund. The assessment will include consideration of all of the assets under management, as well as an evaluation of the historical experience of the relevant individual managers.

<u>Question 2</u>:

Second, how much relevance should be given to the assets that are currently under management of a given firm in relation to the size of the fund to be created by that manager? Are similar asset classes as meaningful in determining the capabilities of the manager?

It is my understanding that Treasury's process is designed to select the best managers. This evaluation will include consideration of a number of factors, including the relative size of the proposed fund compared to assets currently under management. Experience with similar asset classes is another factor that will be considered. These factors will be evaluated in the broader context of the applicant's full profile.

<u>Question 3</u>:

Furthermore, some observers have questioned whether there may be a bias towards large institutional fund managers in the PPIP. Do you agree with this criticism? Are large institutions presumed to be more stable or are they presumed to be able to raise large amounts of capital more quickly? Are they presumed to be better managers of these assets?

It is my understanding that Treasury is seeking to find the best managers who will make the program as effective as possible. In selecting managers, Treasury will look for demonstrated capacity to raise private capital, experience investing in eligible assets, and operational capacity to manage the funds in a manner consistent with Treasury's stated investment objectives, while also protecting taxpayers.

I believe that Treasury has encouraged asset managers to partner so that larger firms partner with smaller firms to bring specific investment expertise, distribution relationships, or other services to the table. As Treasury announced publicly last week, many managers have chosen to submit applications that reflect partnerships of this kind.

After the initial pre-qualification of Fund Managers, Treasury is considering opening the program to other Fund Managers and may adjust the requirements to best meet the needs of the program and encourage participation.

Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP)

Last month, the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) issued his most recent quarterly report. In the report he made a number of recommendations that he thought would improve accountability and transparency in the TARP. He also mentions that the Department of Treasury has

rejected a number of his recommendations. For example, the SIGTARP highlights that Treasury refuses to adopt his recommendation that all TARP recipients be required to: (1) account for the use of TARP funds; (2) set up internal controls to comply with such accounting and; (3) report periodically to Treasury on the results, with appropriate sworn certifications.

<u>Question 4</u>:

Do you agree with Treasury's position? If so, why?

It is my understanding that the recommendations made by the Special Inspector General for TARP raise important points that have been helpful to Treasury in structuring and documenting transactions under the programs. Treasury staff meets regularly with representatives of the Special Inspector General for TARP to brief them on program development and implementation. If confirmed, I will work to ensure that Treasury gives all of the comments and suggestions made by the Special Inspector General for TARP serious and thoughtful consideration. Treasury has already adopted many of the recommendations of the Special Inspector General for TARP – particularly those pertaining to potential program vulnerabilities and compliance issues.

In order to promote confidence in these programs and protect the public interest, Treasury has introduced a number of initiatives designed to increase transparency and accountability. An important element of Treasury's commitment to transparency is communicated through the monthly lending and intermediation survey and snapshot, which was launched in January 2009. This initiative helps the public easily assess the lending and intermediation activities of banks participating in the Capital Purchase Program. The snapshot captures data from the 21 largest recipients of investments under the Capital Purchase Program. In March 2009, the snapshot program was expanded to include all banks participating in the Capital Purchase Program, including more than 500 small and community banks across the country.

Participants in the Capital Assistance Program must submit plans demonstrating how they intend to use their capital to preserve or strengthen their lending capacity compared to what it would have been but for government capital assistance. These institutions must also detail their lending in monthly reports broken out by category, showing the volume of new loans they provided to businesses and consumers and how many asset-backed and mortgage-backed securities they purchased, accompanied by a description of the lending environment in the communities and markets they serve.

<u>Question 5</u>:

Are there any recommendations made by the SIGTARP in its quarterly report that you think Treasury should reject as well? If so, which ones and why?

As I understand it, Treasury is currently in the process of evaluating the recommendations in the latest Special Inspector General for TARP report. If confirmed, I commit to working with the Special Inspector General for TARP. The work performed by the Special Inspector General for TARP is important to ensuring that Treasury's financial stability programs are transparent and accountable, and that they best serve the public interest. Treasury should adopt recommendations made by the Special Inspector General for TARP that can be implemented consistent with the goals of ensuring financial stability and economic growth.