

S. HRG. 111-990

**ANALYSIS OF THE PRESIDENT'S
FISCAL YEAR 2011 BUDGET WITH
TREASURY SECRETARY TIMOTHY GEITHNER**

HEARING

BEFORE THE

**COMMITTEE ON FINANCE
UNITED STATES SENATE**

ONE HUNDRED ELEVENTH CONGRESS

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**ANALYSIS OF THE PRESIDENT'S
FISCAL YEAR 2011 BUDGET WITH
TREASURY SECRETARY TIMOTHY GEITHNER**

TUESDAY, FEBRUARY 2, 2010

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:10 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Rockefeller, Kerry, Lincoln, Wyden, Stabenow, Cantwell, Nelson, Menendez, Carper, Grassley, Hatch, Snowe, Kyl, Bunning, Crapo, Enzi, and Cornyn.

Also present: Democratic Staff: Bill Dauster, Deputy Staff Director and General Counsel; Russ Sullivan, Staff Director; Kathy Koch, Chief Tax Counsel; Tom Klouda, Professional Staff Member, Social Security; Hun Quach, International Trade Analyst; Tiffany Smith, Tax Counsel; Holly Porter, Tax Counsel; Kelcy Poulson, Tax Research Analyst; and Mary Baker, Detailee. Republican Staff: Kolan Davis; Staff Director and Chief Counsel; Mark Prater, Deputy Chief of Staff and Chief Tax Counsel; Emilia DiSanto, Special Counsel and Chief Investigative Counsel; Jim Lyons, Tax Counsel; and Nick Wyatt, Tax and Nomination Professional Staff Member.

**OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR
FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. The committee will come to order.

In 1958, former President Harry Truman said, "It's a recession when your neighbor loses his job, but it's a depression when you lose yours." For more than 7 million Americans, this great recession has been a great depression. The American economy has lost more than 7 million jobs since the Great Recession began. The non-partisan Congressional Budget Office tells us that the Recovery Act that we enacted last year added between 600,000 and 1.6 million jobs.

The Congressional Budget Office says that the Recovery Act lowered the unemployment rate by between 0.3 and 0.9 percentage points from where it would have been. Plainly, there is more work to do. Plainly, creating jobs must be our top priority. We need to work on legislation that will create jobs, and we need to work across the aisle so that legislation on which we work can become law.

Yesterday, the President released his budget. Appropriately, the budget focuses on job creation. The President calls for a job creation tax credit for small businesses. This credit would encourage businesses to hire. I note that two members of this committee, Senators Schumer and Hatch, have advanced a similar proposal.

The budget proposes to increase incentives for investment by small businesses in plants and equipment. These investments would also help to create jobs. The President recommends extending the provisions for enhanced section 179 expensing and bonus depreciation.

And the budget would also encourage investment by excluding from income all capital gains from certain small business stock held for more than 5 years. I note that two members of this committee, Senators Kerry and Snowe, have advanced a similar proposal.

To help family businesses, ranchers, and farmers to avoid laying off their workers, the President's budget would provide certainty under the estate tax. I note that several members of this committee, notably Senators Lincoln, Cantwell, and Kyl, have been working hard on their proposals in this area as well.

I support the President's tax cut proposals for job creation. I look forward to working with my colleagues on both sides of the aisle on these measures.

In addition to these administration proposals to create jobs, I have a proposal to create jobs by increasing small business lending through the Community Development Financial Institutions network. These nonprofit lenders serve communities by providing access to capital to small businesses to help create jobs.

As we seek to find sources of sustained economic growth, I note that we must also push to open new markets to U.S. exports. The President's budget also calls for \$265 billion to accelerate economic recovery and help families, businesses, and State governments to get through this recession.

The budget also focuses on the economic security of middle-income Americans. The budget makes permanent many of the tax cuts enacted in 2001 and 2003. These include lower individual income tax rates, family tax incentives like the child tax credit, and education incentives like the student loan interest deduction. In addition, the President's budget would expand the Child Dependent Care Credit, almost doubling it for middle-income families.

The President's budget also provides for permanent Alternative Minimum Tax relief. Without the relief proposed by the President, more and more middle-income taxpayers will be paying this tax every year. I support these tax cuts proposed by the administration as well and look forward to working with my colleagues on both sides of the aisle on these measures.

Of course, another role for the budget is to measure the fiscal state of the country. Many budget experts believe that, when the economy is at full employment, annual deficits should not cause debt held by the public to rise as a share of the economy. Using this yardstick means keeping annual deficits at or below 3 percent of Gross Domestic Product.

Currently, we are far from full employment, but let us look at fiscal years 2014 to 2020. If no policies change, the budget deficit

will be 5.1 percent of GDP in fiscal year 2014 and grow to 5.6 percent of GDP by fiscal year 2020. These deficits would cause debt held by the public to rise as a share of GDP. The President's budget proposes a number of policies that would significantly reduce the size of these future deficits.

The President proposes to freeze the total funding for annually appropriated non-security programs for 3 years, and the President proposes a fee on large financial institutions to recoup projected taxpayer losses from the TARP program.

When you add up all the budgetary pluses and minuses from the President's policy proposals, you get about \$2 trillion of net deficit reduction over the 10-year period of fiscal year 2011 to fiscal year 2020. This leads to a deficit of 3.9 percent of GDP in fiscal year 2014 and 4.2 percent of GDP in 2020. These deficits are an improvement from doing nothing, but these deficits remain unacceptably high.

I note the Obama administration has decided to issue an executive order to create a bipartisan commission to recommend how to reduce Federal deficits. I hope that the commission can recommend proposals that achieve significant fiscal savings, and that many of these proposals can be enacted into law.

We face a daunting problem for our fiscal policy over the long run, not just the next 10 years. Budget analysts make clear that a primary cause of this explosion is that health care costs are growing faster than the economy. The solution to this problem is to enact comprehensive health care reform that includes serious cost containment, and that is exactly what we are trying to do.

According to the nonpartisan Congressional Budget Office, the Senate-passed health care bill would reduce deficits by \$132 billion during the next 10 years, and it would cut deficits by \$650 billion to \$1.3 trillion during the second 10 years. I look forward to working with my colleagues in both the House and the Senate to enact comprehensive health care reform. There is much work to do.

So let us continue to work on legislation to create jobs, let us, as much as possible, work across the aisle so that the legislation on which we work can become law, and let us get to work now.

Senator Grassley?

**OPENING STATEMENT OF HON. CHUCK GRASSLEY,
A U.S. SENATOR FROM IOWA**

Senator GRASSLEY. Thank you, Chairman Baucus. Welcome, Mr. Secretary.

Today we focus on the revenue side of the budget. The budget illustrates the fiscal perils the country faces. The President and Congress face a very tough set of tasks to get us to fiscal discipline. Ignoring that path only makes the ultimate reckoning more difficult.

We need to ask three questions: where are we; how did we get here; and, finally, where are we going? The President is right, that he did inherit large deficits and debt. I have one chart that shows the inherited deficit and another chart that shows that debt. Republicans recognize the inheritance.

To have an intellectually honest discussion, members on both sides need to own up to the fact that the deficits and debt were be-

queathed on a bipartisan basis. The congressional Democratic leadership wrote the budgets and passed the spending bills for 2 years prior to President Obama coming on the scene. An outgoing President, a Republican, signed these bills. These are the facts: a Democratic Congress and a Republican President left deficits and debt.

Over the past year, with the levers of power all concentrated in the hands of those on the other side, we have seen the fiscal path worsen. Deficits, as you see, are up and debt is up. That, Mr. Secretary, is where we are. How did we get here? How did the bipartisan fiscal problems arise? Both sides disagree. Many on the other side look at the last 2 decades of fiscal history and reduce it to two points. All of the “good” fiscal history of the 1990s is attributable to the 1993 tax increase bill, and all of the “bad” fiscal history of this decade is attributable to the bipartisan tax relief plans of 2001 and 2003.

Last year during the budget debate, I showed that this revisionist fiscal history does not stand up to scrutiny. The data was drawn from the Clinton administration’s Office of Management and Budget and the Congressional Budget Office. What we do know is that a growing U.S. economy is the basic tonic to the fiscal ailments. Fiscal history in the past 2 decades shows that revenues grow strongly when the economy recovers. That history shows that with bipartisan tax relief in effect, revenues grew faster than after the partisan tax increases. You can see that in the chart here as well.

The two sides disagree, though, on this relationship. It is like the saying about the tail wagging the dog. From our view, a healthy economy is the dog and the revenue is the tail. Too often, the other side viewed tax increases as a necessary imperative to a healthy economy.

Now, I believe that fiscal history shows it to be precisely the opposite. The division between the two sides on their views on how we got here informs the two sides’ views of where we go from here. The President, in his State of the Union address, indicated that we need to look forward. I agree. In this town, too often the tendency is to grow spending, raise taxes. Seldom do folks look at restraining the growth in spending. Unfortunately, looking at the path ahead, the President’s budget proves that point. Appropriations are up 25 percent over the last 2 years.

How many families have had the luxury of growing their budgets by 25 percent over the last 2 years? How many businesses, large and small, have had the luxury? The answer is, American families and businesses have done just the opposite over the last 2 years. The President talked about a freeze in that spending and got pushback from his own congressional leadership.

So, look at the budget and you will find a big fiscal hole. That chart is up here now. Democrats and Republicans know the hole is there, the President knows the hole is there; everyone agrees that the hole exists. Those on the other side, consistent with their view of fiscal history, view the tax side of the ledger as under-subscribed. The President’s budget is consistent with that view.

Let us take a look at a few examples of the tax increase bias. Both sides agree small business is the key to a goal both sides agree on: job creation. Yet, the President’s budget raises the mar-

ginal rate on small businesses by over 15 percent. The congressional Democratic leadership will go further.

The House health care reform bill would have gone yet further, raising the marginal rate about 33 percent. The Senate's health care reform bill would have raised the marginal rate by 20 percent. Once enacted, either of those bills would take the marginal tax rates well above the highest rates during the Clinton era.

More dramatic marginal rate increases would fall on investment. For instance, if the House health care reform bill were enacted, it would push the marginal rate on capital income up by almost 70 percent. The response from some on the other side is that, because these heavy tax increases are aimed at taxpayers over a certain income level, somehow they would cause no economic harm.

That position is very politically popular, but ignores the fact that taxes affect behavior. Economic growth occurs from positive behavior of families, businesses, and investors. It is often said that tax cuts are not free, but on the other side of the coin, from the viewpoint of those paying higher taxes, tax increases certainly are not free either.

Some of the group targeted for the tax increase may absorb it, but others will react by changing behavior. Small businesses will be affected. That means workers, suppliers, and others will be affected. Likewise, if investors shift their money into tax-favored activities, the supply and cost of capital for garden-variety business activities is adversely affected.

What is more, contrary to the rhetoric of many, it is not just the top 5 percent of the earners who are singled out for tax increases in the budget. The revenues from the cap-and-trade program will adversely affect many families earning below \$250,000 a year income, and the Democratic congressional leadership's health care bills both contain tax increases that adversely affect millions of middle-class families.

I would like to have you take another look at a chart, look at the fiscal hole in the fiscal path ahead. What I would ask my friends to do is look not just at the tax side of the Federal ledger, look at the spending side. Think about that every time a new politically popular entitlement program is proposed. Every new entitlement, every expanded entitlement, every double-digit increase in new appropriation spending is popular with the group targeted to get that benefit.

To those who oppose these initiatives, it seems like they are always on the defense. Somebody has to pay for the spending, and that somebody is usually the portion of Americans not targeted for the benefit. In a budget with rising deficits, it means those Americans not targeted for benefits can expect future tax increases.

Looking forward then, we need to examine tax policy initiatives in this budget in three phases: short-term, mid-term, and long-term. In the short term, the President, Democrats, and Republicans agree on a basic objective: jobs, jobs, jobs. Everyone agrees, these jobs will come from the expansion of small business.

What are small business folks saying? They are worried about the business environment. There are higher taxes in that environment. There are many new mandates in that new environment.

There are new regulations in that environment. There is a tight credit market in that environment.

Since this hearing is about tax initiatives in the budget, I would like to focus on that. Some higher taxes are known, such as the marginal rate increases in the budget before us. Some are possible, and to some degree not known. Will the taxes directed at small business in the House and Senate health care bills materialize? My advice—and this is to the President and everyone on down—listen to what small business is saying: back off the marginal rate tax hikes. Do not bury recovering small businesses with new taxes and penalties. Be cognizant of the tax burden that you are raising on capital. Remember, cash is the lifeblood of small business. Be sensitive to the credit markets that small business is struggling with.

In the mid-term, the first 5 years of the budget, take a look at how all the fiscal policies, especially the new spending, affect current and future hidden tax burdens.

In the long-term, years 6 through 10 of the budget, realize that spending on its current path is unsustainable. It is the explosion of spending, not taxes at or above historical averages, driving those frightening deficit numbers.

Thank you, Mr. Chairman.

Senator BUNNING. Mr. Chairman?

The CHAIRMAN. Senator Bunning?

Senator BUNNING. I would like a personal inquiry.

The CHAIRMAN. The Senator will state it.

Senator BUNNING. Senator Roth used to swear in—sometimes, not all the time—our witnesses on a given occasion. I would make a request that our witness be sworn in today.

The CHAIRMAN. A member of our committee, Senator Bunning, has asked that I require Secretary Geithner to testify under oath. I will respectfully decline to do so. If the Senator wishes, I will explain why.

Senator BUNNING. I think I understand why, because anyone who does not tell the truth to the Congress is under the same regulations.

The CHAIRMAN. There are many reasons. One is, there is no Senate rule or committee rule on this subject.

Senator BUNNING. No, there is not.

The CHAIRMAN. In practice, most committees, and this committee, rarely require witnesses to testify under oath at legislative hearings. There are a couple of instances when this committee does, and that is when we have an investigative hearing or a confirmation hearing. In all other hearings, we do not ask witnesses to take an oath.

Senator BUNNING. Thank you.

The CHAIRMAN. Secretary Geithner, as Treasury Secretary representing the Obama administration, we will now turn to you. Please proceed.

**STATEMENT OF HON. TIMOTHY F. GEITHNER, SECRETARY,
DEPARTMENT OF THE TREASURY, WASHINGTON, DC**

Secretary GEITHNER. Chairman Baucus, Ranking Member Grassley, members of the committee, it is a pleasure to be back before you today.

I just want to start by welcoming the very constructive tone in both your opening statements. I think that if you listen carefully, there are at least five things I think most Americans would agree on now in what you both said: one is that deficits matter; another is tax cuts are not free; another is we should be paying for programs that are new that we commit to; fourth, we face great fiscal perils as a country; and finally, our priority now, though, has to be to make sure this economy is growing and getting people back to work.

Now, a year ago when the President took office, our Nation was in a deep recession; the economy was contracting at an annual rate of about 6 percent. The financial system was on the verge of collapse, credit was frozen, the housing market was in freefall. Millions of Americans had lost their jobs, and we were losing about three-quarters of a million jobs a month.

We also faced a deficit of \$1.3 trillion and projected deficits before we took a single act that, according to CBO, would more than double our Nation's debt over the next decade.

Now, this recession has caused tremendous damage, and millions of Americans today are still living with the consequences of that damage. We all know that the road to jobs, to greater economic security, to fiscal sustainability start with economic growth. Today, in large part due to the policies Congress enacted and we put in place to put out the financial fire, our economy is growing again. Last quarter, it grew at an annual rate of about 6 percent, more rapidly than at any time in the last 6 years.

Now, this is progress. It is not enough, though. That is why we need to renew our focus on job creation, on investment, and on innovation.

Now, when you talk to, as I know you do, small businesses across the country today, they tell a similar story. They talk about uncertainty about demand for their products. They say that their ability to expand and hire depends on better access to credit.

I was in Minneapolis last week, and I visited a small family-owned business called Standard Heating and Air Conditioning, and with financing from their community bank, a bank that is also a community-owned finance institution, they were able to build a new warehouse for their growing business and add 80 jobs. I met with their banker, who said that without access to capital from the TARP, such a loan would not have been possible.

I met with a bakery owner with plans under way to build a second plant that would create 150 jobs, if they can raise the credit necessary to finance that expansion. Small banks, as you know, are a very important source of credit for small businesses. That is why, when the President took office, the only incremental money that we put into banks was not to the largest banks in the country, but to small community banks, regional banks.

That is why, today in New Hampshire, the President will announce that he will support new legislation to transfer \$30 billion of TARP funds, funds that we took back from our investments in the major institutions, to help create a new small business lending fund. This new fund will offer capital to community banks, that have historically been at the center of lending to small businesses and that we need now to be able to grow and expand.

That is also why he is going to propose, today, legislation to support \$17.5 billion in SBA loan guarantees. We want to increase the loan size, the maximum loan size, under the SBA's most heavily used program, and to extend the Recovery Act provisions that waive fees and raise guarantees, further improving access of small businesses to credit.

Now, in addition to these steps on credit, we are also proposing to extend Recovery Act tax relief for small businesses, and we are proposing a new \$33-billion small business jobs and wage tax credit. This credit would provide a \$5,000 credit to every new employee hired in 2010 and will reimburse employers for their payroll taxes on salary increases above inflation.

We are also proposing to extend additional tax cuts for investment through the expensing, bonus depreciation measures, R&D tax credits that the chairman referred to, and, as you know, we proposed a permanent exemption from the capital gains tax for small businesses.

Now, we are going to continue to work very hard to help stabilize the housing market, to make sure that we help more homeowners keep and stay in their homes. We understand and we know that government has to be smarter in doing things only governments can do. In the President's budget, we have laid out a comprehensive agenda to invest in innovation and strengthen our economic foundation.

This budget is designed to help make sure that Washington is creating the conditions that allow the private sector to grow and expand, to allow businesses, small and large, to create jobs and make investments. To do this, we need financial reform, because families and businesses both need a financial system that supports not just innovation and choice and provides better protection for consumers, but is taking the savings and investments of Americans and channeling them to innovation and investment, not financing real estate and financial booms.

We need to encourage innovation. Last year, with the investments Congress approved, we supported the largest investments in basic research funding in the history of this country, and we want to build on that with new incentives for R&D and for investments in new clean technologies that will help improve economic productivity.

The CHAIRMAN. Mr. Secretary, you can disregard that blinking light there. You just take whatever time you want to take.

Secretary GEITHNER. Thank you, Mr. Chairman.

The CHAIRMAN. However, I will apply a time limit to all the rest of us.

Secretary GEITHNER. We need to increase exports. The more products American businesses sell to other countries, the more jobs it will support in America. We need to invest in education. Businesses need an education system that does a better job of teaching and creating a skilled and productive workforce, and that is why this budget supports reforms to raise the quality of achievement produced by our schools, but also makes a college education more affordable.

And, of course, we need health care reform so we can help provide greater economic security for the tens of millions of middle-

class families and businesses and help reduce their health care costs.

Now, these are reforms that the government has to make. When government fails at these basic challenges, Americans suffer and businesses suffer. The market cannot solve these challenges on its own. The government needs to address these challenges in order to provide the foundations for a stronger, more dynamic private sector. That is why the budget proposes a series of important investments in these areas.

Now, part of laying a foundation for future economic growth and prosperity is returning to living within our means. When we have strong growth in place, we need to begin the process of bringing down these deficits. These deficits are too high, and the American people and investors around the world need to have confidence in our will and our ability as a country to bring them down over time.

Now, the President's budget proposes some important steps towards that objective. First, he proposes, starting in 2011, that we cap non-security discretionary government funding for 3 years. Second, we are proposing some important changes to make our tax system more fair and help begin the process of bringing down our deficits. We propose to allow the tax cuts for the most fortunate few Americans, the highest earning 2 or 3 percent of Americans, to expire.

We propose closing what is called the carried interest loophole by taxing the income of hedge funds and private equity managers in the same way we tax the income of teachers and firefighters. We want to eliminate unnecessary tax subsidies. But as we take these modest steps, we are also proposing to extend, just for 1 year, the Making Work Pay Tax Credit, which goes to 95 percent of working Americans. We proposed, as you know, a series of additional tax incentives to help retirement security, make college education more affordable, and help increase the dependent care tax credit.

Now, we are looking to close down TARP at zero cost to taxpayers. Last year at this time the independent budget scorekeepers expected that the cost of fixing this financial crisis could exceed \$500 billion; today those estimates are now down in the range of \$100 billion. We have proposed a fee on the largest financial institutions in the country, those institutions that benefitted most from our efforts to repair the financial system, that will help ensure that American taxpayers are not exposed to a penny of losses under TARP.

Third, we must restore the basic disciplines of budgeting that all American families live with by reinstating pay-as-you-go. Any new initiative on the tax or the expenditure side should be paid for without adding to the deficit. In the 1990s, that basic set of disciplines helped play an important role in moving us from a deficit that was 4.5 percent of GDP in 1991 to a significant surplus in 2000.

Now, the budget outlines a path to bring our deficits down, as a share of GDP, to just below 4 percent of GDP. While government support for the economy is critical now, we cannot let our future deficits and debt continue to grow faster than our economy without hurting future investments in growth. This is going to be a difficult task.

It is going to require very tough choices, politically unpopular choices, and it is going to require Democrats and Republicans to come together on things that will make a serious difference in bringing down the long-term deficits. That is why the President has supported the creation of a bipartisan fiscal commission, which will be charged with identifying responsible policies that can bring these deficits down and win support on both sides of the aisle.

Now, the fiscal commission's first task, of course, is going to be recommending changes that will bring the operating budget—meaning the budget times expenditures for interest—to balance over the next 5 years. It is also going to be asked to find and identify solutions to our longer-term fiscal problems.

I just want to conclude by saying that America is in a much stronger position today than it was a year ago, but our challenges are not just to repair the wreckage caused by the recession. We are in a very tough, competitive race, with companies and with governments around the world. That race will determine who leads the future, which economy will be stronger, more creative, better at attracting talent and investment, and better at sharing the gains of growth more broadly across all our citizens.

Now, we have in many ways dominated our competition for decades, and we are going to do so in the future, but our lead in some ways is eroding, and it is eroding because for too long our government has not been able to make the kind of policy changes and reforms, the kind of investments, that are essential to broad-based economic growth. That is why the investments and reforms we propose in the budget are so important.

I look forward to working very closely with the committee, and I look forward to answering your questions.

[The prepared statement of Secretary Geithner appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary.

First, I very much appreciate the emphasis on jobs, especially small business. You mentioned several areas, the \$30-billion TARP, \$17-billion small business loan guaranty, \$33 billion in small business employment tax credits, et cetera.

The President's announcement today on \$30 billion of TARP: would you be a little more explicit in how that will work? You might pay some attention to some of the concerns that, if some of that money gets loaned or gets made available to banks, sometimes they do not lend as much as we want them to.

Secretary GEITHNER. Exactly right. The most important things we can do for small businesses now are to give them tax incentives to invest, as we do for a range of things you highlighted and Senator Grassley highlighted in your opening statements, to add this new tax credit to encourage hiring, which, building on suggestions made by many members of Congress, including as you said, Senator Schumer and Senator Hatch, to expand what the SBA can do. SBA programs can be very powerful, and by expanding the size of loan guarantees, reducing the fees, we think that helps. But a critical role has to be to try to make sure that banks and Community Development Financial Institutions have access to the capital that allows them to lend.

Now, a dollar of capital for a banker or CDFI is probably one of the most effective uses of taxpayer resources, because, for every dollar you give for capital, it can support up to \$8 to \$12 in additional lending. Banks that need additional capital can use capital under this program to support additional lending, and they are going to be less likely to have to reduce lending if they were unlucky, or unwise, or unfortunate and made some bad decisions during the boom.

But to do that, we need to make sure that they are going to take this capital and use it to actually expand lending, so we have suggested a variety of ways to do that. We think we have some good ideas to do that, but we want to work with Congress, to work with members of this committee, work with members of the Banking Committee to find the best way possible to do that. But small businesses rely on banks for really all the credit they generate, and to help them you need to make sure that the banks they rely on have the financial ability to help them.

The CHAIRMAN. How are you going to guarantee that the banks actually lend? Because that has been a concern in the past, that sometimes banks make other investments to fatten their bottom line, and they have not used all the capital that has been available to them to actually lend.

Secretary GEITHNER. Well, actually, I think the available evidence shows that banks that actually took capital expanded lending. You saw more lending by banks that took capital from the government than by those that did not. So, I think it is actually a pretty good story on this side. But you are right, our objective has to be to make sure we design these things to substantially improve the odds that you see lending grow, not shrink.

Now, a lot of banks took on too much risk in this crisis. That was true of community banks, too. A lot of them have been forced to retrench and pull back, and that has hurt a lot of their traditional customers, small businesses. So, I think it is a very legitimate objective for us to work together to find some ways to mitigate that pressure, to work against that pressure.

The CHAIRMAN. Can I ask, how do you balance spending for job creation and address the recession on the one hand, and cut back to address the fiscal problems on the other? What are some of the parameters, what are some of the benchmarks in making that decision here? Basically, I think the deficit increases in the short term, and under the budget proposal, decreases in the longer term. How do you decide where to draw that line?

Secretary GEITHNER. I think you have it exactly right. Many people think these objectives are in conflict, but they are not, for the following reason: if we do not succeed in repairing the damage caused by this crisis, we do not succeed in getting growth back on track, having a growing economy again, with businesses confident, we will not be helping our long-term deficits—they will be worse.

The fiscally responsible thing to do right now, given the scale of the damage caused by the recession and the importance of the recovery, is to make sure we are doing sensible things, effective, targeted things, to help reinforce recovery, improve business confidence, get Americans back to work.

Now, we cannot do that effectively unless people also believe that, once growth is established, that we are going to bring down those long-term deficits. So, unless we convince people that we can restore gravity to our long-term fiscal position, then we are going to have limited ability to meet these immediate challenges that we all share.

The CHAIRMAN. I guess my question is, how did you decide to draw the line where you did? That is, why not more, a percent more in short-term stimulus? Why did you draw the line where you did?

Secretary GEITHNER. There are two critical aspects of the issue right now. One is, how much more now can we afford, because there are limits to what the government can do now. Our deficits, as everybody says, are alarmingly high. They are too high. They are going to have to come down. We do not have unlimited resources available that we can go borrow from the rest of the world and put into even well-designed programs. So, there are limits on that.

What the President has proposed in the budget is to set aside \$100 billion on top of some of the extension of measures in the Recovery Act already approved, like the extension of Unemployment Insurance. I believe the country can afford that. If we design the use of that package sensibly, that will be a good thing, not just for growth but for our long-term fiscal position.

The second question was timing. How quickly do we move to restraint? In the President's budget we propose, in fiscal year 2011—it begins in the fourth quarter of this calendar year—which we believe will be more than a year after we have had positive growth restored, to begin to bring those deficits down.

Now, we proposed to reduce them by 2 percentage points of GDP next fiscal year. Some people may think that is too much. I think the economy may be a little fragile, still short of growth then, and it is possible that will be right. Many people say we should cut more deeply than that. I would suggest that we begin the process of restraint when we are more confident the recovery will be well-established.

The CHAIRMAN. My time has expired. I just would point out the obvious, namely, that we cannot afford the luxury of making mistakes. We have to get this right. That means burrowing down a little bit, digging down a bit deeper, drilling down a little bit more, asking tougher questions and getting the data to get this as right as we possibly can. By "right" I mean the balance between the two objectives here. We just cannot afford, again, the luxury of just being cavalier, being easy about this. This is serious stuff.

Secretary GEITHNER. I agree. We have to make sure that every additional dollar that we support is going to have a high return.

The CHAIRMAN. Right. Right. All right.

Senator Grassley?

Senator GRASSLEY. Mr. Secretary, on February 11th last year, the Congressional Budget Office wrote a disturbing letter outlining the effects of making the provisions contained in the stimulus bill permanent, and I would ask the chairman to insert that letter in the record at this point.

The CHAIRMAN. Without objection.

[The letter appears in the appendix on p. 159.]

Senator GRASSLEY. The stimulus bill was sold as a temporary measure to get the Nation through tough times; however, to the surprise of very few, Congress is already being asked to extend the temporary tax and spending provisions in the stimulus bill.

We have a chart here outlining the contents of that letter from the CBO. The stimulus bill, as originally passed by the House, was estimated to cost \$820 billion. As large as that number is, it is only about a quarter of the whole cost of making the tax and spending provisions of that bill permanent. CBO estimated that the whole cost of permanence, including debt service, would total \$3.3 trillion; the actual price tag of the stimulus bill, as signed into law, was a little different. But the point of this chart is to show the true cost of making the temporary stimulus permanent.

I think, even in Washington, that \$3.3 trillion is a whole lot of money. It is kind of like we thought that we maybe bought a pet gecko, and we ended up with a Godzilla. Well, what we want from you is assurance that this will not be let loose on the American people. We of my party are often criticized for not offering tax increases to facilitate debt reduction. The same criticism could be made of people on the other side of the aisle for enacting so-called temporary spending that is likely to have a larger-than-anticipated fiscal impact once the temporary provisions are extended.

So, trying to get back to what we originally thought we were doing, would you be able to tell us that you are going to be able to contain the hidden fiscal liability of extending the stimulus bill? Could you promise to ensure that the cost of the stimulus bill is limited to the original estimate?

If you agree that we should limit the fiscal impact of the stimulus bill to a temporary nature, would you be willing to carry this out by either working to support the original expiration dates contained in the stimulus bill or by offsetting any extensions with spending reductions in other programs?

Secretary GEITHNER. Senator, I think it is very important that we all commit to the objective of making sure that the temporary things we did to pull the economy out of crisis are temporary and do not build in long-term expectations of higher expenditures in the future. I completely agree with that. Part of getting our deficits down over the medium term is going to be making sure we let those emergency actions or temporary actions expire and do not get built into expectations of future spending.

We do believe there is a very strong economic case now for extending certain provisions of the Recovery Act that we think have a powerful impact on investment and job creation. As the chairman said, we need to be careful those things meet that test. We are not going to propose to extend everything. We propose some limited extension of those provisions.

We think there is a good economic case for that because we want to reinforce recovery and growth, but I agree with you, we cannot let that add to expectations about long-term commitments on the expenditure side, or it is going to make it harder for us to bring those deficits down over time.

Our basic test should be: what is going to add jobs, what is going to add spark to investments, what is going to provide good leverage

for the taxpayers' money? We need to make sure we are doing that in a way that is fiscally responsible over the medium term.

Senator GRASSLEY. Mr. Chairman, I would like to reserve 44 seconds for next round so I can ask a longer question.

The CHAIRMAN. You may even have more than 44 seconds next round.

Senator GRASSLEY. All right.

The CHAIRMAN. Senator Rockefeller?

Senator ROCKEFELLER. Senator Grassley, you have actually just 31 seconds.

The CHAIRMAN. He is a good man; we will give him 44 seconds.

Senator ROCKEFELLER. Yes, that is true. That is true.

Secretary Geithner, I want to go right to coal, in the energy part of the budget. Let me just say this. I come from a State, West Virginia, which has a very hostile attitude towards any changes in current practices in coal and which is against cap-and-trade, which is against any kind of change really at all. Not in all cases. I am trying to change that. This budget is going to make it really hard for me. Let me explain.

The way I see it is that the renewables give this country about 6.7 percent of its electricity, and that coal gives it about 85 percent. But you have put all kinds of tax credit eliminations in about coal, which come out of the meeting in Pittsburgh of the G-20. I understand that. I also do not really believe that China and India are ever going to be a part of that.

So on top of that you shift, in a relatively small thing, but a very nettlesome thing, the cost of OSM onto the coal industry, the Office of Surface Mining. You shift that onto the industry, and you call it a fee. You make the States do it. States have to put down a fee. So coal is caught in a very difficult place because it is not certain that we are going to get a climate bill this year. It would be good if we did.

I talk to the people I represent about the fact that cap and trade was, in fact, the exact mechanism we used some 30 years ago to do acid rain. There is no difference. At that time it came in at only 20 percent of the cost of what people had predicted, the experts had predicted. I am trying to be helpful in this. I talk to coal miners, I talk about cap and trade, I talk to industry; some are reluctant, some are not.

Now, in your budget—and the way I see it, the way out is technology, Carbon Capture and Storage being the major part of that—you have a total of \$545 million for the country in the budget for research and development, i.e., CCS. Just to put that into perspective, that amount has already been about spent on just doing 17 percent of the emissions of one power plant, the largest power plant in North America, American Electric Power in West Virginia, just 17 percent of their emissions, they have reduced that by 90 percent. Others can reduce it and take 95 percent of the carbon out, 90 percent, 95 percent. When you get to 95 percent, that is cleaner than nuclear power.

Now, my question to you is, what is there in here which is hopeful for coal? Because what you are doing is, you are going to cut down the production of coal this year when we may or may not have a climate change bill. John Kerry's bill and other bills may

very well talk about substantial amounts of money for clean coal, making coal clean, which I am strongly for.

In the meantime, you are sort of saying to West Virginia, forget it; \$545 million is what we think of CCS, and in the meantime we are going to take away your tax credits so production of coal is going down, and that is what you got from our budget, which sort of makes me think, thank heavens that it is the President's budget and its staying power may be a week or two. We write the legislation.

I want to do it in a way which makes coal clean, which puts a discipline on the coal industry and the coal miner and on myself to do the right thing for the country and not continuing giving 54 cents a gallon to methanol, which I understand is a political move and it always has been, and I will not get into that.

But I want you to know, there really is not anything in this budget which I can take home or talk about in favorable terms with respect to coal, when I want to. The President talked in the State of the Union about being for research and development, CCS, et cetera, but the budget does not reflect it.

I have run out of time for a question, so I would just make that as kind of an enunciated.

Secretary GEITHNER. Mr. Chairman, can I make a very quick response?

The CHAIRMAN. Yes.

Secretary GEITHNER. We are very supportive, like you are, in trying to make sure we are providing significantly larger incentives and subsidies to encourage clean energy technologies, including clean coal. There are a range of provisions in the budget that I would be happy to go through with you that do substantially increase what the government is doing to help facilitate that transition.

Again, we want to make sure we are doing things that are going to work, but we want to support the same objective. We believe, as you do, that the answer is in technology, and we would be happy to work with you to make sure that we have the best ideas for how to do that in the budget.

Senator ROCKEFELLER. All right. But they are not in there yet, you do agree?

Secretary GEITHNER. Well, I think if you look at the tax credit for renewable energies and you look at the broad range of support for R&D, there is more support in there for that objective than the specific provision for CCS that you refer to. But again, we are happy to work with you. I think we have the same basic objective. We understand the tension between the reality today that coal has a major role, and will continue to play a major role, in our energy future, and we want to use coal more efficiently and make sure that we adopt a kind of clean technology.

The CHAIRMAN. Senator Hatch? Thank you. Oh. Senator Hatch is not here.

Senator LINCOLN? There she is, over there.

Senator LINCOLN. Thank you, Mr. Chairman. I appreciate you and the ranking member for holding the hearing, and certainly Secretary Geithner for being here.

Mr. Secretary, we all know that a budget is nothing more than a blueprint that outlines a list of priorities and it is not binding legislation, but it does indicate your values. It indicates how you plan to lead this Nation in the year ahead. And just in talking about, all of the ideas that people have for years beyond 2010 are grand and glorious, but Americans are hurting right now, and we need to have a real plan for 2010 and 2011.

So I want to begin my comments—and then I will move to any questions I might have—just to say that in the budget that the administration has proposed, I think there still is a great deal of nervousness among Americans, and I hope that you will work with us to try to alleviate some of that.

In the wake of the difficult economic times for so many Americans, I see in the budget that is before us today that we put in place a new cap-and-trade system, just as Senator Rockefeller was mentioning, and its long-term goals, perhaps, have changed the longstanding tax policies that encouraged domestic oil and gas production. I think this would undoubtedly result in an immediate increase in energy prices for consumers and for businesses at a time when they cannot afford it. So, although we all want to have long-term goals, we have to understand what the immediate presents.

I see the imposition of new taxes on our businesses that are trying to compete around the world, without any substantive policies to reward them for keeping jobs here at home, which is critical, not only that we do the research and development, but that we encourage those industries to ensure that that research and development stays here in this country, in American jobs. I see additional tax and regulatory burdens being placed on small businesses and the self-employed.

I see a financial regulatory reform proposal that seeks to recreate the wheel. We do not need to recreate the wheel, putting the vast majority of Main Street banks that have played by the rules all along into a whole new regulatory structure, when the focus should be on improving oversight of the bad actors, many of those obviously in New York, or on either coast, but the majority of them not being in middle America where jobs need to be created.

I see a budget that puts a bull's eye on many policies that rural America relies on. I come from rural America. I grew up in a farming community, in a farm family. This government has provided for many of these policies that rural America relies on, and it has been in government policy that has been provided for in the farm bill just 2 years ago. But to cut them off or to leave them hanging at the uncertainty of whether or not that contract that we made with rural communities and agricultural providers across this country, to cut that contract short in an economic time when they do not know what to expect—

I go through all of this to say that I guess I do not understand, and I think most Arkansans do not understand, the vision of the administration when it comes to putting in place economic policy that works for our Nation in today's economy and the economic climate today, to create the jobs that Arkansans need now in our economy. It is critical that we focus on the here and the now.

Mr. Secretary, I do not know how many people you talked to, folks out there in the real world. I know you mentioned your visit

to Ohio. I do not know how many farms you visited or farm country you visited, so I do want to help pass along that message, that the budget and the administration's economic policies as of late provide more questions oftentimes than they do answers. Americans, individuals and businesses, they are desperately trying to regain their footing. They are trying desperately to pull themselves back from the brink of this economic crisis.

Now is the time to provide stability and certainty. You mentioned certainty in almost the first four or five words out of your mouth. I hope you mean that. I cannot begin to impress upon you how critical that is in these economic times: confidence in economic policies that they have seen and understand and have bet their businesses on, in many instances. My concern is, I think our budget can do more. I think it can do more than that.

Building on that point, one of the first things that we as a government can do to help provide some economic stability is to focus on legislative issues that should have been addressed last year. I pledge that to myself and to my colleagues here, that we have to do as much, but many of those have been put aside from the effects of the long debate that we have had on health care.

I just hope that you will take an opportunity to look at many of those things: 40 Empowerment Zones, 40 Renewal Communities across the Nation; somewhere between 500,000 and 700,000 jobs either directly or indirectly that benefit from those EZ/RC incentives. There are so many other incentives out there. You look at venture capital and the biodiesel tax credits that expired at the end of 2009. There is no certainty for venture capital now. They do not invest in our renewable energies because they do not know what to expect; the 10,000 to 15,000 jobs in the timber industry directly impacted by the Tree Act provisions, which did expire last May and were not renewed. We need you to help us focus on those issues. There is somewhere between 2.5 million and 6.7 million taxpayers—

The CHAIRMAN. Mr. Secretary, I want to let you respond very, very briefly. Actually, the Senator's time is—

Senator LINCOLN. Well, I am just going to hit briefly on small business and then I will end, and you can answer however you would like.

The CHAIRMAN. Mr. Secretary, briefly, if you wish to respond.

Secretary GEITHNER. Well, Senator, I was just going to say, I agree with you. While I am testifying today on the President's fiscal year 2011 budget, 2011 feels like a long way away to many people. It begins October 1. Our focus right now—and we want to work with Congress right now—is on a set of additional measures to help reinforce this recovery and get more people back to work, and that is why the President said in the State of the Union that our immediate priority is to focus on the things that matter right now.

Now, there are limits to what we can do, and we want to make sure we are doing things that go directly to small business, job creation, to incentives for adoption of clean technologies, support for infrastructure, help for State and local governments. Those, we think, matter a lot and make a lot of difference, and we cannot wait to do those things, I completely agree with you. But we also

need to make sure that we are looking ahead a little bit. We need to make some choices now about the longer term.

I completely agree with what you said about certainty. Their recoveries depend on confidence. They depend on the confidence of businesses, they depend on the confidences of American families that we are going to make things better, repair the damage done. That is critical, and everything we do should be guided by that basic recognition.

We need to give people a little bit more clarity than we have been able to do as a country over the last many years about what are going to be the rules of the game, what tax policies, what regulatory policies are going to be out there. I completely agree with you on that, and that is why it is important that we swing to earth a bunch of the things that we are still working on up here, like in financial reform, health care reform, so people can plan for a more certain future.

The CHAIRMAN. Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman.

Mr. Secretary, you mentioned certainty and confidence. Without question, those are the two key elements that are the essential ingredients in making an economic recovery a strong one, a sustainable one. I held some small business forums just a couple of weeks ago in the State of Maine, and what I heard from small businesses on the ground—because I think there is a disconnect between Washington and the rest of the country, Main Street, between reality and fiscal fantasyland here in Washington about the practicalities of the policies that are coming out of Washington.

Whether they are speculative or they are real is immaterial. If the perception is that we are going to have more policies coming out of Washington that are going to increase the cost of doing business, they are simply not going to do business. I heard that time and time again, that uncertainty is impossible for them to predict or to calculate the cost.

If I heard it once, I heard it a number of times. People say, how do I calculate the cost of doing business when I am hearing in Washington they are going to increase the tax rates? Frankly, when we talk about \$250,000, we are talking about small businesses, because 93 percent of all small businesses have flow-through income. They are small businesses, and they pay 82 percent of those taxes. So, that is going to have a profound impact.

Furthermore, as we continue to discuss a potential tax increase, they are going to freeze. They are going to stand still. That is the point. That is what is going to hamper our ability. Then you talk about all of the tax increases in the proposed health care bill, the 62-percent increase in the Medicare payroll tax. They are looking at that. That disproportionately affects small businesses.

I think that there is not only a disconnect, but there has been this huge lag time to respond to the needs of small business in a practical fashion. There is no way they are going to move forward to job creation. Then who would take the risk? Depending on what they are hearing coming out of Washington these days, would you take the risk? Would you put your money on the line? I mean, that is the issue. I heard that over and over again, and rightfully so.

So, until we get certainty on taxes, on regulation, on the issue of health care and how that is boomeranging off the walls here between the House and the Senate, we are not going to experience job creation. So I would like to hear from you, what certainty is there when we are talking about these tax increases. I mean, that is going to represent a 9- to 15-percent increase in taxes.

Furthermore, on paying things, you say we should pay for things, pay for everything. But using TARP is not a means of paying for it. That is a loan that was meant to be paid back, not to be spent, ultimately. I think that we ought to use unused stimulus funds for that purpose, and so I hope you would consider that. I am asking for a list from the OMB director for all unused, unspent stimulus funds, to use that as an offset.

And finally, I think we should have a jobs impact statement on every piece of legislation that comes through the U.S. Congress so that we know whether or not it is actually creating jobs, losing jobs, or preserving jobs. I mean, I think it is that critical for the future of this country and for the interests and well-being of small business, the one entity we are depending on to create jobs.

Secretary GEITHNER. Senator, I agree with much of what you said. I think what businesses need more than anything else is more confidence there is going to be growing demand for their products, and they also want less uncertainty about what is going to happen in Washington and about the basic rules of the game. I completely agree with you about that.

I want to respond, though, to two things you said in particular, and this is important. We have proposed—you are actually right—to let the tax cuts that were given to Americans with incomes above \$250,000 expire at the end of this year. Congress designed them to let them expire, proposed to let them expire. But independent analysts who have looked at this—it is not just the Treasury Department analysts who have looked at this—say that those will only affect 2 to 3 percent of small businesses. Now, you could say 2 to 3 percent is a lot of small businesses, but it is only 2 to 3 percent. Again, I think the fairest independent assessments of that stuff justified that conclusion.

Now, I completely agree with you that to bring health care to resolution would be helpful in reducing some uncertainty about what has actually happened, but it is also important to recognize that businesses today under our current system, small business in particular, face enormous hidden costs in our health care system. Those that have health care pay much more for it than large businesses do. They all pay for the hidden costs of paying for the uninsured.

This country's health care system today is not a good system for businesses or small businesses, and they are facing much more rapid growth in health care costs than large businesses. But I agree with you that bringing resolution to health care reform would be helpful to certainty and confidence, and I think it would be good for small businesses, too.

The CHAIRMAN. Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman. I want to pick up on your questions as well.

Secretary Geithner, the banks are getting bigger, and lines of credit to Main Street employers are getting smaller, and it looks like a vicious cycle. The taxpayers bail out the too-big-to-fail institutions, only to be more vulnerable to them.

Now, a few minutes ago you told the chairman that the banks that got bail-out money were increasing lending. Your own Treasury data, however, paints a different picture. The Treasury data demonstrates that the 22 banks that got the most help from Treasury bail-out programs have actually been decreasing small business lending. The Inspector General's report on January 30, the TARP report, says exactly the same thing.

So my first question to you picks up on the chairman's point about the urgency of small business lending. Tell me, if you would, how the new program that is being discussed is going to be an improvement on the two programs that your own data and the Inspector General have said are not working?

Secretary GEITHNER. I think if you look carefully at the evidence of people who took TARP money and those who did not, I still think the evidence is pretty good that, on a relative basis, you saw more lending, or a less sharp reduction in lending, across those institutions.

Senator WYDEN. Not for small business.

Secretary GEITHNER. Yes, I think even in that case. But again, the point is, I think our basic challenge is, how are we going to make this better, how are we going to fix it? To be honest about it, the big challenge we have had is that small banks have not been willing to come and take advantage of these programs because they have been deeply concerned about both the stigma that comes with taking out assistance and the potential concerns about conditions, actual and prospective. We had hundreds of small banks that withdrew their applications from the Treasury, even as we tried to make these programs more attractive. They do that because of, again, a fear of the stigma and fear of the conditions.

So what we propose is to in some sense separate this from the trauma and damage of association with the TARP and do it with a better, more sensibly designed set of conditions. But that requires legislation, that requires working with you, and it requires getting some input, frankly, from banks, community banks and others, on how best to do it.

We proposed one way to do it, but there are a lot of people out there with lots of ideas on how best to do it. We are willing to work with you and other members on how best to do it. But if you do not do things that help community banks, it is very hard to do enough to help small businesses that depend on community banks.

Senator WYDEN. I would like a more detailed answer in writing, if I could get that, because I continue to be uncertain with respect to how this new program is going to improve on two others that your Department and the Inspector General have criticized.

[The information appears in the appendix on p. 117.]

Senator WYDEN. Let me go to an area where we are seeing progress, and that is the funding of infrastructure. The Build America bonds program, to a great extent because of the chairman and Senator Grassley, we thought might promote the issuance of perhaps \$5 billion worth of bonds for roads and transportation sys-

tems. As you know, it exceeded \$60 billion. Clearly, this is now the boldest effort in municipal finance as it relates to generating improvements in infrastructure.

Now, you all proposed making this permanent, but you also, it appears to me, seem to be suggesting that there be additional areas that would be eligible for Build America bonds: refinance projects, covering operating expenses. What concerns me is, if the country goes that route, that will not do as much to create new jobs, new family wage jobs, particularly in transportation where there is the great economic multiplier, as the original bipartisan proposal that Senator Thune, Senator Talent, a big group of us have been working on.

So tell us, if you would, how your revisions in the Build America bonds program will still help us to achieve what has long been the bipartisan objective up here, which is to generate more new jobs in the infrastructure area.

Secretary GEITHNER. You are right, it is a remarkably effective program, to the credit of you and many of your colleagues up here. Senator Baucus, I know, has been very supportive of this stuff. It is one of the most effective programs per dollar of taxpayers' money that we have seen out there. That is a good case for making it permanent.

But we think there is also a good case to look at the scope of applicability, but we do not have a monopoly of wisdom on this. We would be happy to work with you in trying to make sure that, if we expand it, we are not going to reduce its basic effectiveness. But we propose something that has no cost, and therefore meets that basic test of fiscal responsibility.

A very important note. Because of this program and a range of other programs, the cost of borrowing by State and local governments has come down very, very dramatically over that period of time, and that has been very, very helpful because State and local governments still face really, really difficult challenges that they have not seen in many, many decades, and we need to keep working at trying to help them get through this. We think this program is one way to do that.

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

I was glad that a lot of my colleagues brought up clarity, confidence, and certainty, because that is one of the unbelievable things that the American people are having difficulty with; therefore, I am going to question you on some other things that kind of led up to that clarity, confidence, and certainty.

The reasons you and others have stated for bailing out AIG and the terms of the bail-out seem to have changed over time, so I wanted to give you the opportunity to set the record straight on two questions. First, why did you believe AIG could not be allowed to fail? Was it the impact on insurance policyholders, the derivative counter-parties, the money market, or something else?

Secretary GEITHNER. Senator, thank you for asking that question. As I have said from the beginning, our judgment was that the failure of AIG would have been catastrophic to the stability of the financial system. It would have had the effect of undermining con-

fidence in the insurance system. It would create a prospect of much greater failure across the financial system. You would have seen much more damage to the basic value of American savings. I think if anyone doubts that, you just have to look back to what happened after Lehman failed.

Our judgment was—and this was not just my judgment, Senator, it was the judgment of a range of people who were responsible for those decisions at that time, including President Bush, Secretary Paulson, and Chairman Bernanke—that those pressures you saw after Lehman's failure would have been dramatically amplified if AIG had failed, and they would have spread to parts of the system that would otherwise have been unaffected, including basic confidence in the insurance system.

Senator BUNNING. Let me get to the point, though. Was it the derivative business, security lending at the insurance companies, the commercial paper, the aircraft leasing business, or something else?

Secretary GEITHNER. Again, it is hard to separate. What is systemic risk is a difficult thing to judge. There is no—

Senator BUNNING. We are all finding that out up here.

Secretary GEITHNER. But that is the reality of it. But again, I think the simplest way to say it is, look at what happened after Lehman Brothers and the broader collapse of many of our large institutions. Look what happened to that. Value of American savings fell by 40 percent. You saw hundreds of thousands of businesses forced to close, millions of people lost their work, basic confidence in the stability of the system was broken. You had the rivets coming off the submarine.

In that environment, to have the largest insurance company in the world, that had written savings protection contracts to thousands—hundreds of thousands—of American households and to a bunch of State and local governments, to have that institution fail in that environment, in our judgment, would have been catastrophic. So what we did was the best we could with limited tools to try to limit risk to the taxpayer and contain that broader damage.

Senator BUNNING. All right.

When did you first become aware that AIG was in trouble, you personally?

Secretary GEITHNER. AIG informed the Treasury and the Fed on Friday—I cannot remember if it was September 12th, or if that is exactly the right Friday. But it was that Friday—that they were—

Senator BUNNING. This was in September?

Secretary GEITHNER. That is right. September 2008. And that they were at the edge at that point and they did not believe that they were going to make it without support from the government.

Senator BUNNING. So AIG's condition did not come up at your July 29th meeting with the company's CEO when he was asking about access to Fed lending?

Secretary GEITHNER. No. As I have testified before, AIG's officials, including the CEO, approached us informally, and other of my colleagues, at other times over the preceding probably 6-month period and said, what if we faced the possibility of significant liquidity pressure? Under what circumstances is it possible for the

Fed to come to our assistance? But it was really only on that Friday, Senator, that they came to us and said—and you know, remember this: the Federal Reserve had no authority and responsibility for the risk AIG was taking. They were subject to supervision by State insurance companies, by Federal regulators.

Senator BUNNING. No. But the Fed did have recourse.

Secretary GEITHNER. The Fed had absolutely no authority, absolutely no responsibility for supervising/overseeing the activities of AIG.

Senator BUNNING. Oh, no. Not for supervising.

Secretary GEITHNER. Yes. But at that point that is why we had—

Senator BUNNING. Is that why TARP money was used?

Secretary GEITHNER. No. But again, you know this history well, Senator.

Senator BUNNING. Yes, I do.

Secretary GEITHNER. When they got to the edge where they could no longer operate without government assistance, they came to the Fed and said, will you help avoid default? We said, like we always do, what is going to be the best way to contain damage at least cost to the taxpayer? We made those judgments with exceptional care, with extreme reluctance. No one would ever want to be in the position, ever, of giving a dollar of taxpayers' money to a company like that that had mismanaged its way, despite the supervision of an insurance company—

Senator BUNNING. Even at the time when you knew it was failing?

Secretary GEITHNER. Of course. No one wanted to be in the position, if there was any other way, to put taxpayer money on the line to prevent default by a company like that. If there was any way to avoid that without a penny of dollars, we would have jumped on that and embraced it.

Senator BUNNING. But you did it with Bear Stearns and not Lehman.

Secretary GEITHNER. Well, the Bear Stearns case—it is good you raised that case.

Senator BUNNING. Yes?

Secretary GEITHNER. In the Bear Stearns case, there was a willing buyer able to come in and buy and guarantee—

Senator BUNNING. There is some question whether they were willing or not.

Secretary GEITHNER. Well, you can ask them that.

Senator BUNNING. We have.

The CHAIRMAN. Senator Stabenow?

Senator BUNNING. Thank you very much. I will continue later on.

The CHAIRMAN. Senator Stabenow, you are next.

Senator STABENOW. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. I want to take the previous questions and actually pivot back to what is happening to American families, American businesses. To avoid a disaster, actions were taken last year, AIG Investment Banks, because the country was at the edge of a cliff and there was a concern about disaster.

We have 15.3 million people who do not have jobs, who do not have breadwinners in their families nationally. That is a disaster.

Most of that, overwhelmingly, did not happen on President Obama's watch or your watch, but I would first state that, when we have 6.4 people looking for jobs, or 6 people looking for work for every job available, that is a disaster.

I believe the Recovery Act was a response to the disaster that families and businesses had been facing and was an appropriate response, and that we need to keep our focus there. So I appreciate your focus on small business, which is critical for job creation. As I am sure you know, even though things have been done through SBA and so on this last year, we do not have enough capital available for small businesses.

We have serious issues. We have small businesses that are now in a situation where they do not have collateral because their equipment, their business is not worth what it was, their home is not worth what it was, and so they now have a one-two punch of, cannot get a loan, do not have collateral as well, which is something that we need to address as we are looking at these issues. We have suggestions on how to do that, but I appreciate the focus on small business, on exports, education, health care costs, deficits.

I would like you to speak just for a moment, though, on why it is so critical now in terms of deficit reduction and the economy to focus on jobs. Jobs and deficit reduction are not separate, in my mind. I wonder if you might just speak a little bit more about how creating jobs will actually grow the economy and reduce the deficit.

Secretary GEITHNER. Well, I believe you said it exactly right. The economy is in crisis still, and for the average American, for many businesses, this is still the worst economic environment and the most challenging economic environment they have ever experienced. That is true, even though we have been successful in putting out this financial fire at the center of the system and even though we have been successful in starting to repair the damage and putting a floor under an economy that is falling off the cliff.

But you are absolutely right. It is because of that that our first priority has to be ways to use additional assistance from the government to provide incentives for investment and for job creation. We want to make sure as we do that—again, because we do not have unlimited resources—that we are focused on things that have the biggest bang for the buck.

Focusing on small businesses and tax incentives and credit is one way to do that. That is not the only answer, though. We think it is important that be complemented by support for a broad range of other investment incentives, for clean energy technologies, for infrastructure, and there are some things that State and local governments need, that they need desperately now to make sure they can weather this major storm ahead.

Senator STABENOW. I wonder if you might also speak a little bit to one critical investment that I am very pleased is in the President's budget, and it relates to manufacturing, clean energy manufacturing. In the 8 years prior to President Obama taking office, we lost almost 6 million middle-class manufacturing jobs in this country. I think there was a belief at that time that, if you could buy something, it did not matter where it was made. We want very much to see the words "Made in America" again on the products around the world, and in this country.

The \$5-billion expansion of the Manufacturing Tax Credit—I am very pleased. I have worked with Senator Bingaman and Senator Lugar, Senator Hatch. We have legislation in to expand what was an effort we worked on very hard with you in the Recovery Act. But I wonder if you might speak to why it is important to focus on the clean energy manufacturing incentives and the success that we have had up to this point.

Secretary GEITHNER. Well, as you heard the President say, and I know you believe this, we want the United States to be a leader in those technologies. We think they are critical. We think in some ways they are the best hope for trying to make sure that we take advantage of the great skills and expertise and productivity of the American worker and have them working on things that are going to be, obviously, central to our economic future.

Now, this tax program is, I think by all measures, a very effective program. It has been remarkably over-subscribed. As you know, we are proposing to expand it. We are not going to wait for Congress to act in this case because we can use the remaining resources we have now to continue to make sure we are providing support on it. But we think it makes a lot of sense, and we would be happy to work with you and your colleagues to make sure that it is designed in a way that it meets that basic test. We want to do things that have the maximum bang for the additional assistance we provide, either through the tax system or direct investments, and this program meets that test.

Senator STABENOW. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. You bet.

Senator Menendez?

Senator MENENDEZ. Thank you, Mr. Chairman.

Mr. Secretary, thank you for your service. I am glad to see the President's budget has something that I have championed, which is Alternative Minimum Tax relief continuing. There are a lot of middle-class families in the country, certainly in New Jersey, that are affected by it.

I appreciate your comments on loan guarantees with SBA. I have a concern, however, that if there are no loans, there are no loans to guarantee, so we look forward to maybe working with you on that to see how, in fact, that actually becomes something much more than a hollow promise.

But I want to go up to three things very quickly, and I hope you will work with me so I can get through them. One is, the administration has proposed a modest responsibility fee on the largest banks to help pay back the taxpayers' TARP funds. The banks are objecting to this modest fee to pay back the taxpayers because of the supposed effects on lending, they claim, and the cost to consumers. At the same time, many of these entities are paying some of the largest bonuses to their own executives.

So, one, how do they reconcile that position? Second, should we not be looking after banks to pay back taxpayers for TARP in a few years? Should we not have those banks continue to pay into an insurance fund so that in the future banks, rather than taxpayers, effectively, would be paying if one of them fails?

Secretary GEITHNER. Senator, I do not think there is any significant risk that this fee, as we designed it, would have a negative impact on lending, probably for the reasons you said: banks do not have to pass this on, and modest reductions in the compensation budget would absorb the cost of the fee.

We think it is absolutely essential to make sure that, in financial reform legislation, we are meeting a basic common-sense test, which is, if the government has to take risk or loss in the future to put out some future financial fire, we do not want the taxpayers to have to bear the burden of that cost. That is why we have proposed to make sure that they do not bear a penny of cost under TARP for what we had to do in AIG or anywhere else, and we want to make sure in the future that taxpayers are not on the hook to save large financial institutions from the consequences of their mistakes.

Senator MENENDEZ. And the question is, how we do that, whether we do it prospectively or retroactively? It just seems to me that, when we do not do it prospectively, we put the taxpayer out there, and then we seek to recoup it. So, it is something we look forward to working with you on.

Second, I find it ironic that some of my colleagues on the other side of the aisle, who passed \$2.5-trillion worth of unpaid-for tax cuts and failed to pay for two wars, passed an expanded drug benefit with an overwhelming Republican majority without financing one dime's worth, have now rediscovered the issue of the deficit. At the same time, I hear the same voices clamoring on that, saying let us fully repeal the estate tax.

What sort of consequence would it be to our deficits if we fully repeal the estate tax? Is there not a way to get about 98, 99 percent of all Americans exempt from the estate tax but not bust the deficit in the process and allow us the room for the middle-class tax cuts that the President's budget calls for?

Secretary GEITHNER. Senator, we believe what the President has proposed, and we hope to work with you to do, is to extend the rates and exemptions that were in place in 2009 and make them permanent. We hope Congress will act and make those changes retroactive to January 1st of this year. We think that is fair. It captures only a very, very tiny fraction of all estates, between 1 and 2 percent. We think it is fair to do it that way. We do not think it would be responsible to—

Senator MENENDEZ. That is, 98 percent of Americans would never—

Secretary GEITHNER. Probably 99.

Senator MENENDEZ. So 99 percent of Americans would never pay an estate tax, only the wealthiest 1 percent would.

Secretary GEITHNER. Again, what we are proposing to do is take what was in place in 2009 and make that permanent. That is a lower rate and broader exception than would be in place if Congress did not act this year, because it would go up higher in 2011.

Senator MENENDEZ. Well, that gives us the opportunity to create absolutely no liability for about 98, 99 percent of Americans and gives us the opportunity to pursue the middle-class tax cuts instead of busting the budget.

Secretary GEITHNER. That is correct.

Senator MENENDEZ. Lastly, last year you and I discussed my concern regarding a current law tax loophole using reinsurance between affiliates that allows foreign-based insurance companies to ship their revenues offshore and avoid paying taxes. This is behavior that gives foreign insurers a significant advantage over U.S. competitors, which both hurts our domestic companies and blows significant holes in our tax base.

I am pleased to see that this year's budget has a proposal to seek to resolve this problem, however, I note the approach you all take differs from the approach of the Senate Finance Committee discussion draft and a similar bill introduced in the House. Could I get you to commit to me that you are willing to work to make this a priority and have your staff work with those of us on the Finance Committee to find common ground to effectively close this loophole?

Secretary GEITHNER. Yes, of course we would be happy to work with you on that.

The CHAIRMAN. Thank you.

Senator MENENDEZ. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator.

Senator Enzi, you are next.

Senator ENZI. Thank you, Mr. Chairman.

One of the things I have been concerned about in the budget is the way that small businessmen are going to be affected by the tax increases. They talk about it being over \$250,000 in revenue. I know a young couple from Gillette, WY who started a restaurant. It was very successful. They have expanded it out to eight restaurants.

I went to their newest restaurant in Casper and ran into one of the people who started it. He said, you know, we started this with \$2,000 in our pocket. We now have eight restaurants, and we still only have \$2,000 in our pocket. Everything they made, they put back into the business. But we are going to stifle the economy by stopping them from putting it back into the business because we are going to make them pay it to the Federal Government instead. I appreciate your comments on small business that you made.

You will remember, in your confirmation hearings, I mentioned that a small businessman from Montana had mentioned to me the need for \$5,000 per new employee in order to be able to expand their business, and I appreciate, particularly, that number being in there. There are a bunch of complications that I will work with you on to be sure that we are expanding jobs in order to get that, but we also need to expedite the way that they get that.

The \$30 billion in small business lending that you mentioned in your opening statement, would that be funded through the SBA? Because the SBA has some requirements about showing that you cannot get money before you can get money, and it takes a long time to go through the process because you do not have enough money to begin with. So they are trying to get the money to the people who need it the most, but in the meantime that kind of stifles the economy. So is there a way to get that through the banks instead?

Secretary GEITHNER. Senator, excellent questions. Let me just start where you ended, and then I want to come back to the beginning. We are proposing both to expand what the SBA can do by

raising the loan limits, and lowering the guarantee fee on the most successful SBA programs.

Karen Mills at SBA is working very hard to make sure that she reduces and streamlines the requirements in those programs without leaving the taxpayer more exposed to risk of loss. But we want to complement that by trying to make sure we are helping community banks, too. So the \$30-billion program the President referred to is to take \$30 billion of repayments we have gotten from the largest institutions, put those aside to help make it available to help community banks that are committing to support small business lending.

I did want to come back to the point on the tax side, though. This is very important. We are, in the interests of what makes sense for the economy and in the interests of certainty and clarity, proposing to make permanent the tax cuts now in place for people earning below \$250,000. As I said, that is about 97 percent of small businesses. The increase only affects 2 to 3 percent of small businesses.

But we are also—and this is very important to emphasize—proposing to extend the expensing provisions to expand the accelerated depreciation allowances, proposing to make permanent the R&D tax credit, and we are proposing a very well-designed additional incentive to small businesses that add jobs and increase wages and payroll. We think that is a very powerful package that gives assistance and clarity to small businesses, on balance. So I hope we can work with you, and we hope we find common ground on what we think is a very well-designed, powerful package of tax measures.

Senator ENZI. Thank you. I will switch, because of my limited time, to another topic here, and that is, you are proposing eliminating tax preferences for the oil and gas industry and for the coal industry. That will cost jobs in places like Wyoming, and it will increase the taxes on the oil and gas industry and on the coal industry, and those will be passed on to consumers in their electricity bills and at the pump. So I am kind of curious as to how we are going to increase the taxes on those industries and keep it from being a hidden tax on everyone else.

Related to that, there is also an abandoned mine land tax that the President is talking about eliminating in certain cases. That is actually a law that was passed. It was not an appropriation. That was one crafted by Senator Baucus and I, and others, that was designed to extend the abandoned mine land tax, which for 30 years had promised that those States that received it would be paid back that money. It was kept in the trust fund, and what we have done is released that money.

In exchange, we got the companies to agree to extend the tax. We got the unions pleased that we were able to take care of orphaned minors. All of those things, plus the production, stand a chance of having difficulties if we eliminate those payments. So, I hope that we will take another look at that.

Secretary GEITHNER. Senator, I am happy to work with you and make sure we understand your concerns with how that was designed and proposed. You are right, we are proposing to eliminate a set of subsidies that now go to the oil, gas, and coal industry, and those will raise significant resources over time. We are doing that not only for the reason that we think it is part of being fiscally re-

sponsible, but because we think we need to eliminate subsidies in the system that go to objectives that conflict with our broader effort to try to improve energy efficiency and reduce carbon emissions, but we recognize they will be difficult.

We do not think they are going to have any effect on prices. We do not think they will. People may disagree about that, and they have been carefully designed in that sense. But I understand that is going to be difficult and hard, and we would be happy to work with you, particularly on your concerns about the way the abandoned mine proposal was designed.

Senator ENZI. Thank you.

The CHAIRMAN. Thank you. Mr. Secretary, I share the concern on that program with Senator Enzi, and I hope we can work that out.

Senator CARPER, you are next.

Senator CARPER. Thanks, Mr. Chairman.

One of the reasons I sought for so long to serve on this committee—8 years, actually, before I finally succeeded in getting here—was I have always admired the bipartisan way that this committee works. That history and that characteristic has really been tested over the last year. We have the opportunity, as we sort of reset here for a bit and focus on jobs and job creation, to go back to the tradition that would help make this effective, and I think very much admired, here in the Senate.

Mr. Secretary, yesterday was Mike Enzi's birthday, today is John Cornyn's birthday. I could probably offer a resolution commending both of them on their birthdays this week; I do not know that I could get 60 votes for it. [Laughter.]

Well, I might be able to.

Senator CORNYN. Well, I bet you could not.

Senator CARPER. I might be able to.

Senator CORNYN. Not for commending us, but for committing us.

Senator CARPER. We could get it out of committee, but after that I am not sure what would happen.

Well, I am going to ask you to spend a minute or two. You have outlined in your oral testimony—I got a copy of it, thanks to your staff—what seemed to be pretty good common-sense ideas to try to keep job creation activity going as we move from a huge net loss of jobs a year ago to something almost dead even right now.

But you have outlined some ideas that it would seem to me would not only enjoy Democratic support, from the administration and from folks on our side, but a number of our Republican friends. I just wanted you to come back, and just talk to us about the ones where you see the most potential for common ground, moving the package forward, and why.

Secretary GEITHNER. Well, Senator, we have tried to take what we think are the best ideas from both sides in this area, and I think at the core of this agenda is the recognition that businesses need to be able to grow if we are going to create jobs, and that requires that government do things that are going to help make that easier, not harder.

Businesses have a huge stake in making sure that we have the government investing in research and development, providing targeted tax incentives that will help the technologies of the future, and making our education system do a better job of educating our

children. These are things that business needs, businesses rely on. I think at that core, these suggestions should have broad support.

I tried to say when I began that you have people on both sides of the aisle now saying very important things, saying that deficits matter, tax cuts are not free, that if we are going to do more programs we have to pay for them, that we have great fiscal perils ahead, but that our priority right now is growth and jobs and confidence.

So I think at that core message, again, our hope is, and I think what the American people want to see, they want to see their leaders coming together and trying to bring practical solutions to those problems. We provide a set of suggestions for doing that. We do not have a monopoly of wisdom, a monopoly of ideas, and we will be open to other suggestions. But I think our test is going to be, again, what is going to offer the best prospect of support now to help repair what is broken in our country, get people back to work.

Senator CARPER. I am going to ask you to be a little more specific, if you will—thank you for what you just said—in terms of the proposals that you submitted to us, whether it be \$17.5 billion in SBA loan guarantees, whether it happens to be the \$5,000 tax credit for those who hire new, that is one agenda, but a good agenda.

Secretary GEITHNER. Business expensing, accelerated depreciation, permanent R&D tax credit, zero capital gains for new investments in small businesses, a new jobs tax credit that rewards small businesses and expand employment and wages, SBA credit to small community banks.

Those things that I have heard from members on both sides of the aisle are very important to them. Again, they meet that basic test: they are pro-growth, they are pro-jobs, you can do them in ways that are fiscally responsible, and you can look at people and say a dollar of taxpayers' money will make a difference in those areas. But those are just some things.

Senator CARPER. I just heard my colleagues on the other side, Mr. Chairman. Those are pretty good ideas. They are not just Democratic ideas, they are not just Republican ideas. Those are pretty smart ideas. I would hope that we could find common ground.

As my time runs out, Mr. Secretary, I had spoken to you before about another idea that could help free up a lot of money that is tied up in the student loan auction rate securities, university dollars. The Department of Economics has actually studied this, and they say we could free up a lot of money, an estimated \$60 billion provided for a stimulus that would not cost taxpayers—as far as I can tell—a dime and would translate into potentially up to 400,000 jobs or more.

I have raised this with you; I have raised it with others in the administration. I thought it was a good idea when the University of Delaware brought it to my attention, and I still think it is a good idea. I would lay it at your feet once more. Thank you.

Secretary GEITHNER. I want to just emphasize that Chairman Mary Schapiro at the SEC and State IGs across the country are working on that. You are right to say there is a lot of money still locked up in that, and I would be happy to spend time with you

working through it, or other things that we can do to help on that problem.

Senator CARPER. Thanks for being here today, and thanks for your service.

The CHAIRMAN. Senator Kyl?

Senator KYL. Thank you, Mr. Chairman.

Secretary Geithner, first let me talk about the bank tax, or fee. How many firms will pay the tax that did not directly receive TARP funds?

Secretary GEITHNER. I do not think I can give you the exact number today. I would be happy to respond in writing on that.

[The information appears in the appendix on p. 108.]

Secretary GEITHNER. We have set it to make sure that it only hits firms that are above \$50 billion in assets. Again, those were the firms that we think were the principal beneficiaries of what we had to do to fix the financial system, even though not all of them were direct recipients of taxpayers' money.

Senator KYL. Yes, we all benefitted from it indirectly. Yes or no?

Secretary GEITHNER. But they also——

Senator KYL. Did all of America indirectly benefit from the infusion of TARP funds?

Secretary GEITHNER. Absolutely.

Senator KYL. Good. All right. Thank you. And I will appreciate getting the number of those that directly received the funds.

The point is, some banks will pay for this, or entities will pay the tax that did not directly receive the funds. Of those that did, were there not some that were reluctant to take the funds and, in fact, argued that they should not have to?

Secretary GEITHNER. Well, I have read that, but I actually think a fair reading, looking back, is that that capital was essential to all of them.

One quick point, Senator Kyl. You need to look—as I know you do—they all benefitted from the guarantees the FDIC provided, the emergency guarantees they provided also.

Senator KYL. All right. Well, let us just go with that then. Because what you said is you are going to keep the fee on until the taxpayers are made whole, and this is almost a direct quote, the taxes on the banks that benefitted most from TARP.

Now, I think you are shooting at the wrong target because, is it not also true that the entities to whom this tax will apply either have already paid, or are expected to repay, what they directly received in the way of TARP funds?

Secretary GEITHNER. Exactly. But the law is——

Senator KYL. All right. All right. So the banks that are going to be taxed, some of them did not receive direct funds, some contend that they did not want to take the funds, and in any event they have paid them back. Now, there was an implicit guarantee for some other folks, however, and a direct guarantee, and they have not paid money back that they received from the government. I am talking about General Motors, AIG, the Government-Sponsored Entities. So they are the ones that have not paid the money back. Why tax entities that have paid the money back, but not tax the entities that have not paid the money back?

Secretary GEITHNER. Senator, the way the law was written, it puts an obligation on me to propose to the Congress how to make sure we recoup any losses. So the question is how to do that. We have the obligation, so the question is how to do that. Again, what we designed—and this is a proposal Congress has to consider—is a proposal that is targeted to people we thought benefitted most from the financial actions we took to rescue the economy. It is fair in that way, and it is designed, in a sense, as a fee on risk, as a fee on leverage, and that will help reinforce an objective I think many—

Senator KYL. But you could also, under that same logic, apply the tax to the three types of entities that I just mentioned.

Secretary GEITHNER. Well, there is no perfect way to do that.

Senator KYL. They benefitted.

Secretary GEITHNER. Yes. But as you said, of course you could cast it much more broadly. You could cast it on every bank in the country.

Senator KYL. Is it not the fact that you are trying to go after the people who have the money, and that is the banks that have repaid the money, and should you not be trying to examine a way to get the money back from the entities that I mentioned?

Secretary GEITHNER. We are going to work very, very hard to make sure that we get as much back as we can from those entities, and we are going to be, I think, remarkably successful relative to what anybody said. But we are still left with that obligation in the law.

Senator KYL. Could you send a letter to the committee at an appropriate time indicating how you think you might be able to get more of the money back from the entities that I mentioned that are not subject to the—

Secretary GEITHNER. Absolutely.

Senator KYL. Now, let me, before the time is out, ask you about the dollar. You have a responsibility for managing dollar policy, and I gather you believe in a strong American dollar.

Secretary GEITHNER. Of course I do. In fact, that particular phrase and commitment of policy was first written in my office at the Treasury Department in 1995.

Senator KYL. Great. Now, let me just ask, does issuing more government debt make the dollar stronger or weaker?

Secretary GEITHNER. Senator, I think you are raising the right question, which is that, if the world does not have confidence in our ability to manage our financial future, then we will lose confidence in—

Senator KYL. Is not an honest way to answer the question that issuing more government debt makes the dollar weaker, and that is a real problem, and we need to do everything we can to work around that problem? It is probably not the best idea in the world to be taking on more debt if we want to have a strong dollar, but there are policy reasons that cause the President to want to do that?

Secretary GEITHNER. No, I would not say it that way. It is very interesting, if you look back at what has happened in the last year.

Senator KYL. Go ahead and say it.

Secretary GEITHNER. When the world was in crisis, when people were deeply concerned about the stability of our financial system and about the stability of the global economy, people still wanted to hold dollars and hold U.S. financial assets. The dollar rose over that period of time, and our borrowing costs fell even though we were taking exceptional actions to help fix this economy. That is because they believed in us. They thought we were going to fix it, and they were counting on us to do that.

Now, as people become somewhat more confident, they are willing to take risk again. That is really the story in this period of time, and Americans should really understand this. When the world was most at risk and most scared, people were still putting their resources in dollars—

Senator KYL. I understand what you are saying. Excuse me. The time is—

Secretary GEITHNER. And we want to preserve that.

Senator KYL. Yes. But here is the point. We are talking about next year's budget and the huge deficit that we are going to incur next year. There is a point at which our lenders are not going to have that same kind of confidence. Would you not be willing to state that you agree with me that it is not a good idea to have a big deficit if we want to have a strong dollar?

Secretary GEITHNER. I agree completely with you that, if we do not make people believe that we are going to fix those deficits, bring them down over time, then we will risk losing confidence in our financial future, and that will raise interest rates, you will have less investment, and that will be bad for the American economy.

The CHAIRMAN. Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman.

Mr. Secretary, why not take the \$30 billion in resources that the President has outlined for small business and implement a program immediately as opposed to working its way through a legislative process in Congress?

Secretary GEITHNER. An excellent question. I think the best way to say it is this. We have been trying for 8 months to try to get community and small banks to come and take capital from the Treasury under programs many of you supported and use that to lend. Frankly, they have not been willing to come. They took back their applications by the hundreds because they were worried about the stigma and the conditions.

Now, it may be that that would fade over time—

Senator CANTWELL. Mr. Secretary, I do not think that they were worried about the stigma of TARP dollars. I do not think they liked the terms of the agreement. For somebody who gave 100 cents on the dollar to AIG, I think you would understand that the terms of the agreement matter.

Secretary GEITHNER. I agree with that. I agree with what you said.

Senator CANTWELL. Why not implement a program now—we have small businesses every day that are folding. We acted with urgency when it came to the big banks, but when it comes to the small banks and small businesses, Americans are being told, no, we are not going to design or come up with a program. So you are

right, the Inspector General has said you were supposed to come up with a program last March, and you have not come up with that.

Secretary GEITHNER. Well, no. But that is not quite true, Senator. Again, we have substantially expanded resources to community development financial institutions. We have had a program in place that is very attractive on its financial terms to small community banks. Some have come. Most people have been reluctant to come. You are absolutely right that terms matter. This is not something that takes any time, this is easy to do, but it requires legislation.

Senator CANTWELL. Excuse me, Mr. Secretary. It does not require legislation. We have been in consultation with CRS, and they say it does not. You said you could not do the bail-out to the auto industry from TARP either without legislation, and then when we did not pass legislation—

Secretary GEITHNER. I never said that, Senator.

Senator CANTWELL. Well, that is exactly what happened, and help was given to the auto industry by the administration afterwards. So I am sitting here with a high-tech company in my State that had a performing line of credit pulled by Bank of America and ordered to repay within 30 days. The CEO took himself off of the payroll just so they could barely survive.

I have a woman who is a State employee with no debt, a credit score over 800, \$400,000 in a home, but she has 25 banks who have denied her access to a line of credit. When the FDIC closed the Bank of Clark County, they basically unilaterally cut customers off of their original—we had a company, Columbia Gin, forcing their owner to try to fund the company out of his own pocket; a restaurant, very popular in that area, its assets were frozen and taken over. These are not people who caused the problem; these are people who had performing lines of credit, and they have had their capital cut right out from under them.

Secretary GEITHNER. Senator, I could not agree more with you. What happened in this is deeply unfair. People who were careful, they were prudent, they were responsible, they ran good businesses, but they were—

Senator CANTWELL. Where is the urgency, Mr. Secretary, in solving this? If we go through a legislative process here and we take another 90 days—and who is to say that in that legislative process you will have had the right criteria and the right terms anyway? We could come out of that just as the TALF program did, just as these other programs that were supposedly going to help small business did, and we find out it has not solved the problem.

So my point is, why wait? Why not come to terms right now with community banks? Because the big banks—somebody came to terms with them, and they walked away very happy customers, but small businesses in America are not getting access to capital.

Secretary GEITHNER. Senator, we want to fix this as quickly as we can. Nothing would make me happier than if small banks want to come today to the program we have in place today and take capital from it. But they have in some ways voted with their feet; hundreds and hundreds took back their applications because of concerns about terms. It is not hard, I think, in this way for a Con-

gress to do a quick, deft, surgical, powerful act to reduce their concern that the conditions they face would make it untenable to run their businesses. I do not think that is hard to do.

Senator CANTWELL. I think, Mr. Secretary, you should take swift, deft action to implement that immediately. If you do not get it, then understand, that is what people in America are angry about. They are angry that that is what happened. The past administration took swift, deft action to help the big banks on terms that some people find outrageous today. Now these small banks are not getting access to the terms that would help small business.

These are not unfair terms, these are not unfair justifications, but people put the screws to the community banks and gave all the money away to the big banks. If we do not implement change right now, we are going to lose more jobs. We cannot propose a budget that talks about credits for keeping small business while, right now, people are cutting lines of credit to small business and they are laying off people.

Secretary GEITHNER. I agree. This is not about the fiscal year 2011 budget, and I agree about the urgency completely. Completely. I completely agree.

Senator CANTWELL. Well, I would urge you, Mr. Secretary, I am telling you, they are coming in to my office every day with these stories. I would urge you and the administration to act now. Do not wait for legislation. Come to terms with the community banks on reasonable terms that they can agree to with a broad spectrum of daylight, and I think that we will be well on our way to getting Americans back to work.

Secretary GEITHNER. I agree with you. The President agrees, too. We are happy to work with you and your staff on the best ideas of how to do that.

The CHAIRMAN. I think there are a lot of Senators who share the concerns raised by Senator Cantwell.

Senator Nelson?

Senator NELSON. Well, this Senator certainly does. I can tell you, daily, Mr. Secretary, I hear the same kind of cries of anguish of small businesses going out of business because the banks will not lend. You go to the community banks, and they say the same thing that I raised with you in the Budget Committee 6 months ago, which is the community bankers say, well, we cannot lend because the regulators will not let us lend. When I raised this with you in the Budget Committee last summer, you said, well, we have a problem—I am paraphrasing—we are going to in essence educate the regulators so that these banks will lend. But the system has not worked, and we are now 1 year after you all have taken office. Where did it go?

Secretary GEITHNER. Community banks that I speak to, and I think they say the same to you, what they say to us is, they have three big concerns. One is, they are very worried that, in financial reform, they are going to be subjected to additional burdens that make it hard for them to run their institutions. That is not for the present, but that is something they are very worried about. We believe we can work on a financial reform package that will be responsive to those concerns.

The second thing they say, they say that our examiners and our supervisors are killing us. They say, after a period where they were very supportive of what the banks were doing, they are now over-correcting, and they are making it harder for them to make new loans to customers they believe in and they support. We hear it from everybody. I completely understand it.

I am the Secretary of Treasury. I do not have the ability to affect and direct what those independent supervisors do. They have made some efforts to put out qualifying guidance. They did last November. The chairman has said he is looking for other guidance, things they can do with the FDIC and the OCC to be responsive to that concern. But you are absolutely right. They say the same things to me. It is not any different.

The third thing they say is, we need the ability to get capital and more help from the SBA. What they say is that we need a little bit more confidence that, if we come and take that capital, we are not going to be subjected to conditions in the future that are going to make it hard for us to run our banks, so we are trying to navigate through those pressures. But I completely agree with you. They say the same thing to us, and basically they have it right.

Senator NELSON. Well, the system is not working. We are the government. We are supposed to help the people by making the system work. You say you do not have any control over the regulators, but your boss does. Your boss is the President of the United States, and he has the power of persuasion. What we would say in the South, well, go have a little prayer session with them. We have to get the system functioning.

Now, let me ask you about something I think you can agree with.

Secretary GEITHNER. I can agree with everything you said on that, too.

Senator NELSON. Well then, let us make it work. All right.

We agree on the fact that bank executives have been getting away with these big bonuses and so forth, so there are a bunch of us who are introducing a provision whereby banks' future tax deductions, large banks, that they are going to depend on responsible executive compensation.

The form would require banks to adopt policies that reward long-term performance, so extended vesting pay, employer stock, claw-back arrangements for misconduct, all of those things would be required. The banks that adopt these responsible pay practices for their executives would therefore see no loss in benefits, and banks that continue those irresponsible executive compensation practices would see their bank taxes rise. Is that something you can get behind?

Secretary GEITHNER. I think you had exactly the right objectives, exactly the right standards, how to encourage more prudent risk-taking and not incent short-term risk-taking, make sure you have longer vesting periods, et cetera. We completely support that. I am happy to work with you and your colleagues on how best to achieve that. We think a centerpiece, of course, is trying to make sure that shareholders have the right to vote on those packages, that there is more disclosure and transparency, and that the supervisors are enforcing just those standards, but I would be happy to take a careful look at your suggestions.

Senator NELSON. All right.

We are about to introduce that. There are a bunch of us who are doing this. I would just say in passing, remember—and I have talked to you until you are sick of me talking to you about this—Florida and other areas of the country are different in the homeowners' mortgages that are under water. Forty percent of the mortgages in Florida are under water.

This loan modification program that you all have started, the banks are using those trial modifications as a way to delay the recognition of the loan losses, and they are not making the permanent changes in the loans. Our people are hurting, and they cannot get the mortgages extended so they can stay in their homes and keep their lives going and keep the property values in the neighborhood from just plummeting, and that would happen when they are foreclosed. Please, we need help.

Secretary GEITHNER. Senator, I agree with you. I think a critical thing we have to do is to make sure that those temporary modifications get converted into permanent modifications. They provide very, very substantial cash flow relief to what is now more than three-quarters of a million Americans. But we want them to be translated into permanent modifications for just the reasons you said.

The CHAIRMAN. Thank you, Senator.

This is perhaps re-plowing old ground. You mentioned three things you hear from banks and their concerns about getting capital to loan to a small business. Could you specifically address what is being done in the administration with respect to each of those three concerns?

Secretary GEITHNER. Exactly.

The CHAIRMAN. Because I think Senator Nelson makes a good point. You may not have direct authority over some of the independent regulators, but you are, after all, Treasury Secretary. You have very credible influence in this administration. So, what is being done?

Secretary GEITHNER. All right. The first concern: is it really a concern about regulatory uncertainty principally in terms of design of the financial reform package moving through the Congress? In the House—and I know Chairman Dodd is working very carefully to try to make sure there is a balanced approach that encourages innovation and competition, consumers have choice, we are protecting banks from competition by unregulated entities—we are working very closely together to try to address those concerns.

Second, is the concern about supervisors. This is a tragic pattern in financial crises. What happens is, you have a long period where credit is too cheap, it is too easy, it is too available. Then when things turn, they over-correct: examiners over-correct, markets over-correct, banks over-correct. This is a very important issue.

The supervisors are worried about it, too. They are trying to send a more consistent signal across the army of examiners across the country for more balance and more care so they do not over-correct, and I think they have more work to do in that area.

Their concern is about, not just the way the SBA program works, but how to make sure they can come take capital under the programs we described and use that for things they believe in. As Sen-

ator Cantwell said, it is not just the financial terms that matter. The financial terms of these programs were quite attractive, and there are many sensible conditions in that program too, but they are worried that the full bulk of conditions and the fear about future conditions will make them vulnerable if they actually come.

We need to be responsive to that concern, because it will not work if we put something out again and nobody comes. So, that is the test we have to meet. We are working very closely with many of your colleagues, including Senator Warner and Senator Landrieu, on ways to make sure we adapt this program so that they will actually come and use it and use it to expand small business lending.

The CHAIRMAN. Another question is on health care. Could you explain how health care reform will help businesses?

Secretary GEITHNER. Senator, you can do this, I think, better than anyone in the country.

The CHAIRMAN. As well as get the deficit down.

Secretary GEITHNER. Yes. Our long-term fiscal costs are primarily driven, fundamentally driven, not just by the aging of our population, but by what is happening to health care costs. The only way to reduce the long-term deficit is to reduce the rate of growth in health care costs.

Now, this is not just about the future. The system we live in today is not fair and is very expensive to small businesses. They are the ones that pay much more, for those that actually pay for health insurance. They are the ones that face, in many ways, the most rapid growth in cost. They bear a substantial part of the hidden cost in the system today.

We are not helping them if we leave that system in place. We are going to be left with a worse fiscal problem and the risk of eroding confidence in our capacity to manage that fiscal problem if we cannot demonstrate we have the capacity to put reforms in place that change how people use health care and reduce that rate of growth in costs. It is good policy for the private sector, the business community, and for the country to do things that will reduce the rate of growth of costs in health care.

The CHAIRMAN. Have you given some thought to addressing corporate governance? Shareholders, in many cases, really do not have much authority, as a practical matter. Executive compensation committees are often handpicked by the top person. That gets to other, similar questions. To what degree are our corporate governance laws/rules a bit dated, and to what degree is the administration, and maybe you, looking at ways to address that?

Secretary GEITHNER. I agree with you that part of what failed in our system was a failure of boards of directors of financial institutions to exercise their responsibility. You are not going to have firms run in the interests of their shareholders over the longer term if you do not have boards of directors that understand the business of banks and are able to exercise a set of constraints and checks and balances on what management is doing.

Now, one of the most important things we can do is improve disclosure to the public and to investors, not just about compensation packages, but of the broader risks the firms are taking. That will help give the market shareholders a bit more leverage and influ-

ence over these decisions and help boards of directors do a better job.

But I think the basic responsibility of government, particularly in the financial sector, is to set and enforce better-designed constraints on risk-taking. We cannot run a system based on the hope that shareholders will be able to act in their long-term interests, that boards of directors will always be wise and knowledgeable about the future.

It is the job of government to make sure there are constraints in place, sensibly designed, that limit risk-taking by those institutions, because there will be times when the interests of the management, the boards, and the shareholders may seem to conflict with what is in the broader interests of the stability of the financial system.

The CHAIRMAN. Thank you. My time has expired.
Senator Grassley?

Senator GRASSLEY. I just have two questions, one on education and tax policy and the other one on questions of oversight, given that we have not gotten documents from you.

On education, I think I can say with confidence that every Senator is concerned about high inflation in the cost of education. Chairman Baucus and I included a package of education tax relief provisions in the bipartisan 2001 Tax Relief bill because of that concern. Recently I introduced legislation to make that package permanent, and I am pleased that the administration's budget includes similar measures.

The administration's budget also includes an expansion of higher education entitlement provisions enacted last year. The provision would lower the cap on student loan payments from 15 percent to 10 percent of a graduate's income, and then would forgive any remaining balance in 20 years instead of 25 years.

As would be expected, this new entitlement is very popular, but some experts worry about two risks from fiscal exposure of the entitlement. One risk would be higher-than-expected interest rates; the second risk would be a continuation of a 30-year trend where higher education cost inflation exceeds general inflation.

As a manager of our Federal debt, I assume that you ought to be, and are, concerned about the potential of unlimited Federal liability. Since 2008, through this committee's oversight functions, I have been reviewing the activities of universities with large endowment funds. For instance, the Harvard endowment was last valued at about \$26 billion, just about the size of the Gates Foundation—of course, that is a private foundation.

Our hearings and investigation found a policy paradox; while these universities are accumulating large endowments, they are at the same time raising tuition and other expenses at alarming rates. Parents and students bear the cost of that burden. It does not make sense to have tax-favored endowments and tuitions both growing geometrically. While some of these institutions voluntarily agreed to increase financial aid, there is no fixed policy to protect middle-class families from future tuition hikes.

So my question: with everyone concerned about rapid inflation in higher education costs, aside from proposing more popular entitlements, what is the administration willing to do to provide incen-

tives to colleges to keep costs down? I ask this question because parents and students are on the hook, and under this budget the Federal Government would be on the hook to even a greater degree, as I read the budget.

Secretary GEITHNER. Senator, I thought you stated the challenge exactly right. I am not sure—actually, I could probably say with confidence, I do not think we found the best mix of policies to try to give Americans confidence that they are not going to see the same rate of increase in tuition they have seen in the past.

We do think it is good public policy to make higher education more affordable to Americans. We want to make sure that people have the chance to go to college and that we are generating a larger number of college graduates as a share of our population in the future. That is good policy. We think there is a very high return on that. But we are happy to hear your ideas and listen to you, work with you on ways we can help, sensible ways we can limit future rates of growth in tuition.

Senator GRASSLEY. Congress would not have to pass a bill if the President would give equal time to helping middle-class families by, as he is doing, jaw-boning banks and Wall Street, et cetera. There would not be a disagreement with me on his part for doing that if he would do the same thing with some of our major universities, or all of our universities, for increases in tuition.

Let me go on. In December, I asked you for details regarding the \$168-million AIG retention bonus payments paid in 2009 and the \$198 million in AIG retention bonuses planned for March of this year. Some of the AIG executives promised to return \$45 million of the 2009 bonuses, but that did not happen. Nevertheless, AIG still plans to pay \$198 million in bonuses this year.

Last week I received a letter, not from you but from Kenneth Feinberg, Special Master for TARP, on executive compensation. He said you asked him to reply on your behalf. He offered to brief me, but did not provide the documents I requested.

The offer of a briefing is appreciated, but first I need the documents. This is especially frustrating because I read in the press that AIG has offered to pay the 2010 bonuses early, by the end of this week, I have been told, rather than in March. AIG is reducing the amount of bonuses by 10 percent rather than collecting on broken promises some executives made to repay 2009 bonuses.

The terms of this bonus deal are exactly the sort of information that should have been provided to Congress earlier in response to my request. We should not have to read about these things in the newspaper, only to have it a done deal. When will I receive the documents I requested in my December 24, 2009 letter, and why is Treasury allowing AIG to pay bonuses again this year?

Secretary GEITHNER. Senator, I will commit to you that we will work as quickly as possible to make sure you have the information you need to provide the oversight that this committee has to provide in this issue, and all other issues.

I just want to emphasize that Ken Feinberg, whom I appointed to try to make sure we are fixing what happened in compensation structure for this set of institutions, is working very hard on just the concern you raised. I am sure he will be able to provide a little more detail in public, and is ready whenever you need his judg-

ments. But in the interim, I will make sure we are providing the information you need and be responsive to your questions on this specific issue.

Senator GRASSLEY. All right.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

I wanted to go back to something you said earlier about the Fed and oversight on AIG. You said that they did not have—

Secretary GEITHNER. Did not have any authority or responsibility.

Senator BUNNING. Right. But they did have authority on almost every AIG major counter-party. Almost every, not all. Is that correct?

Secretary GEITHNER. No, that is not quite correct, because a very large number of AIG counter-parties, on their derivatives transactions, were foreign banks.

Senator BUNNING. I agree with that. I am talking about the United States of America's counter-parties.

Secretary GEITHNER. Many of those counter-parties were.

Senator BUNNING. All right.

Secretary GEITHNER. But remember, what is important to recognize is the Fed, under the laws of the land, had authority over institutions called bank holding companies. AIG had hundreds—tens, hundreds, thousands—of counter-parties that were not bank holding companies.

Senator BUNNING. Correct.

I want to go back to something that Senator Cantwell was talking about, because, if I heard it once I have heard it one hundred times from my community bankers, and that is that it is the Fed regulators that have stopped the flow of money out of the community banks to the small business person for fear of the Fed regulators coming in and consuming the bank or stopping all lending to the people who absolutely need the lending. I am talking about small businesses that have 50 jobs, and small businesses that need a line of credit, and on down the line. I am telling you, it is almost unanimous. It is not totally, but it is almost unanimous with the community bankers in Kentucky.

Secretary GEITHNER. I have heard the same thing. I think that in many cases I am sure those concerns are justified, and I think you are exactly right to emphasize it, and I think you need to keep this message very clear to those supervisors and examiners: they need to make sure that they are not making this problem worse. It is very difficult as it is—

Senator BUNNING. They are both Federal and State examiners.

Secretary GEITHNER. Yes.

Senator BUNNING. The State examiners are scared to death that they are not going to be as tough as the Fed regulators.

Secretary GEITHNER. I think all the examiners—this is what happens in a recession like this—are scared. They are looking over their shoulder. They are worried they are going to get killed and lose their jobs if they look like they are too soft in this environment. Many are concerned they were too soft before. Of course, the risk is that they will over-correct.

Senator BUNNING. All right.

Mr. Secretary, I want to follow up on something you said at the House Oversight Committee hearing last week. You were clear that you supported the decision to pay AIG counter-parties off at par, no doubt about that, and that you played no role in the decision to cover up those payments. What I want to know is, if you thought then, and think now, that it was the right decision to keep that information of those payments private?

Secretary GEITHNER. That is a very good question, but let me say what I said to your colleagues in the House. When the Fed disclosed that information in March of 2009, it looked like, to me, it was the right thing to do. I thought it was the right thing to do at that point, and I think it is reasonable for many people to say, looking back now, if it was right then, why not right earlier?

But this is a very important thing for me to say: I did not stand in their shoes at the time. I have enormous trust and confidence in the integrity of the people who made that decision, and their care and experience and judgment. I do not know how to say it differently than that. It was the right thing to do in March of 2009. I understand why so many people would say, if it was right then, why not earlier, but that is hard for me to speak to since I did not sit in their shoes then.

Senator BUNNING. All right.

Then do you think it is appropriate for one Federal agency or regulator to negotiate with another Federal agency on behalf of somebody whom they regulate? Because that is what happened here. Your New York Fed lobbied the SEC to keep the information secret that normally would have been made public.

Secretary GEITHNER. Again, I cannot speak to the details of that question, and I do not think that is an accurate characterization of actually what happened in that case, but that is something that you would better address to the Fed and to the SEC.

Senator BUNNING. Do you think firms that receive government assistance should be less transparent than public firms that do not receive it?

Secretary GEITHNER. Absolutely not, Senator. One of the most important reasons why our system is more stable today is because we forced and compelled a level of disclosure and transparency on our largest institutions about their risk of loss and recession than they or any of their foreign competitors have ever been subjected to.

Senator BUNNING. Mr. Secretary, the Inspector General on TARP would disagree with you 100 percent.

Secretary GEITHNER. No.

Senator BUNNING. I read his report.

Secretary GEITHNER. Not on this question, I do not think he would. Again, what made it possible for us to put out this financial fire with very little cost to the taxpayer was we made it possible for private capital to come in and pay us back. That was only possible because we forced a level of disclosure and transparency on these institutions that went dramatically beyond what existing regulation required. That was a sensible thing to do.

Senator BUNNING. You have read the Inspector General's report on TARP?

Secretary GEITHNER. Of course.

Senator BUNNING. All right.

Secretary GEITHNER. And I spent a lot of time with him and his colleagues, helping them work through and understand the choices we made in that context.

Senator BUNNING. Well, just so I know that you read it.

The CHAIRMAN. Senator Cantwell?

Senator BUNNING. Thank you.

The CHAIRMAN. Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman.

Following up on this issue with the small community banks and the examiner issue, as you are calling it—I will come back to the regulatory uncertainty issue. But on the examiner issue, is the issue not really that capital requirements and leverage ratios were changed by the FDIC basically coming in and saying, you have to have more capital, and basically at a time when, where would you go get capital? Where would you get capital? Nobody could get capital, and so what they did is they basically started canceling loans to individual businesses. That is where they got the capital ratio to come back. They basically started saying to small business, you do not have your loan anymore.

So why not come back and lower the cost of the TARP money through dividends and warrants? Why not adjust that, and adjust the viability? I mean, we were basically saying to people, you can have TARP money if you can prove that you are viable without TARP.

Secretary GEITHNER. Excellent question. You are absolutely right, the community banks now have a very hard time raising capital. That is part of what is forcing them to shrink, apart from what they are getting in terms of pressure from examiners. I am very supportive personally—and, if you just look at what the President announced back in October, you can see that he is—of trying to make sure that the economic terms, in terms of dividends and warrants, et cetera, are more economically attractive for them. I completely agree with that.

Senator CANTWELL. All right.

Secretary GEITHNER. I completely agree with that.

Senator CANTWELL. All right.

And what about the viability?

Secretary GEITHNER. Viability. Let us just sort of sit back and think about it this way. Banks in the country, particularly small banks, are still under enormous pressure. We have to be careful that we are using any assistance we provide as carefully as we can, as wisely as we can. The viability test that exists out there is, I am trying to make sure that it is going to institutions that are more likely to use it to expand. If you use it at firms that do not meet an objective standard of viability, then there is a risk not just that you put the taxpayers' money unnecessarily at risk, but it will not be effective.

Senator CANTWELL. What about viability with TARP?

Secretary GEITHNER. Well, we have looked at a variety of different ways to make sure—and under our current system you can count the TARP dollars you get towards meeting—I will have to go back and check to make sure this is right—that viability standard.

Let me say it differently. If you raise some capital as part of TARP money, you can count that to help meet the viability standard.

But again, Senator, what we are trying to do is make sure that the dollars we give do not put the taxpayer unnecessarily at risk, and they go to banks that are more likely to use those dollars to expand credit. We want to get that balance perfect. I am not claiming that supervisors got that balance perfect. In the system we have in place, we leave it to the supervisors to make that broad judgment about viability. We do not make the independent test of viability because it is a hard thing for this Treasury to do, to go bank-by-bank and make that test of viability.

Senator CANTWELL. But the criteria, I think, the viability criteria, is part of the challenge along with making it a more affordable program. Again, I cannot emphasize enough the anger in America when people get 100 cents on the dollar for something, and then these people are basically cutting them out of capital because of these requirements.

Secretary GEITHNER. I agree with you about that, but I want to be careful that I did not misstate this. Let me make sure. I will make sure I describe for you in writing exactly the way the current viability test works, and you are going to hear more details from us on very small banks and CDFIs, some suggestions for how we can mitigate just the concern you described.

Senator CANTWELL. I could not urge you enough to act without legislation.

On regulatory uncertainty, one thing that concerns me greatly about the proposal is that, on this issue of separation of commercial banks and investment banking, the definition of “prop trading” is going to be so narrowly defined as—I think it was *The Economist* or one of the publications recently came out saying that it was going to be “a door to massive loopholes.” So how is that going to work?

Secretary GEITHNER. It is a very hard thing to draw that line in a way that is sensible, but I agree with your concern. I think that is something we can solve. My colleague, Neal Wolin, is testifying later today before the Banking Committee, and he will have a chance to talk through some of the complications we have in drawing that line.

Senator CANTWELL. Even the CFO of Goldman Sachs says it will be very difficult to distinguish between prop trading and trading for clients, or hedging.

Secretary GEITHNER. That is right.

Senator CANTWELL. Even he is saying it is going to be difficult.

Secretary GEITHNER. You have to start by recognizing the reality that it is difficult, but that is why reform is so important. I mean, the basic objective we are trying to do is to make sure we have clear constraints on risk-taking by these large institutions so they do not bring us to the edge of collapse again.

Part of that is making sure they are holding enough capital against those risks, but part of it involves tougher constraints on what they can actually do. But we have to design those in ways that are sensible and careful, and recognize the reality of the way institutions are run.

Senator CANTWELL. I think you know I support a more clean approach.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Thank you, Secretary Geithner. Clearly, we have huge challenges ahead of us. I think you can tell, this committee wants to work with you. It is a 2-way street. No surprises, but tell us what you are working on. Let us know because we want to help both stimulate the economy and get those jobs. I also urge you to take very strong heed to the words of Senator Cantwell about urgency. I think there is a sense that perhaps there is not a sufficient sense of urgency in the administration for getting assistance for small businesses, and also for community banks, to get that program working better.

Secretary GEITHNER. We share that sense of urgency, the President does, and we want to make sure we are doing things that work and make a difference. Where we do not need legislation, we will not come and ask you to do something.

The CHAIRMAN. I think that is advisable.

Secretary GEITHNER. But where we need it, we need to work quickly on it. I do not think this is complicated. I really do not think it is. It does not need to take a lot of time.

The CHAIRMAN. Well, thank you. We will not keep you any further. You have work to do. Thank you for coming.

The hearing is adjourned.

[Whereupon, at 12:32 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Hearing Statement of Senator Max Baucus (D-Mont.) Regarding the President's FY 2011 Budget

In 1958, former President Harry Truman said: "It's a recession when your neighbor loses his job; it's a depression when you lose yours."

For more than seven million Americans, this Great Recession has been a Great Depression. The American economy has lost more than seven million jobs since the Great Recession began.

The nonpartisan Congressional Budget Office tells us that the Recovery Act that we enacted last year added between 600,000 and 1.6 million jobs. CBO says that the Recovery Act lowered the unemployment rate by between 0.3 and 0.9 percentage points, from where it would have been.

Plainly, there's more work to do. Plainly, creating jobs must be our top priority.

We need to work on legislation that will create jobs. And we need to work across the aisle, so that the legislation on which we work can become law.

Yesterday, the President released his budget. Appropriately, the budget focuses on job creation.

The President calls for a job creation tax credit for small businesses. This credit would encourage businesses to hire. I note that two Members of this Committee — Senators Schumer and Hatch — have advanced a similar proposal.

The budget proposes to increase incentives for investment by small businesses in plants and equipment. These investments would also help to create jobs. The President recommends extending the provisions for enhanced section 179 expensing and bonus depreciation.

And the budget would also encourage investment by excluding from income all capital gains from certain small business stock held for more than five years. I note that two Members of this Committee — Senators Kerry and Snowe — have advanced a similar proposal.

And to help family businesses, ranches, and farms to avoid laying off their workers, the President's budget would provide certainty under the estate tax. I note that several Members of this Committee — notably Senators Lincoln, Cantwell, and Kyl — have been working hard on their proposals in this area, as well.

I support the President's tax cut proposals for job creation. I look forward to working with my Colleagues on both sides of the aisle on these measures.

In addition to these administration proposals to create jobs, I have a proposal to create jobs by increasing small business lending through the Community Development Financial Institutions network. These non-profit lenders serve communities by providing access to capital to small businesses to help create jobs.

And as we seek to find sources of sustained economic growth, I note that we must also push to open new markets to U.S. exports.

The President's budget also calls for \$265 billion to accelerate economic recovery and help families, businesses, and state governments to get through this recession.

The budget also focuses on the economic security of middle-income Americans.

The budget makes permanent many of the tax cuts enacted in 2001 and 2003. These include lower individual income tax rates, family tax incentives like the child tax credit, and education incentives like the student loan interest deduction.

In addition, the President's budget would expand the child and dependent care credit, almost doubling it for middle-income families.

The President's budget also provides for permanent Alternative Minimum Tax relief. Without the relief proposed by the President, more and more middle income taxpayers would be paying this tax every year.

I support these tax cuts proposed by the administration, as well. And I look forward to working with my Colleagues on both sides of the aisle on these measures, as well.

Of course, another role for the budget is to measure the fiscal state of the country.

Many budget experts believe that when the economy is at full employment, annual deficits should not cause debt held by the public to rise as a share of the economy. Using this yardstick means keeping annual deficits at or below three percent of GDP.

Currently, we are far from full employment. But let's look at fiscal years 2014 to 2020. If no policies change, the budget deficit will be 5.1 percent of GDP in fiscal year 2014 and will grow to 5.6 percent of GDP by fiscal year 2020.

These deficits would cause debt held by the public to rise as a share of GDP. To address these challenges, the President's budget proposes a number of policies that would significantly reduce the size of these future deficits.

The President proposes to freeze the total funding for annually appropriated non-security programs for three years.

And the President proposes a fee on large financial institutions to recoup projected taxpayer losses from the TARP program.

When you add up all the budgetary pluses and minuses from the President's policy proposals, you get about \$2 trillion of net deficit reduction over the 10-year period of fiscal year 2011 to fiscal year 2020.

This leads to a deficit of 3.9 percent of GDP in fiscal year 2014 and of 4.2 percent of GDP in 2020. These deficits are an improvement from doing nothing. But these deficits still remain unacceptably high.

I note the Obama Administration has decided to issue an Executive Order to create a bipartisan commission to recommend how to reduce Federal deficits. I hope that the commission can recommend proposals that achieve significant fiscal savings, and that many of these proposals can be enacted into law.

We face a daunting problem for our fiscal policy over the long run, not just the next 10 years. Budget analysts make clear that a primary cause of this explosion is that health care costs are growing faster than the economy.

The solution to this problem is to enact comprehensive health care reform that includes serious cost containment. And that is exactly what we are trying to do.

According to the non-partisan Congressional budget Office, the Senate-passed health care bill would reduce deficits by \$132 billion during the next 10 years. And it would cut deficits by \$650 billion to \$1.3 trillion during the second 10 years.

I look forward to working with my Colleagues in both the House and the Senate to enact comprehensive health care reform.

There is much work to do.

And so, let us continue to work on legislation to create jobs. Let us, as much as possible, work across the aisle, so that the legislation on which we work can become law. And let us get to work now.

**Statement for the Record
by Senator Michael B. Enzi (R-WY)
on "The President's Fiscal Year 2011 Budget"
February 2, 2010
Senate Finance Committee**

Mr. Secretary, I appreciate your appearance before this committee today because I have some very pointed questions for you.

After reviewing the President's budget proposals for the upcoming fiscal year, I'm struck by one thought: what on earth did the people of Wyoming do to anger this Administration?

As a former mayor and state legislator, I know how tough it is to craft a budget that pleases everyone, but after reviewing President Obama's blueprint, I can't help feeling that the people and businesses of Wyoming have a giant bulls-eye on their back.

Between the elimination of tax preferences for traditional energy sources like coal, oil, and natural gas, the elimination of statutorily promised payments from the Abandoned Mine Land Trust Fund, and the increase in the marginal individual income tax rates, Wyoming will be hard-pressed to see an end to this recession any time soon—all thanks to this Administration.

Perhaps you and your colleagues are unaware the importance of the energy industry to the Wyoming economy and the major role Wyoming's coal, oil, and natural gas play in supplying energy for the rest of the United States. Permit me a moment to enlighten you.

Mining is one of the largest industries in my state. Nearly 1 in 12 workers is employed in the sector and even more hold jobs in the supporting industries. The same holds true for the petroleum industry, where 1 in 12 adults are directly employed. Both industries provide some of the highest paying jobs in the state. The average employee in the coal industry earned more than \$75,000 in 2007 compared to the statewide average of \$39,245, and it is estimated that the petroleum industry has an annual payroll of \$1 billion in Wyoming alone.

Wyoming's energy production also contributes substantially to our state's tax base. In fiscal year 2007, oil and natural gas production contributed more than \$2.2 billion to state and local governments.

At a time when the Administration is preaching about the need to create jobs, the budget proposals promote policies that are designed to kill jobs in states like Wyoming.

Continuing traditional energy production is clearly important in Wyoming, and my constituents tell me that these proposals will impact their ability to produce energy, employ people, and collect local, state, and federal energy taxes. However, it isn't only

my home state that benefits from Wyoming's energy production. That production can help fuel our nation's economic recovery by ensuring that other states have clean, reliable, and affordable domestic energy.

Wyoming's geologic basins contain some of the largest fossil fuel deposits in the United States. The state's estimated recoverable coal reserves are second only to Montana's, and its dry natural gas reserves and crude oil reserves are among the largest in the nation. Wyoming has over a dozen of the nation's largest oil and gas fields, including the Pinedale Anticline and the Jonah natural gas fields, which rank among the top ten in the nation.

The Powder River Basin in northeastern Wyoming is the largest coal-producing region in the Nation, accounting for nearly two-fifths of all coal mined in the United States. Powder River Basin coal seams are thick and facilitate surface mining, making extraction easy and efficient. As a result, the price of Powder River Basin coal is less than that of coal produced elsewhere in the United States. Powder River Basin coal also has lower sulfur content than other coal varieties, making it attractive for electricity generators that must comply with strict emission standards.

More than thirty states receive coal from Wyoming, and several mid-western and southern states are highly or entirely dependent on Wyoming supply. States that use coal to generate electricity have substantially lower energy prices than states that choose other sources, and as we seek to promote economic recovery, we should be working to keep energy prices low instead of promoting policies that will lead them to increase.

The Administration's proposals to eliminate all tax preferences for traditional energy will cost Wyoming jobs, will increase energy prices in my state and across the nation, and will keep more Wyomingites out of work. Simply put, the Administration's proposals on fossil fuels strike at the heart of my state's economic engine and our nation's energy supply.

The President's plan to raise the top two marginal income tax rates will have a negative impact on two more important Wyoming industries: agriculture and tourism. Many of the ranches and the small businesses that support tourism in the state (hotels, restaurants, etc) are family-owned businesses and are structured as limited liability corporations, partnerships and occasionally, subchapter-S corporations.

Because they earn more than \$250,000 annually, you call these taxpayers "wealthy." But you and I both know that many of these small businesses see very little of that "profit." Instead, it is reinvested in the business.

During a trip home last year, I visited a restaurant that started in Gillette, Wyoming and over the years expanded to eight different locations. At the location I went to, one of the owners happened to be there. We started chatting and he proudly admitted to me, "We started this business on \$2,000. Now we have eight stores, and we still have only

\$2,000." That's because everything has been plowed back into the business, creating more jobs and income for the people of Wyoming.

When you tax the 'wealthy' you think you're taxing Wall Street fat cats – and you are – but you're also penalizing the small, independent business owner. For this reason, I plan to offer an amendment to the legislation extending the lower marginal rates that would preserve the 2001 tax rates for small business and I hope it will have the President's support.

President Obama once said the federal budget didn't need a hatchet, it needed a scalpel. As you press for the changes I highlighted today, I hope you will grasp that scalpel and use it to protect Wyoming jobs.

Thank you.

Treasury Secretary Timothy F. Geithner
Written Testimony
Senate Committee on Finance
February 2, 2010

Chairman Baucus, Ranking Member Grassley and members of the Committee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2011 Budget.

The U.S. economy is still in the midst of one of the most challenging periods in our nation's history. We have pulled back from the brink of financial collapse and a historic recession. The overall economy grew at an annual rate of 4 percent over the last six months of 2009, but millions of Americans remain out of work and the economic pain of the recession can still be felt throughout our nation. This crisis has caused enormous damage to the basic economic security of tens of millions of Americans.

This is why we have a lot of work to do together to make sure that as overall economic growth recovers, so does job growth. We must restore confidence in the economy's fundamental resilience, and we are taking the steps to ensure sustainable growth going forward that is more widely shared among the American people.

Our immediate priority is to work together to encourage the creation of more and, better-paying jobs. We can only achieve that objective if we are committed to laying a foundation for job creation in the private sector. In the short-term that means ensuring that the true engines of job creation, America's businesses, have the right incentives to expand and hire through new targeted measures in 2010 that will speed job creation.

But laying a new and stronger foundation for the private sector requires more: it requires an equally strong public commitment to invest in the innovation, modern infrastructure, and the education of our future and present workers. These investments will enable our businesses to compete, increase productivity, and most importantly, will help create good, well-paying jobs. In the long-term, this new foundation requires the creation of a strong investment climate by showing our commitment to return the deficit to sustainable levels and establishing the right rules to restore trust in the core functions of our financial system. When recovery is firmly in place and the economy is back on its feet, we need to begin the process of bringing down the deficits that Washington has been accumulating for almost a decade. These deficits are too high and left unchecked they will burden our children and grandchildren, and could drain investment from the private sector, drive up interest rates and threaten the very prosperity we are seeking to produce.

The commitment in this Budget to job creation, innovation, investment in the skills of our people and fiscal sustainability is essential to setting the stage for the kind of broad-based economic growth that will provide middle-class Americans with rising living standards and financial security.

Pursuing these goals requires a careful balance. It means not turning too quickly away from our immediate goals of jobs and recovery, while also not ignoring the long-term health, education and energy challenges that our nation cannot afford to further ignore. And it means laying out a

clear path to fiscal sustainability, and demonstrating our commitment to walk that path by taking the first critical steps along it.

Recovery and Job Creation

As the President said last week, jobs must be our most immediate focus. That means that even before we get to our FY 2011 Budget, we will work with Congress to enact legislation to accelerate the pace of job growth.

First and foremost, we will do this by providing businesses – especially small businesses that have been major job creators in recent years – with tax cuts and other incentives to put more Americans back to work quickly.

The Administration proposes to extend Recovery Act business tax relief, and to create a new, temporary tax credit for job creation. We will extend Recovery Act measures that allow small businesses to deduct the full cost of new investments in qualifying equipment. And we will allow all businesses to take bonus depreciation deductions this year for qualifying capital investments.

Under our new “Small Business Jobs and Wages Tax Cut,” all businesses will be eligible for a \$5,000 tax credit for every new employee they hire in 2010. An additional bonus amount will be available to firms that increase their payroll by adding hours or raising wages, with the total credit amount capped at \$500,000 per firm. Because it will use a 2009 baseline, there are no games or accounting tricks any business could perform to get the job or wage tax cut without actually increasing jobs or wages.

In order to get money out to businesses quickly and thus provide a fast-acting incentive to hire, firms will be able to claim the credit on a quarterly, rather than annual, basis. We expect that over one million small businesses that are growing jobs or wages will receive the credit.

This combination of tax measures will boost the pace and quantity of business investment and, with it the number of new jobs that businesses create.

To cope with the difficulty that small businesses face in getting bank credit, the Administration is proposing legislation that will use \$30 billion from TARP to create a new separate program designed to provide capital to small and community banks. Our proposal includes a carefully-designed incentive structure that improves the terms of the capital the more a small bank expands lending to small business. And we will explore additional ideas from Congress on other ways this facility could work to expand lending to credit-worthy small businesses.

We also call for extending through September of the effective Recovery Act measures that supported up to \$15.4 billion in Small Business Administration loans through lower fees and higher guarantees during this difficult time. And we will support legislation to increase the loan size of the SBA's two most heavily-used guarantee programs.

Second, the President has proposed measures to spur immediate job growth by creating incentives to invest in our environment and energy security. In addition, the Budget includes an extra \$5 billion to expand the number of firms eligible to receive a tax credit for investments in U.S. factories that produce clean energy products. This will boost jobs by helping to build a strong U.S. clean energy industry. And because it is an expansion of an existing program, there

are already worthy businesses ready to receive the benefit so that the additional amount will go to work quickly creating new jobs.

The President is also proposing new incentives for consumers who retrofit their homes to make them more energy-efficient, and we are seeking to expand several Recovery Act initiatives that promote energy efficiency and clean energy and that have been particularly popular and effective at job creation.

Third, the President is proposing to boost infrastructure investment beyond what was included in the Recovery Act so that we can continue modernizing our transportation and communications networks. This increase will support needed public works, provide private sector companies with new work, and spur additional hiring.

As we take all of these steps to get Americans back to work, we need to extend Recovery Act relief for those most hurt by the nation's economic troubles. This will include emergency assistance to seniors, unemployment compensation and COBRA assistance for the unemployed, and relief to revenue-strapped states and localities to help prevent layoffs.

Building a New Foundation

While our first aim must be to restore job growth, the FY 2011 Budget looks beyond the immediate recovery to build a new and stronger foundation for growth in the years ahead. Our aim in doing so is to produce growth that once again raises the living standards of all Americans.

We cannot afford an economic expansion like that of the past decade when, as the President said last week, jobs grew more slowly than during any previous recovery; the incomes of average American households declined while the costs of health care and college reached new highs; and much of our growth was built on the sands of a real estate and financial boom.

In order for Americans to thrive, this nation must rely, as it always has, on a vibrant private sector. Our entrepreneurs, small and large businesses, workers, and nonprofit organizations must be the engines of productivity growth and the primary creators of new, high-quality jobs. Washington's role must be to create optimal conditions for small and large American businesses to grow, innovate and create jobs.

Government can play this important role by helping to ensure that families can save and that businesses have ready access to the credit needed to grow; by helping to expand the body of technical knowledge and the quality of public infrastructure to encourage new businesses and greater productivity; by expanding the market for American goods and services by increasing our exports to the rest of the world; and by helping Americans to better educate themselves in order to best employ the latest knowledge and compete in an increasingly globalized marketplace.

The President's Budget outlines policies to make important progress on all of these objectives.

A strong, healthy financial system is crucial for sustainable growth, job creation, and broad-based prosperity. Such a system helps families save for a house, a child's education and retirement. And it channels those savings into investments that let businesses grow, hire, and raise incomes.

Our financial system is far stronger today than it was a year ago. But it is operating under the same rules that led to its near-collapse and a dangerous recession. These rules must be changed to keep the system from taking unjustifiable risks and so that it can fuel growth.

We need a financial system that is safer; in which financial firms, especially large ones, have more capital to absorb their own losses and cannot take risks that threaten the whole economy. Consumers need to be given the information they require to make the decisions that are right for them and they need to be protected from unfair and fraudulent practices. The government needs to have the authority that it did not have in the recent crisis to break apart and unwind failing firms in ways that limit damage to the system as a whole.

The Administration has proposed reforms that would accomplish these goals, and the House has already passed legislation. We must finish the job of enacting comprehensive reform for the sake of people's financial safety and to ensure growth.

At the very core of the Administration's efforts to build a new foundation for growth are our efforts to encourage American innovation. We already made the largest investment in basic research funding in history last year, and we propose to build on that. Even with our tight fiscal constraints for discretionary spending, our Budget for the next fiscal year will increase civilian research and development (R&D) by 6.4 percent. Our aim is to help create the conditions for greater economic productivity and the emergence of new growth- and job-creating businesses. And with most of these new investments offset by reductions in military R&D, we will pursue this aim without increasing the size of government or government spending.

As the President has said, no area is riper for R&D-driven innovation than energy. Whether you are a consumer watching the cost of filling your gas tank go up or a scientist tracking how climate change is affecting our planet, it is clear that we can no longer afford our heavy reliance on fossil fuels to power our economy.

The transition from fossil fuels to clean energy will challenge both America's technical ingenuity and our political will. But the challenge holds out tremendous possibilities not just for improving our health and the environment, but for creating new, high paying "green" jobs and driving the recovery of America's manufacturing economy.

This Administration is committed to creating clean energy and green jobs. The Recovery Act is already investing \$90 billion in clean energy technologies. And our FY 2011 Budget extends that commitment. As I have already mentioned, it expands by \$5 billion our Advanced Energy Manufacturing Tax Credit, a 30 percent credit for qualified investments in new, expanded or re-equipped clean energy projects. It substantially expands support for construction of new nuclear power plants by increasing loan guarantee authority for such projects by \$36 billion. It funds a \$500 million credit subsidy to support \$3 billion to \$5 billion of loan guarantees for energy efficiency and renewable energy projects. It continues work begun under the Recovery Act to modernize our electrical grid so that it is smarter, stronger, more efficient, and helps foster the growth of wind and solar energy projects.

We will make parallel investments in infrastructure with the intention of taking full advantage of the knowledge generated by the new R&D we are funding. These investments are designed to be launched as quickly as possible in order to create jobs. They will include increasing a \$7.2 billion

program to expand access to broadband computer networks, and following through on our five-year, \$5 billion commitment highlighted by the President last week in Florida to develop high-speed rail.

We are also proposing to expand and make permanent the very successful Build America Bond program, which was part of the Recovery Act. Build America Bonds have expanded the investor base for municipal bonds and lowered borrowing costs, helping to restore a badly damaged municipal finance market and support job creation through new infrastructure projects. States and localities have already issued over \$64 billion in such bonds through the end of December. The President's Budget proposes making Build America Bonds permanent with a subsidy rate that makes extension revenue-neutral. The Budget also proposes expanding the eligible uses of these bonds, allowing them to support financing for nonprofits and a wider range of municipal borrowing.

A critical component for building a new foundation for stable, long-term growth, and a complement to our efforts to increase R&D and innovation, is opening up foreign markets to American goods and services. The President has set a goal of doubling our exports over the next five years and thereby supporting two million American jobs.

Our Budget will substantially increase funding to expand exports, especially those produced by U.S. small businesses. The Budget will provide a 20-percent increase in Commerce Department funding that promotes exports from small businesses, as well as funding for the Import-Export Bank to expand U.S. small business use of the Bank's financial export assistance.

History shows that, besides R&D, the investment that pays the greatest returns in improved productivity and greater prosperity is education. The Budget makes substantial new investments in this area, as well.

The Budget will provide new incentives for the rising generation of students to train as scientists and engineers. And because in order to succeed in a global economy higher education is a necessity and not a luxury, the Administration proposes to increase community college graduation by 5 million students by 2020.

The Budget increases maximum Pell Grants awards to \$5,710, and further propose to make Pell Grants an entitlement program, to further the President's commitment that coming from a lower-income family should never be a barrier to any young person with high educational aspirations. In addition, it will extend the American Opportunity Tax Credit, which provides a tax incentive of up to \$2,500-a-year toward college costs – or up to a total of \$10,000 for a young person getting a four – year degree.

The Budget will support the Administration's efforts to make major reforms and improvements in the nation's elementary and secondary schools to help students graduate so that they are ready for postsecondary education or a career. It will expand the Recovery Act's successful Race to the Top competition for funds to include not only states, but individual school districts, and by investing in a new competitive fund to encourage states to develop innovative techniques for recruiting, retaining and rewarding effective teachers.

Finally, this budget is designed to give middle – class Americans a chance to get back on their feet and contribute to this economy. That commitment has been central to the Administration's

policies from the outset. The middle class was the focus of the Recovery Act. And soon after taking office, the President created a Middle Class Task Force, led by Vice President Biden, aimed at raising the living standards of working families.

In this budget, we build on that commitment. We are proposing to extend the lower- and middle-class tax cuts that are scheduled to expire at the end of 2010. Among its effects, this extension will ensure that 97 percent of small business owners who file individual income tax returns will be spared an increase in their tax rates. The Budget will also extend the Recovery Act's Making Work pay tax credit. And through the initiative of Vice President Biden, we will expand the Child and Dependent Care Tax Credit to help those who are working or going to school and are also responsible for caring for others.

We will further assist tens of millions of middle - class families if we pass health care reform that protects every American from the worst practices of the insurance industry, gives small businesses and uninsured Americans a chance to choose an affordable health care plan in a competitive market, and requires every insurance plan to cover preventative care.

The Administration and Congress have worked hard over the past year on health care and we have no intention of letting the chance for real reform slip away. It is crucial to remember that beyond the difference reform would make to the quality, cost and coverage for tens of millions of Americans, reform would reduce the growth of health care costs. This would be of immense importance to the efficiency of our economy and to our ability to reduce deficits over the long-term.

The Fiscal Imperative

American families are making tough choices in difficult times; Washington must do the same.

Every American knows that the path of our deficits is too high and that if they persist long after this recession ends, they will pose a corrosive threat to our economic future.

That is why we believe that even as we take emergency action to spur demand and job growth, it is not too early to begin the process of imposing policies that can start bringing the deficit down to sustainable levels once recovery and job growth have a firm footing. Failure to show our commitment to bring down medium-term and long-term deficits can weaken a recovery. Failure will mean higher rates for families that want to buy a home or businesses seeking to start or expand. Failure will limit the government's ability to respond in future crises.

Of course, in tackling this problem, we must strike precisely the correct balance with the job- and growth-spurring measures required to assure recovery, and the investment in innovation and education to lay a new foundation for future growth. If we fail to do so, we risk driving the economy back into recession, causing immense additional harm to middle-class families and making it even harder to fix our fiscal problems.

This last point bears repeating. Advocating deep and immediate cuts would damage growth, exacerbating our fiscal challenges.

On the day that President Obama took office, the budget deficit for 2009 stood at \$1.3 trillion – 9.2 percent of GDP – and the projected 10-year deficits for the following 10 years were \$8 trillion.

These huge deficits are the result of the prior Administration's decision to enact large tax cuts and a prescription drug bill without paying for them. Over the next ten years, those measures alone are projected to add \$5.8 trillion to the deficit, including interest expense on the additional associated debt.

The impact of the policies on our nation's debt burden was magnified by the great recession the President inherited and its impact on revenues and automatic increases in spending on safety net programs. Together these automatic changes will increase deficits by about \$2.4 trillion over the next ten years. Simply put, over \$8 trillion of the projected deficits we faced as we put together this budget were due to the fiscal policies of the last eight years and the effects of the deep recession this President inherited. A much smaller amount – less than one tenth of the effect of the unpaid for policies and the recession – is attributable to the cost of the means by which we supported and pulled the economy out of crisis.

Deficit trends of this level are not sustainable. Beginning to correct them will require cutting deficits enough to stabilize the debt-to-GDP ratio at a manageable level so it is no longer rising. This requires cutting the deficit to 3 percent of GDP. This Administration is committed to achieving the goal of deficits that are roughly 3 percent of GDP by 2015. Doing so would mean that the on-going expenses of government will be completely covered by incoming revenues; the only thing adding to the deficit will be interest costs on the accumulated past deficits.

This is an ambitious goal. The deficit in the current fiscal year is expected to reach 10.6 percent of GDP. To reach our 3 percent fiscal target between now and 2015, we must lower deficits as a share of GDP by more than they have been reduced in any five-year period during the past six decades.

The President's Budget proposes a series of actions that would begin to put us back to a responsible, sustainable fiscal path. Let me highlight those changes:

The Budget will freeze all non-security discretionary funding for three years (2011-2013) at 2010 nominal levels, with funding after the three years increasing only at about the rate of inflation. The freeze will reduce deficits by \$250 billion through the end of the decade. Among other things, it will require us to eliminate or consolidate funding for several education programs even as we make significant targeted investments to improve education. It will mean reducing spending on the National Park Service, terminating the Brownfield Economic Development Initiative for poor areas that the President advocated during the election campaign and still supports.

In addition, we need to restore the basic set of disciplines that helped make sure that if Congress proposes new policies or tax cuts, these are paid for with offsetting cuts or changes in policy. In the 1990s, Washington started to live by the budget rule and the basic common sense principle that if the President and Congress wanted to pass an expensive tax cut or entitlement increase – however worthy – they had to find offsetting measure to ensure it did not increase the deficit or debt. This common sense rule – called PAYGO – helped Washington move from large deficits to

surpluses. If Washington had lived up to this principle during the last decade it would have served as a bulwark against the unpaid for tax cuts and entitlement increases that make up the heart of the current deficit and debt. Reinstating PAYGO will help return the government to fiscal sustainability.

The Budget will include proposals to close the “tax gap” by collecting more of the taxes that are owed, but are not paid. This is critically important. Tax evasion not only reduces tax revenue, thereby resulting in an implicit tax increase on those Americans who pay their taxes, it also reduces the faith Americans have in the tax system, starting a vicious cycle that can result in even more evasion. I appreciate this Committee’s longstanding interest in, and leadership on, efforts to reduce the tax gap. I look forward to working with the Committee to address this important issue.

The Budget will provide nearly \$250 million in new enforcement initiatives to improve compliance, which will build on the foundation established in the FY 2010 budget to hire nearly 2,000 new employees dedicated to addressing international tax evasion by businesses and affluent individuals, improving information reporting, and broadening collection activities.

Since President Obama took office, the United States has aggressively pursued international tax agreements to further cross-border tax information exchange. In the past year alone, the United States has signed agreements improving tax information exchange with Switzerland, Luxembourg, Liechtenstein, Gibraltar, Monaco, and Chile. The United States also is working multilaterally to make sure that countries meet international standards on tax transparency and information exchange. The Administration is committed to preventing the facilitation of offshore tax evasion. Finally, the Internal Revenue Service has vigorously pursued enforcement actions against those hiding money offshore. All these efforts are being undertaken to address a fundamental concern: Again, tax evasion, especially through the use of offshore entities and accounts, undermines confidence in our tax system and results in an implicit tax increase on those who pay the taxes they owe.

Our Budget will include a number of proposals to increase information reporting and withholding. The most significant proposal involves addressing the use of offshore entities and accounts to evade U.S. taxes. This initiative will result in billions more in revenue over the budget window and just as importantly send the message that if you hide income and assets offshore to evade tax, we will find you and you will pay. I applaud the leadership this Committee has shown on the issue.

We are also proposing substantive changes to our tax laws to address rules that yield unfair and economically inefficient results. For example, our proposals to reform our international tax rules, to address those aspects that disadvantage investment in the United States and encourage companies to ship jobs overseas. Of course, we recognize that this is an area where our tax law must strike a balance. We are concerned about the competitiveness of U.S. companies abroad and recognize that the growth of U.S. companies globally can benefit the United States. But we recognize that allowing a company that moves jobs or investments overseas to gain a competitive advantage through our tax code against a competitor that chooses to expand investment and job growth in the United States is unfair and is bad policy. This Budget seeks to strike that balance by limiting our proposal regarding the deferral of expenses only to interest. In addition, we drop a previous proposal to limit the ability of taxpayers to elect the tax status of business entities

under the so-called “check-the-box” rules. We remain concerned about the misuse of those rules to inappropriately avoid U.S. taxes, and thus are proposing tighter rules regarding the use of foreign tax credits, as well as a new provision to backstop our transfer pricing rules that will subject to immediate U.S. tax excessive returns on intangibles transferred to low-tax foreign affiliates. Our goal in these proposals is to limit the role taxes play in business investment decisions by reducing implicit tax incentives to move investment and jobs overseas. We are, of course, open to discussing how best to achieve that goal.

Our proposals to allow some of the Bush Administration’s individual tax cuts to expire as scheduled and to limit the value of certain tax benefits are restricted to those with the highest incomes. Moreover, we again propose that the income earned on a so-called “carried interest” be taxed as ordinary income and not at preferential capital gains rates, so that private equity and hedge fund managers pay tax on their compensation under the same rate structure as average Americans.

The new Budget will include the President’s Financial Crisis Responsibility fee to be imposed on our largest financial firms. The fee will raise \$90 billion over 10 years. And it will be extended beyond that period in the event that the cost to the taxpayers of saving the financial system turns out to be greater than that. This last point is another one that bears repeating; the fee can and will be extended until every penny of taxpayer assistance to the financial system has been repaid and the cost of the rescue to taxpayers is zero.

The Administration’s Budget will cut the deficit as a share of GDP by half as a share of the economy, from the 9.2 percent of GDP the President inherited in 2009 to 4.2 percent of GDP in 2013. The deficit will fall further in 2014, to 3.9 percent.

But this is not enough.

That is why the Administration supports the creation of a bipartisan Fiscal Commission. The Commission will be charged with identifying policies that could win the necessary political support to complete the job of achieving fiscal sustainability. Specifically, it would be asked to propose how to balance the budget exclusive of interest payments on the debt by 2015.

Both Democratic and Republican administrations have turned to similar bodies when the nation faced complex and contentious fiscal decisions. For example, in 1981, President Reagan established by Executive Order the so-called Greenspan Commission to cope with financing problems of Social Security. We could make progress tackling today’s fiscal problems with similar bipartisan action.

While the new Fiscal Commission’s first job will be to balance the operating budget of the government—the budget absent interest payments on the debt—by 2015, the panel also would be charged with proposing changes to address the unsustainable rate of growth in entitlement spending and the long-run gap between government revenues and expenditures. The nation will be challenged anew to maintain fiscal balance as the Baby Boom generation retires, especially if we fail to reform health care. This will make the Commission’s latter charge as difficult, and important, to meet as its immediate one.

Finally, I want to highlight progress we achieved over the past year in rescuing our financial system and our economy at a lower cost to taxpayers than many anticipated.

Treasury has taken steps to dramatically bring down the cost of the Troubled Asset Relief Program (TARP), which helped stabilize the financial system, and to shift the focus of the program to small business and housing. As a result of careful stewardship and improved financial conditions, the projected cost of TARP has fallen from \$341 billion last August to \$117 billion in this Budget, and we have removed an additional \$250 billion reserve in place in the event that additional financial stabilization efforts were necessary. If Congress joins with the President in enacting the financial fee, American taxpayers will not have to pay one cent for the financial rescue.

Conclusion

While our country is in a stronger position today than it was one year ago, we still face tremendous challenges. In meeting those challenges, the true engine of job growth and prosperity, the private sector, must lead the way. But the government must help create conditions that allow businesses to thrive.

We must work together to spur job growth, to invest in ways that make our economy stronger in the future, and to lay the foundation for long-term growth. And we must work together to ensure that our government goes back to living within its means.

These goals reinforce each other; they are not in conflict. Without growth, we cannot begin the process of restoring fiscal responsibility. Without confidence that we can bring down our long-term deficits, it will be harder to make sure we are getting Americans back to work and improving economic security.

We are a strong and resilient country. We have successfully confronted great economic challenges in the past, and we will do so again. This is a question of will, not ability. The American people want to see us do this together – to work to solve the problems that we all face and to get the economy back on track.

I look forward to working with you in a bipartisan manner on this endeavor.

Thank you.

Questions for the Record
Treasury Secretary Timothy F. Geithner

Questions from Senator Baucus

- 1) **Last week, the President released a proposal that provides a credit for hiring new people. It also provides a credit for increasing wages.**

a. Why is a jobs credit for hiring a good thing to do?

Although the U.S. economy is growing again, the President has made it clear that he will not be satisfied until economic growth is translating into robust job growth. Businesses are beginning to invest and expand again, but many remain reluctant to hire. In this economic environment, a tax credit for new jobs can accelerate the pace of job growth. For that reason, the Congress enacted the HIRE Act, which provides a new payroll tax exemption for hiring unemployed workers. This legislation, which was signed by the President on March 18, 2010, provides incentives to spur hiring and help put Americans back to work.

b. How many jobs per dollar can be created with a jobs credit?

A recent study by the Congressional Budget Office (“Policies for Increasing Economic Growth and Employment in 2010 and 2011,” January 2010) identified an employment tax credit as the most effective way to increase job growth among the tax provisions it examined. However, the study notes that the actual number of jobs created depends on the design of the particular employment tax credit. The HIRE Act provision was carefully designed to minimize gaming and to maximize job creation. The Treasury Department’s Office of Tax Policy has estimated that an employment incentive like the one in the HIRE Act would benefit over 1 million employers.¹

c. At what level is a jobs credit effective?

The Administration believes that the HIRE Act’s incentives for hiring and retaining unemployed workers provide a powerful short-term incentive to create good jobs and to retain new hires. The HIRE Act provides a payroll tax exemption for the employer’s 6.2 percent share of social security tax for wages paid to a qualifying employee. A qualifying employee is a person who had been unemployed or employed for less than 40 hours during the prior two months. In addition to the payroll tax exemption, a credit of up to \$1,000 per worker is available with respect to a qualifying employee that continues to be employed by the employer for at least 52 weeks provided that the employee’s wages do not decrease significantly in the second half of the year.

d. Back in 1977, the tax code contained a jobs credit for new hires. The data collected suggests it was not well utilized, primarily because it was too

¹ Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2010 and 2011*, January 2010.

complicated and the administration failed to publicize it. How would you advise we avoid the pitfalls of the previous jobs credit today?

The evidence on the 1977 credit is mixed, but many studies, such as by John Bishop and Robert Tannenwald, have found that the credit created a large number of jobs per dollar spent.

It is also important to realize that the current environment is much different than it was more than three decades ago. The vast majority of businesses use paid tax preparers or software to file their tax returns. In addition, payroll processors are more prevalent now than thirty years ago. Both of these features make it more likely that employers would be aware of the tax benefits provided in the HIRE Act and will be able to take advantage of them. Moreover, the payroll tax exemption can be claimed by taxpayers on their employment tax returns, so it can be claimed more timely than if it were restricted to being claimed on the annual income tax return. Finally, efforts to publicize the credit should help make employers more aware of it when they are making hiring decisions.

e. How can we reform the tax code to better support long-term job growth in the United States?

Major tax reforms share similar goals – the tax system should be simpler for individuals and businesses to navigate and easier for the IRS to administer. The tax system should be made fairer by eliminating tax advantages and loopholes. And the tax system should also raise sufficient revenue to fund necessary government expenditures.

We are proposing in this year's Budget many changes that will make our tax code fairer and more conducive to job growth in the United States. We recognize, however, that more needs to be done. The President supports the goal of comprehensive reforms that promote economic growth, simplify the tax system, and fairly raise the revenue needed for the Federal government to meet its obligations. We look forward to working with Congress to achieve further reform and simplification.

- 2) **We have heard from many businesses who are urging Congress to extend the capital investment incentives from Stimulus – that is, bonus depreciation and enhanced Section 179. Similarly, many small businesses are encouraging Congress to eliminate all capital gains tax on investments in small businesses. The President has included these provisions as part of his budget proposals and has also discussed these proposals in the context of job creation.**

a. How do these three provisions (bonus depreciation, Section 179, and zero capital gains for small business investment) help businesses create jobs?

The three provisions lower the after-tax cost of new investments and thereby create an increased demand for capital and thus also an increased demand for labor. These effects should increase the number of business-created jobs. Bonus depreciation and section 179 expensing are similar in that they accelerate capital recovery allowances through time. Section 179 offers a full and immediate deduction ("expensing") of certain tangible investment costs for small businesses, while bonus depreciation can be viewed as a partial expensing measure available to all businesses. Full expensing can yield an effective income tax rate near zero on the returns from investments. Bonus depreciation has a similar, but smaller, effect on lowering the effective tax rate on the returns from eligible investments.

Zero capital gains taxation for small business investment can also enhance job creation. For example, exempting gains from tax with respect to small business corporate stock should encourage investment by small businesses. Moreover, the proposal effectively lowers taxes on profits retained and reinvested by a small business corporation, because such retentions tend to increase the equity value of the corporation. Effectively lowering taxes on small business in this manner will lower the costs of new investments financed through profit retentions.

As recommended by the Administration, the higher section 179 expensing limits have been extended through 2010 under the recently enacted Hiring Incentives to Restore Employment Act. We congratulate the Congress for taking this step to help small businesses invest in new productive assets and thereby create new jobs.

b. How has the utilization of these provisions since they were enacted in the 2009 stimulus bill helped businesses stay afloat?

The investment incentives encourage businesses to accelerate investments by allowing them to more quickly deduct the cost of acquiring new, productivity-enhancing investments. Nonresidential fixed investment – purchases of everything from software to buildings – is a key element in economic recovery. This component of spending fell nearly 40 percent at an annual rate in 2009Q1, but the rate of decline subsided and spending turned positive in the fourth quarter. The incentives have helped slow the decline in investment spending and provided support for the return to growth.

c. Please provide Treasury's analysis of the number of jobs created as a result of these provisions.

While providing a precise estimate for the jobs impact of these provisions is difficult, the Council of Economic Advisers estimates that the Recovery Act added between 1.8 million and 2.1 million jobs at the end of 2009, relative to what would have happened in the absence of the Act, and we believe that business tax incentives' share of this impact is roughly proportional to their share of the overall Act.

- d. Please comment on the argument advanced by many businesses that these provisions have a double benefit? For example, bonus depreciation helps the business who can write off the cost of equipment more quickly as well as helping the business who is selling the equipment.**

Statutory provisions that lower the tax costs of investments in new tangible property increase the demand for investments in such property. For this increase in demand to translate into new actual investment spending requires that equipment providers increase the quantities supplied to the market. The changes in the quantities supplied should generate new jobs. The net result will be increased aggregate employment, output, and income.

- e. How else can we help businesses create jobs? What other incentives can we provide?**

There are many good ideas to help businesses create jobs. For example, the Administration has announced proposals to provide an additional \$5 billion in 48C tax credits for renewable energy manufacturing projects. This extension reflects the overwhelming number of quality applications for the initial \$2.3 billion provided by the Recovery Act.

Likewise, the Administration has proposed an incentive-based program to make credit more available to small businesses. The President has proposed a Small Business Lending Fund targeted at community and smaller banks that lend the most to small businesses, and offer incentives for banks to increase small business lending.

Improving the nation's infrastructure with additional dollars to continue modernizing our transportation and communications networks will, in the long run, make it easier and less costly to conduct business. The Administration will continue to work with Congress on additional steps to help businesses expand, and will view all bills moving forward through the prism of how it will help create jobs.

- 3) Last year's stimulus bill included a COBRA subsidy that helps individuals and their families maintain health insurance while looking for a new job. I commend the Treasury for promptly issuing guidance on this new program so that unemployed workers and their families were able to get help as soon as possible. We are now considering extending this program and the President's budget also proposes extending this subsidy through the end of the year.**

- a. Please provide updated information on the number of individuals or families who have benefitted from this COBRA subsidy.**

In accordance with Section 3001(a)(11) of ARRA, the Treasury Department's Office of Tax Policy is working with the IRS to complete an interim report to be submitted to Congress that will include an analysis of the number of individuals provided the COBRA subsidy and the total amount of the expenditure. The IRS has a process in

place to compile the necessary data, and we hope to be in a position to complete the interim report within the next few months.

b. Please identify any implementation problems experienced by the Treasury or the IRS that we need to consider as we consider further extending the program.

Based on Treasury's and the IRS's experience with the implementation of the COBRA subsidy program, as well as the reports we hear from our colleagues at the Department of Labor and from the public, our assessment is that the program has been well received and the administration of the program has gone relatively smoothly. While early on some employers and COBRA administrators raised concerns about the need to adjust their payroll and health coverage administration systems to comply with the COBRA premium assistance requirements, overall, we have received minimal negative feedback.

We have heard from a few Members of Congress about concerns raised by their employer constituents on the impact of the COBRA subsidy on cash flow. We are working with these Members and others to address these concerns. Based on the comments we have received to date, it appears that this concern has arisen in only a limited number of cases, and we would not recommend changing the current reimbursement arrangement, which appears to be working efficiently for the vast majority of employers.

4) Last Saturday's *New York Times* reported the following about China's race to manufacture alternative energy equipment:

"China has leapfrogged the West in the last two years to emerge as the world's largest manufacturer of solar panels...these efforts to dominate renewable energy technologies raise the prospect that the West may someday trade its dependence on oil from the Mideast for a reliance on solar panels, wind turbines and other gear manufactured in China."

I am pleased that the President proposed \$5 billion in more funds for Section 48C. The Finance Committee wrote and passed this credit as part of last year's Recovery Act, to promote the production of clean-energy technology here in the U.S.

Are there other incentives we should consider to encourage clean-energy technology?

The Administration's Budget supports a wide variety of incentives for clean-energy technology. These include—

- \$36 billion in new loan authority for nuclear power facilities;
- \$500 million in credit subsidies to support loan guarantees for innovative energy efficiency and renewable energy projects;

- \$545 million for climate change technology funding focused on the development of carbon capture; and
- \$2.3 billion in funding for applied energy research and development to position the United States as the world leader in energy technology.

In addition, the Budget proposes the continuation of existing tax incentives for biodiesel, renewable diesel, alternative fuels, alcohol fuels, low-sulfur diesel fuel, new energy efficient homes, energy efficiency improvements to existing homes, lean burn diesel, hybrid and alternative fuel vehicles, alternative fuel refueling property, and sales to implement FERC or State electric restructuring policy. Finally, the Budget also proposes to make permanent the research and experimentation tax credit.

- 5) **The Administration proposes to expand and make permanent the Build America Bonds program. The Build America Bonds program is a tremendous success. Over \$64 billion of Build America Bonds have been issued through the end of 2009. These bonds have been used to build everything from highways and museums to fire stations and schools. Thousands of construction jobs will result from these projects moving forward and all at a considerable savings to state and local governments. By making the program permanent you create certainty in the bond market and by expanding the program you allow even more projects to move forward.**

The Administration proposes decreasing the subsidy from its current level of 35% to 28% in order to make the proposal revenue neutral. What effect will this have on Build America Bonds?

The present Build America Bond program with its 35 percent borrowing subsidy rate was a “deeper” borrowing subsidy program than traditional tax-exempt bonds and was intended as a temporary stimulus incentive under the Recovery Act to promote public capital infrastructure investments in 2009 and 2010 at a time when the tax-exempt bond market faced challenges. The Build America Bond program also was intended to broaden the market for State and local governmental debt to include investors without regard to tax preferences. We agree that the Build America Bond program has been a successful program and has expanded the market for State and local governmental debt.

The Administration’s Budget proposal to expand and make permanent the Build America Bond program at a reduced 28 percent borrowing subsidy rate was intended to provide a sustainable program with appropriate regard for Federal revenue costs. The proposed 28 percent borrowing subsidy rate was designed to be approximately revenue neutral relative to the estimated future Federal tax expenditure for tax-exempt bonds. We expect that even at the lower subsidy rate Build America Bonds will still in many circumstances provide borrowing cost savings and a broader market in comparison to the alternative borrowing option of tax-exempt bonds.

6) Questions on the tax gap:

- a. Which proposals in the budget will do the most to close the \$345 billion annual tax gap?**
- b. What criteria did you use when deciding which measures to propose? How do these criteria comport with the policies and strategies set forth in Treasury's "Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance", released on July 8, 2009?**

The "tax gap" is the difference between the amount of federal taxes that are owed and the amount that is actually collected. Most of the tax gap is caused by underreporting of income or erroneous claims of deductions and credits. To address these issues, the Budget includes a number of proposals to increase both information reporting and withholding, especially with respect to offshore transactions. Together these proposals would raise over \$30 billion in revenues.

Three of the most significant Budget proposals to address the tax gap were enacted earlier this year. First, the Budget proposal addressing under-reporting of income through use of accounts and entities in offshore jurisdictions (\$5.4 billion over the budget window) was enacted in the Hiring Incentives to Restore Employment (HIRE) Act. Second, the Budget proposal to codify the economic substance doctrine (\$4.2 billion over the budget window) was enacted this year as a part of the Health Care and Education Affordability Reconciliation Act. Third, the proposal to require information reporting of payments to corporations (\$9.2 billion over the budget window) was enacted this year as part of the Affordable Care Act (ACA). The enactment of these proposals will substantially assist efforts to address the tax gap.

Besides the three provisions that were enacted this year, the Budget has a number of additional proposals for addressing the tax gap, including:

- Increase certainty with respect to worker classification (\$7.3 billion over the budget window); and
- Require information reporting for rental property expense payments (\$3.1 billion over the budget window).

Additional proposals would require information reporting for private separate accounts of life insurance companies; require a certified TIN from contractors and allow certain withholding; require increased information reporting for certain government payments for property and services; increase information return penalties; allow assessment of criminal restitution as a tax; expand IRS access to information in the National Directory of New Hires for tax administration purposes; make repeated willful failure to file a tax return a felony; facilitate tax compliance with local jurisdictions; extend the statute of limitations where a State adjustment affects Federal tax liability; improve the investigative disclosure statute; and implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes.

Many of these proposals were described in the Treasury Department's *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance*, published on July 8, 2009. Others were developed since the publication of that report. Together these proposals are intended to implement the first component of the Treasury Department's seven-component strategy to reduce the tax gap: Reducing opportunities for evasion. As described in that report, this component includes implementing and expanding information reporting authorities, strengthening tax administration, expanding penalties for noncompliance and combating under-reporting of offshore income.

We have also requested in the Budget additional enforcement resources for the IRS particularly focused on cross-border tax issues. With these resources, the IRS will continue initiatives implemented with the funding from 2010 appropriations and establish new initiatives that will help the IRS continue to increase the roughly \$50 billion in enforcement revenues generated each year.

- 7) **The complexity of the tax code may create challenges making it difficult for taxpayers to comply and for the IRS to administer. Many go to tax preparers, even for returns that should be rather simple. The President's doesn't address the complexity of the tax code.**
- a. **How does tax reform fit into the administration's plans over the next 2 years?**
 - b. **What is the status on the Volcker tax reform task force? When will his report be issued? What are some of the recommendations you expect to be included in that report?**
 - c. **What would you deem the most important reason for tax reform?**
 - d. **How can tax reform address the economy and jobs?**

We share the President's view that we must simplify the tax code, restore fairness, and encourage pro-growth, pro-jobs tax policies. These are the most important reasons for tax reform. We are proposing in the Budget many changes that will make our tax code fairer and more conducive to economic growth in the United States, and have added many such proposals to our proposals from last year.

We recognize, however, that more will be necessary. The Administration supports the creation of a Fiscal Commission. The Fiscal Commission is charged with identifying policies to improve the fiscal situation in the medium-term and to achieve fiscal sustainability over the long run. Specifically, the Commission is charged with balancing the budget excluding interest payments on the debt by 2015. The result is projected to stabilize the debt-to-GDP ratio at an acceptable level once the economy recovers. The magnitude and timing of the policy measures necessary to achieve this goal are subject to considerable uncertainty and will depend on the evolution of the economy. In addition, the Commission will examine policies to meaningfully improve the long-run fiscal outlook, including changes to address the growth of entitlement spending and the gap between the projected revenues and expenditures of the Federal Government.

The President's Economic Recovery Advisory Board (PERAB) and its Tax Task Force are separate and independent of the Treasury Department. On November 27, 2009, PERAB Chairman Paul Volcker announced that the Task Force had asked the Administration to extend the deadline for release of its report on tax reform and that the Task Force expected to provide its report to the Administration after the holidays. Mr. Volcker indicated further that the report would discuss the pros and cons of a spectrum of reform ideas relating to tax simplification, enforcement of existing tax laws and reform of the corporate tax system without considering policies that would raise taxes on families making less than \$250,000. Mr. Volcker also stated that PERAB is not tasked with providing its own policy recommendations for the Administration, and that the final report will be an almanac of options from a broad range of viewpoints. At this point, we understand that the Task Force is continuing its consideration of submissions from the public and its work on a report. No release date for the report has yet been announced.

- 8) The Administration proposes to reform international tax provisions to reduce incentives for U.S. based multinationals to invest abroad rather than in the United States. The proposals included in this year's budget are estimated to raise a total of \$122 billion while provisions included in last year's budget raised \$210 billion.**

- a. Why are the international tax changes this year more limited in scope than last year? For example, it appears modifications to check-the-box provisions are not included this year but were included last year.**

The Administration is committed to eliminating incentives to shift jobs and investment overseas. The FY 2011 Budget includes a robust set of international reform proposals that address those concerns. This year's package includes two new proposals, one addressing transfers of intangibles and the other addressing the use of offshore reinsurance. The Administration's FY 2011 international proposals would raise approximately \$122 billion compared with the approximately \$151 billion mid-session review estimate of last year's proposals. (The original FY 2010 Budget estimate was reduced from \$210 billion to \$151 billion at the Mid-Session Review because of changes in economic and other assumptions as well as certain technical revisions.) The FY 2011 Budget estimate reflects further reductions attributable to changes in economic assumptions since the mid-session review and modifications to the proposals.

We dropped the so-called check-the-box proposal, and narrowed the expense deferral proposal, to address some concerns raised and to focus our package on addressing more specifically transactions that shift investment and jobs. The Administration continues to be concerned that the check-the-box rules may facilitate the avoidance of U.S. tax on offshore profits in inappropriate ways and continues to consider appropriate reforms.

b. This year's budget includes a provision to tax "excess income" earned by foreign subsidiaries that is associated with transfer of intangibles offshore.

i. Are you concerned that U.S. multinationals are inappropriately shifting income from intangibles to foreign subsidiaries?

Increased globalization and technological advances have resulted in an economy where intangible assets play an increasingly important role. Valuable intangible property can be easily moved across borders, resulting in multinational corporations transferring intangible assets to subsidiaries in overseas tax havens, thereby shifting profits overseas and avoiding U.S. tax. Recent empirical analyses raise concerns that income shifting through transfers of intangibles to low-taxed affiliates has resulted in a significant erosion of the U.S. tax base (see e.g., Government Accountability Office, *U.S. Multinational Corporations: Effective Tax Rates are Correlated With Where Income is Reported*, GAO-08-950, 2008; Department of the Treasury, *Report to Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties*, 2007).

The potential significant tax savings achieved by shifting income to offshore affiliates puts significant pressure on the enforcement and effective application of current transfer pricing rules. The proposal is intended to serve as a backstop to current rules for valuing intangible property rights transferred to a related person, and to prevent the inappropriate shifting of income resulting from the transfer of high-value intangibles offshore to low-tax environments. It is consistent with and complementary to the principles of the current transfer pricing rules.

ii. To what extent is the current transfer pricing rules not adequate to prevent potential abuses?

The potential significant tax savings achieved by shifting income to offshore affiliates puts significant pressure on the enforcement and effective application of current transfer pricing rules. The proposal is intended to serve as a backstop to current rules for valuing intangible property rights transferred to a related person, and to prevent the inappropriate shifting of income resulting from the transfer of high-value intangibles offshore to low-tax environments. It is consistent with and complementary to the principles of the current transfer pricing rules.

c. How will these proposals affect the ability of U.S. based multi-national corporations to compete abroad?

The Administration is focused on finding ways to encourage job growth through economic expansion and making America competitive in the global economy. Our Budget proposals seek to level the playing field by reducing the incentives in our current system to invest abroad and by closing loopholes that encourage income shifting to low-tax countries. The proposed international tax changes address specific problems in our existing tax laws. For example, deferring the deduction of interest expense allocated to deferred foreign income would reduce the tax incentive for U.S. companies to make investments offshore (as opposed to here in the United States). Other proposals address misuse of the foreign tax credit and aggressive transfer pricing. In addition, our Budget encourages investment here in the United States, by proposing to permanently extend the research and experimentation credit.

d. Early last year a tax reform task force was established as part of the President's Economic Recovery Advisory Board (PERAB). A report was expected to be issued in December, but that report has been delayed.

Please see response to Question 7.

e. When do you expect that report to be issued?

Please see response to Question 7.

f. Do you view the proposals in the budget as changes that should be made on a stand-alone basis or as part of a broader tax reform effort?

The proposed international tax changes address specific problems in our existing tax laws. For example, limiting the deduction of interest expense allocated to deferred foreign income would reduce the tax incentive for U.S. companies to make investments offshore (as opposed to here in the United States). Other proposals address misuse of the foreign tax credit and aggressive transfer pricing. These Budget proposals would make our tax code fairer and more conducive to economic growth by reducing incentives to invest abroad and by closing loopholes that encourage income shifting to low-tax jurisdictions. Accordingly, we do not believe that implementation of these proposals should await broader international tax reform. We believe, however, that more fundamental tax reform also may be necessary to achieve our goals and make the United States more competitive. This will require consultation with your Committee and with others in Congress. We look forward to working with you to explore and develop ideas that you may have as to how best to achieve our mutual goals.

- 9) **We recently enacted temporary relief from the new funding rules of the Pension Protection Act of 2006. But we've been hearing many concerns from employers that this is not enough and that further relief is necessary in order to prevent employers from freezing their plans, closing plants and stores, and laying off workers due to the drop in asset values in 2008.**

- a. **To what extent does Treasury believe that further temporary, targeted relief from the PPA funding rules is warranted?**
- b. **Why weren't relief proposals included in the budget?**
- c. **What actions would you recommend Congress take to address the funding challenges being faced by employers?**
- d. **In light of the sharp decline in asset values in 2008, to what extent will the PPA funding rules affect the ability of American businesses to maintain their employees, their pension plans, and their businesses?**

Recent investment losses and current low interest rates have forced many employers to increase their pension contributions significantly, even while many businesses continue to struggle in a recovering economy. The Administration supports targeted legislation that allows plan sponsors to temporarily delay pension contributions resulting from these unique circumstances, giving them more time to make up these extraordinary losses while requiring the same funding levels by the end of a defined period. By making pension commitments more affordable for employers, this legislation could encourage employers to continue to offer retirement benefits and free up resources for business investment and job creation. At the same time, the legislation should not allow employers who take advantage of this relief to use their resulting improved temporary cash flows to put payments to shareholders and executives ahead of the security of workers' pensions.

10) I have long been concerned about the effect of higher tax rates on small business owners. Your staff has indicated that allowing the current top two marginal tax rates for single filers earning more than \$200,000 and for married couples filing jointly earning more than \$250,000 to expire will only affect about 2 percent of those taxpayers with pass-through income from businesses.

- a. **What additional information can you provide on what types of businesses are affected by the higher rates?**

It is difficult to fully describe the types of business owners that would be affected by these tax changes because of the wide variety of business ventures and the limited reliable information contained on income tax returns about these businesses. For example, tax data does not include sufficient information to discern those who would typically be considered small business owners from partners in large law firms, accounting firms, and investment banks, hedge funds and private equity funds. Moreover, the taxpayers involved in these ventures differ in the level of participation in the businesses themselves. That said, based on a broad definition, only about two percent of families with business income would be affected by the proposed increases in income tax rates that would apply to those with income over \$250,000 (\$200,000 for single filers).

b. What is the average annual net income for S corporations (by shareholder), partnerships (by partner), and sole proprietorships? To what extent are service corporations different from other businesses in their income profiles and how they might be affected by an increase in the top two income tax rates?

For Tax Year 2006, we have the following data:

- Average net income per S corporation shareholder: \$58,000
- Average net income per partner: \$40,000
- Average net income per sole proprietor: \$12,600

For S corporations in the service sector, net income per shareholder varies quite a bit by type of service being provided. For example, for Tax Year 2006, the average reported income (as identified on their returns) was \$18,400 for firms providing accommodation and food services, \$49,300 for firms providing professional, scientific, and technical services, and \$72,700 for offices of health practitioners and outpatient care centers. Overall, we expect only a small fraction of service corporations to be affected by allowing the top rates to return to their level during the 1990s, when the nation enjoyed sustained economic prosperity.

11) The IRS budget has been increased by 4% - almost \$500 million dollars.

a. What were your priorities in setting the IRS budget?

The FY 2011 Budget is the result of a thorough examination of Treasury programs, their existing funding levels, and how those programs support the Department's high priority performance goals. One of those goals is to improve voluntary tax compliance. FY 2011 IRS program increases will improve service, strengthen enforcement and make progress in modernization. These initiatives are described below.

The Department also identified offsets to program increases when appropriate. Efficiencies, savings and program reductions totaling \$167 million are included in the IRS Budget, as well as savings of \$32.7 million in one-time costs associated with the FY 2010 enforcement initiatives.

b. How will services, including the ability to reach the IRS by telephone, voluntary compliance and enforcement be improved as a result of the increase in funding?

The program increases included in the IRS budget fund enhancements in phone service, the IRS.gov web site, enforcement activities, and the new taxpayer account database.

Increase Phone Service

The Budget provides \$21 million to improve the level of service associated with the IRS toll-free tax assistance lines. The demand for phone service has significantly increased in recent years. The IRS effectively addressed some of the rising demand by automating certain taxpayer and employee activities, including the web-based *Where's My Refund?* And Employee Identification Number (EIN) applications, and integrated automation technology tools. This funding will raise the level of service to 75 percent from an actual of 70 percent in FY 2009.

Improve IRS.gov

The Budget includes \$25 million to improve the IRS.gov web site. Taxpayers are increasingly turning to IRS.gov to find forms and answer questions. In FY 2009, taxpayers viewed more than 1.7 billion IRS.gov pages, and more than 54 million taxpayers used *Where's My Refund?*, an increase of 39 percent, with 453,000 taxpayers using the Spanish version.

Revamping IRS.gov will increase customer satisfaction through improved navigation, content quality, and search capabilities. The initiative will also support the Department of the Treasury's efforts to increase the number of paperless transactions with the public, including progress toward the High Priority Performance Goal of 81 percent of individual returns e-filed by the end of FY 2011.

Strengthen Enforcement Activities

The IRS requests \$247.4 million for investments in compliance programs. The enforcement initiatives will address underreporting of income associated with international activities and noncompliance among corporate and high-wealth taxpayers. These investments will bring in nearly \$2 billion in additional annual enforcement revenue. This estimate does not account for the deterrent effect of IRS enforcement programs, conservatively estimated to be at least three times larger than the direct revenue impact.

Complete the New Taxpayer Account Database

The Budget provides \$387 million for Business Systems Modernization at the IRS. This funding will be used toward the new taxpayer account database. The new database will support daily processing and result in faster refunds for all individual refund filers. Daily updating of individual taxpayer accounts will improve service and accuracy and reduce interest paid on late refunds.

c. How will this budget help to close the \$345 billion annual tax gap?

The Treasury Department remains committed to addressing the tax gap. The FY 2011 Budget provides \$247.4 million to improve business and international tax compliance, increase information reporting, and broaden collection activities. The IRS expects these initiatives will bring in nearly \$2 billion in additional revenue once new employees are brought on board and become fully trained.

The FY 2011 Budget also includes legislative proposals that will improve tax compliance with minimum taxpayer burden. These proposals specifically target the tax gap and will generate \$26 billion over the next ten years. The Budget proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

Dollars in Millions						
FY 2011 Enforcement Investment	First Year (FY 2011)			Full Performance (FY 2013)		
	Cost	Revenue	ROI	Cost	Revenue	ROI
All Enforcement Initiatives	\$247.4	\$719.8	2.9	\$209.6	\$1,946.2	9.3
Direct Revenue Producing Initiatives	\$236.9	\$719.8	3.0	\$200.6	\$1,946.2	9.7
Address Business and Individual International Compliance	121.1	300.8	2.5	101.3	812.2	8.0
Reduce the Reporting Compliance Tax Gap	77.7	211.7	2.7	65.8	659.6	10.0
Reduce the Nonfiling and Underpayment Tax Gap	38.1	207.3	5.4	33.5	474.4	14.2
Other Enforcement Initiatives	\$10.5	\$0.0	0.0	\$9.0	\$0.0	0.0

12) The Administration proposes imposing a new “financial crisis responsibility fee” on banks with assets over \$50 billion to recoup projected taxpayer losses from the TARP program. For U.S. based companies, total worldwide assets will be taken into account. However, for foreign based banks, only their U.S. activities will be counted.

a. Are you concerned that the structure of the fee in this manner will provide a competitive advantage to foreign based banks that are operating in the United States?

We do not believe that the fee will provide a competitive advantage to foreign banks that are operating in the United States. With respect to their U.S. operations, large foreign banks will be subject to the fee. It is important to reiterate our commitment to require the financial sector to repay the taxpayer for the extraordinary benefits received and to ensure taxpayer dollars that supported these actions are reimbursed by the financial sector so that the Federal budget deficit is not increased.

The Financial Crisis Responsibility Fee (FCRF) proposal is entirely consistent with the agreement by the G-20 Leaders in Pittsburgh that the costs of the financial crisis should be recouped from the financial sector. We are working through the G-20 and the Financial Stability Board to encourage other major financial centers to adopt comparable approaches.

b. Was consideration given to alternative structures such as an additional tax based on income?

The Administration conducted a thorough process, during which we reviewed a variety of alternatives. Following this process, we determined that the FCRF was the

most effective measure to recoup money for the American taxpayers while attacking some of the fundamental risks that remain in our financial system, by discouraging excessive and risky leverage at our largest firms. We are not only recovering tax dollars, but also promoting sound practices. The fee will be structured to fall most heavily on the very largest and most levered financial firms that rely on the most volatile funding sources.

Thus, the Fee will serve as a taxpayer reimbursement device and as a mechanism to force the major financial firms to internalize some of the externalities they generate. The Fee will provide an incentive for these firms to reduce their size, leverage, funding volatility, and overall risk.

- 13) The IRS, Treasury and the Department of Justice spent a lot of time and resources last year to reach a settlement agreement with UBS and the Swiss government to turn over information on 4,450 US individuals with UBS Swiss bank accounts. The Swiss court recently ruled that failure to report income or file US tax forms doesn't rise to the level of tax fraud that would require disclosure to the US. Now the Swiss government has suspended further disclosures and may seek to renegotiate the agreement.**

- a. Do you believe the agreement is in jeopardy? What are Treasury and the IRS doing to salvage the agreement?**

As you note, last year the United States reached an historic agreement with the Swiss government to gain access to information about thousands of secret bank accounts held by Americans at UBS. As a result of the agreement and the voluntary disclosures that news of the agreement generated, the IRS is pursuing leads to uncover other tax evaders and those who assist them. Last month, the Swiss Government lost a court case in Switzerland involving further disclosures of UBS accounts. The Swiss Government has stated publicly its intent to honor the agreement reached with the United States and we expect them to do that.

Through its international enforcement programs, the IRS is clearly making progress on combating the use of offshore accounts to avoid paying tax. As a result of the IRS's stepped up international efforts, thousands of individuals have come forward and declared their offshore accounts to the IRS. Under the terms of a special voluntary disclosure programs conducted last year, over 14,700 individuals agreed to pay back taxes and interest, along with hefty penalties. Just as important, those people are now back participating in the tax system for years to come. The Administration continues to devote unprecedented focus and resources to international tax compliance. The President's FY 2011 Budget includes nearly 800 international enforcement personnel for the IRS, and this is on top of the nearly 800 included in the FY 2010 request.

Finally, the Administration continues to support legislation to provide additional tools to combat offshore tax evasion. In particular, Mr. Chairman, we applaud the

leadership role taken by you and Senator Kerry in introducing the Foreign Account Tax Compliance Act to reduce the taxes lost through illegal use of hidden accounts and to make sure that everyone pays their fair share. This legislation will help assure that the UBS experience will not be repeated.

b. To what extent will the Foreign Account Tax Compliance Act legislation that I introduced in October, and that has been adopted in this budget, streamline the information sharing process and avoid situations similar to UBS in the future?

The Administration appreciates the strong leadership you have shown on this important issue. The Foreign Account Tax Compliance Act (FATCA) legislation that you introduced in October and included in jobs legislation recently passed by the Senate, which is fully consistent with the Administration's FY 2011 Budget proposals to combat offshore tax evasion, would strengthen information reporting by providing strong incentives to foreign financial institutions to identify and report to the IRS accounts owned by certain U.S. persons, either directly or through certain foreign entities. FATCA focuses on financial institutions (including offshore investment vehicles) because these institutions are in the best position to obtain and report to the IRS the information it needs to enforce U.S. tax laws.

The legislation would give broad authority to the Secretary to prescribe due diligence and verification procedures with respect to the identification of U.S. accounts, to ensure that foreign financial institutions live up to their obligations. We anticipate that such procedures will include the possibility of audits to verify compliance. These procedures should give the IRS the flexibility it needs to ensure that banks comply with their obligations. Additionally, if a foreign financial institution failed to honor its agreement, the IRS would have the power to terminate the agreement. This legislation will help assure that the UBS experience will not be repeated.

14) I strongly believe small business lending is critical for economic recovery and job creation. However, previous efforts to increase small business lending have met with limited success. Can you provide more specific information on what the Department of Treasury is doing to ensure small businesses have access to the capital they need to lead America's economic recovery?

The Administration recognizes that expanding access to credit for small businesses is necessary to help smaller firms play their crucial role in supporting an economic recovery. As a result, Treasury has put forward a proposal to create, through legislation, a new \$30 billion Small Business Lending Fund (SBLF). Under the fund, the Administration proposes to provide capital to community and smaller banks to support additional small business lending. Banks would receive a reduction in the dividends they pay on this capital based on additional lending over a baseline set using 2009 data, providing an incentive for banks to use this capital to extend more credit. At the same time, we are working with Congress to identify additional ideas that could be included in the SBLF.

In addition to the new SBLF, Treasury has worked closely with the SBA to support new lending to small businesses during this critical time. Treasury has worked closely with SBA on Recovery Act efforts to temporarily increase guarantees and reduce fees for SBA-guaranteed loans and has continued to support efforts to expand these provisions. Treasury has taken steps to unfreeze the secondary markets on which some SBA loans are bought and sold, helping to return activity and pricing on these markets to pre-crisis levels. Treasury and SBA continue to work together to support measures to increase loan sizes, increase the availability of working capital loans, and help address small business real estate issues through allowing refinancing through the 504 program.

- 15) I am increasingly concerned about the U.S. – China economic relationship. A litany of recent Chinese actions from unjustified countervailing duty investigations, to the cyberattacks against Google and other U.S. companies, to China’s refusal to appreciate the renminbi despite strong economic recovery have undermined the ability of U.S. companies to operate in China, and have undermined the competitiveness of U.S. businesses vis-à-vis their Chinese counterparts. As Treasury Secretary, you play a significant role in guiding the U.S. – China economic relationship. Where do you see our relationship headed? What steps do you plan to take to address imbalances in the U.S. – China economic relationship?**

Through intensive engagement in multilateral and bilateral fora such as the G-20 and the U.S.-China Strategic and Economic Dialogue, the Administration is working to strengthen the global economy and the international financial system to promote the interests of U.S. workers and firms.

One of the most important aspects in addressing the financial and economic crisis is laying the foundations for more balanced, sustained growth of the global economy.

China has made a strong cyclical recovery – contributing to a turnaround in the global economy after the crisis – based on domestic stimulus. To sustain the progress, deeper reforms and foreign exchange flexibility will be essential. The recent lack of flexibility of the renminbi exchange rate and renewed accumulation of foreign exchange reserves risk unwinding some of the progress made in reducing imbalances as stimulus policies are eventually withdrawn and demand by China’s trading partners recovers. I can assure you that I will continue to push hard at every opportunity to achieve progress in this area.

Questions from Senator Grassley

- 1) **When you appeared before this committee as Treasury Secretary nominee last year, 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, you indicated that, in general, you 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 19.4% 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?

The President's FY 2011 Budget incorporates revenue increases (along with significant tax cuts), restraints on spending, and responsible reform of the health care system as initial steps toward getting our fiscal house in order. He also supports a bipartisan fiscal commission to help break down some of the political barriers that have made it difficult to address our long-term fiscal problems.

- 2) **Do you recognize that there is a downside to future economic growth if we return to record levels of Federal taxation?**

It is true that a poorly designed tax system can be a drag on economic growth. However, it is also true that government borrowing can be a drag on economic growth, as can restricted amounts of government spending (particularly on investments needed to maintain a productive workforce and an innovative, strong economy). The President's FY 2011 Budget represents a responsible approach to addressing the major fiscal imbalances.

Questions from Senator Rockefeller

- 1) **Secretary Geithner, I was proud to work for years with House Ways & Means Committee Chairman Charlie Rangel on the Qualified School Construction Bonds. We worked hard to have these bonds included in the American Recovery and Reinvestment Act. While some states and districts have had problems with these bonds, the West Virginia School Building Authority used its entire 2009 allocation, and West Virginia is eager to do the same this year. In fact, my state needs this authority as soon as possible.**
 - a. **When will the Treasury Department release guidance on the 2010 allocation for the Qualified School Construction Bond to states? West Virginia is ready to move forward and we cannot delay investments in our schools any further.**
 - b. **When will the Treasury Department issue its regulations on strippability for the bonds? Let me be clear, however, that I do not want the Treasury Department to delay 2010 allocation guidance to states that are eager and able to use these bonds as soon as guidance is issued.**

The Treasury Department released guidance on the 2010 volume cap allocations for Qualified School Construction Bonds on March 17, 2010. The Department released interim guidance on “stripping” tax credits from qualified tax credit bonds on March 24, 2010.

- 2) **In the House jobs package, the Ways and Means Committee included a provision for Qualified School Construction Bonds to have a “direct payment” feature similar to Build America Bonds. Given the success of Build America Bonds, this seems like a great idea to leverage more school construction and job creation.**
 - a. **Has the Treasury Department taken a position on this issue? Is “direct payment” for school construction bonds good policy?**

The President recently signed the HIRE Act, which gives State and local governments the option to convert the method of delivering the Federal borrowing subsidy on certain qualified tax credit bonds, including these Qualified School Construction Bonds from tax credits claimed by investors to direct Federal payments made to issuers, as done for Build America Bonds. As with the successful Build America Bond program, we believe this new direct payment option offers access to a broader conventional taxable bond market, borrowing cost savings, and a streamlined IRS compliance framework focusing directly on governmental issuers who benefit from the subsidy. The market has shown a preference for direct payment Build America Bonds over tax credit bonds. Despite their theoretical efficiency, tax credit bonds face challenges, including a small undeveloped market, illiquidity cost premiums,

uncertain investor demand for tax credits, and difficult IRS tax administration issues in tracking tax credits.

- 3) **Secretary Geithner, I was pleased to see the President's FY2011 budget called for a two year extension of the New Markets Tax Credit (NMTC) with an annual allocation amount of \$5 billion. I have championed the NMTC in the Senate, along with my colleague Senator Olympia Snowe, because I have seen the NMTC in West Virginia and states across the country bring private capital investment into businesses in some of our poorest rural and urban communities.**

I was also pleased to see that the detailed budget estimates provided by the Treasury Department called for offsetting the Alternative Minimum Tax (AMT) requirements for all NMTC allocation authority awarded but not yet invested. However, I did not see the AMT issue addressed in the "Green Book."

- a. **Can you please clarify the Administration's position on providing AMT relief to NMTC investors?**

I would urge the Administration to support AMT relief for NMTC as soon as possible to keep the NMTC investor markets competitive and vibrant and to enable community development entities to encourage small and medium sized banks to invest in NMTC.

NMTC has generated over \$14.3 billion in investments in low income communities. However, as the taxable income of many banks and corporate entities decline, there is growing concern that investors will have less appetite for the tax credit as they have less taxable income to offset. This problem is compounded by other, more attractive options in the credit marketplace. The Housing and Economic Recovery Act of 2008 provided AMT relief to the Low Income Housing Tax Credit and the Historic Rehabilitation Tax Credit.

The Administration's Budget incorporates a provision that would allow the New Markets Tax Credit (NMTC) to offset AMT liability for both new allocations of the credit and also for new investments made under prior year NMTC allocations. Permitting the NMTC to offset AMT will allow the NMTC to compete with other credits that currently offset AMT (like the Low Income Housing Tax Credit and the Historic Rehabilitation Tax Credit) and continue to attract investor capital in today's challenging economy.

- 4) **Secretary Geithner, can you discuss the important link between health care investments and economic growth? Do you see additional opportunities to fund some of the high caliber, shovel-ready projects across the nation for which there was not enough ARRA money?**

Health reform that lowers costs and expands coverage will facilitate economic growth in several important ways.

First, making our health system more efficient means we can achieve better health outcomes at lower cost, allowing families to allocate resources to other productive uses and reducing health care costs for businesses, which will increase U.S. competitiveness.

Second, health reform will reduce the federal budget deficit. As the President has often said, reducing the overall rate of health care cost growth, so that Medicare and Medicaid costs can come down without sacrificing quality, is critical to long-term fiscal sustainability. If deficits continue to grow, they could limit our ability to invest in areas that will promote future growth. The President's health plan would reduce the deficit in both the first ten years and the subsequent decade.

Third, there are benefits to economic growth from expanding coverage and guaranteeing access. For example, health reform will address the problem of "job lock," so workers would no longer stay at jobs that do not utilize their talents merely because they are afraid of losing their health insurance. A healthier population would also mean fewer disabled workers and fewer sick days.

Regarding the second part of the question, the Administration's FY2011 Budget contains a number of new proposals to fund critical infrastructure investments, such as expanded access to broadband services, improved clean water provision, and modernization of the Nation's electricity grid.

5) Secretary Geithner, do you agree that the investments included in the health care reform bills being considered by Congress would provide significant new opportunities to spur economic growth and job creation?

One of the most important elements of health reform is to improve the efficiency of the health care system by reducing the provision of unnecessary and even harmful care. This would free up resources for more productive activities. The Council of Economic Advisers released a report this year that estimated the gains from reducing the rate of health care cost growth through reductions in low-value care. The report concludes that "properly measured GDP"—as in, a measure of GDP that accounts for the substitution of wasteful economic activity from beneficial economic activity—would be four percent higher in 2030 if health care cost growth were reduced by one percentage point annually through reductions in low value care. Moreover, as premiums adjust downward to reflect this slower growth in health care costs, firms and workers can devote less of their compensation toward costly health insurance and more toward salary and wages. The CEA estimates that even this one-percentage-point slowdown in the growth of health care costs will increase the median income of families of four by \$6,800 in 2030.

6) Secretary Geithner, what do you believe would be the long-term impact of health reform on our nation's small businesses and their ability to be competitive? Don't you agree that, given the increased burden of health care costs for our

small businesses, the reforms to decrease the cost of premiums and plan administration would assist small businesses in retaining and potentially expanding jobs?

The health care status quo puts small businesses at a severe disadvantage. Small businesses pay 18% more than large employers do for the same health insurance coverage.

There are a number of reasons for these higher prices. Small firms have less bargaining power and pay higher brokers fees than their larger competitors. Because health insurers' administrative costs can be spread over more employees in large firms, premiums for small firms include up to three times as much in administrative costs as premiums for large firms. And the status quo also discriminates against small businesses based on the illness of employees. Even one sick employee—or dependent—can dramatically raise health insurance costs for a small employer, making it difficult for the employer to continue offering health insurance while not cutting wages.

The new law will end the discrimination against small businesses when it comes to health care. A small business health insurance tax credit will be available immediately and save small businesses about \$40 billion over the next ten years. A health insurance exchange will allow small businesses to pool together to increase their purchasing power and benefit from increased competition. Moreover, because the plans would prohibit insurers from pricing on the basis of health status, small firms would pay the same price to cover their employees regardless of whether one of them, or one of their dependents, falls ill. These provisions would offer major benefits to small businesses relative to the status quo.

7) Secretary Geithner, what has been the impact of the ARRA provisions on enrollment in the TAA health coverage tax credit?

The Health Coverage Tax Credit (HCTC) can be claimed either as an advanced credit or as a credit on the individual's year-end tax filing. ARRA increased the HCTC from 65 percent to 80 percent and expanded coverage for an additional 24 months for certain family members who otherwise would have lost eligibility for the credit upon the eligible individual's death or enrollment in Medicare or upon divorce from the eligible individual.

As of April 1, 2010, the level of enrollment in the advanced HCTC is above 25,000, which is nearly 11,000 (66 percent) above pre-ARRA levels. The number of new enrollments increased rapidly through the later months of 2009 and into the early months of this year, we expect total participation to continue to grow over the next few months.

Furthermore, we expect some newly eligible individuals not claiming an advanced credit to file for an end-of-year HCTC on their 2009 tax returns, filings of which have

just begun. Thus, we believe that the ARRA provisions will ultimately result in even higher observed enrollments than those we have seen thus far.

- 8) **As you know, the ARRA provisions expire on December 31, 2010. And, I noticed that neither your budget request nor the Department of Labor's budget request includes a legislative proposal to extend these provisions. Shouldn't these improvements to the health coverage tax credit be made permanent?**

As you correctly note, the Administration's Budget does not include a legislative proposal to extend the ARRA expansions of the HCTC. Time permitting, prior to taking any action on the HCTC, it may be desirable to estimate the cost-effectiveness of the HCTC and also to take into account the GAO's findings.

- 9) **Secretary Geithner, I am deeply concerned that eliminating tax incentives for coal production will lead to higher electricity prices for consumers and increased costs of production. How will eliminating coal tax incentives affect coal production? Will the effects on coal production vary in different coal producing regions of the country?**

Over the long term, reducing tax preferences will result in a more efficient allocation of capital, which will tend to increase national output. In other words, eliminating these tax subsidies will make our overall economy stronger over time.

In addition, our analysis indicates that changes in domestic coal production costs resulting from loss of these subsidies will have little effect on U.S. prices. The tax subsidies for the coal industry amount to less than one percent of average total revenues from coal production. The overall market impact on consumption and production is likely to be very small. Regional production impacts may vary based on the relative size of the subsidies received by the industry in each region.

Charting the path toward clean coal utilization is essential to achieving the Administration's clean energy goals, supporting American jobs, and reducing greenhouse gas emissions. Rapid development and deployment of clean coal technologies, particularly carbon capture and storage (CCS), will help position the U.S. as a leader in the global clean energy race. The President has established an Interagency Task Force on Carbon Capture and Storage to develop a comprehensive and coordinated federal strategy to speed the development and deployment of clean coal technologies.

In addition, the Treasury Department has the authority to allocate over \$1.5 billion in additional credits under sections 48A and 48B for advanced coal technology and coal gasification technology. Moreover, the budget proposals for the Department of Energy include a balanced research and development (R&D) portfolio of carbon capture and storage technologies. In particular, the \$545 million for climate change technology funding provided for Fossil Energy R&D in the FY 2011 Budget will help

reduce greenhouse gas emissions by focusing resources to develop carbon capture technologies with broad applications to advanced power systems, existing power plants, and industrial sources. The President's Budget also proposes to make the credit for research and experimentation expenses permanent. This should substantially assist the efforts of coal producers to develop clean coal and carbon capture and sequestration technologies.

10) Secretary Geithner, have you examined tax policy changes to further incentivize the deployment of carbon capture and sequestration (CCS)? Does the Administration believe that current CCS tax incentives are adequate to lead to widespread deployment of this important technology?

The Administration supports the transition to clean coal technologies. The Treasury Department has the authority to allocate over \$1.5 billion in additional credits under sections 48A and 48B for advanced coal technology and coal gasification technology. Last year, Treasury issued procedures under which taxpayers can apply for these credits and is currently considering taxpayer applications in cooperation with the Department of Energy. Taxpayers will be told whether their applications have been accepted or rejected before the end of April. Treasury has also recently issued guidance on the refined coal credit which rewards coal producers for reducing sulfur dioxide, nitrogen oxide, and mercury emissions that result from burning the coal.

In addition, Treasury published guidance that will enable taxpayers to claim the carbon sequestration credit under Section 45Q. This credit supports the development of carbon sequestration technology for use at coal-burning utilities and other industrial sources by providing a credit of (1) \$10 per metric ton for qualified carbon dioxide that is captured at a qualified facility, used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposed of in secure geological storage, and (2) \$20 per metric ton for qualified carbon dioxide captured by a taxpayer at a qualified facility and disposed in secure geological storage without being used as a tertiary injectant. The credit sunsets at the end of the calendar year in which a cumulative total of 75 million metric tons of qualified carbon dioxide have been captured and sequestered.

The President's Budget includes proposals for an additional \$5 billion in advanced energy manufacturing credits which may be used for, among other things, technologies that reduce greenhouse gas emissions. The Budget also proposes to make the credit for research and experimentation (R&E) expenses permanent. This should substantially assist the efforts of coal producers to develop clean coal and carbon capture and sequestration technologies.

The Budget for the Department of Energy includes a balanced research and development (R&D) portfolio of carbon capture and storage technologies. The \$545 million for climate change technology funding requested for Fossil Energy R&D in the 2011 Budget will help reduce greenhouse gas emissions by focusing resources to

develop carbon capture technologies with broad applications to advanced power systems, existing power plants, and industrial sources.

In addition to these initiatives, the President has established an Interagency Task Force on Carbon Capture and Storage. This task force, which includes the Department of the Treasury, will develop a plan to overcome barriers to the widespread, cost-effective deployment of carbon capture and storage within 10 years, with a goal of bringing 5 to 10 commercial demonstration projects online by 2016. The plan will explore incentives for commercial carbon capture and storage adoption and address barriers to deployment.

Questions from Senator Hatch

- 1) **Mr. Secretary, in your testimony, you indicated that we must restore confidence in the economy's fundamental resilience. I'm sure that you will agree that in order to restore confidence in our economy, we must get consumers and businesses to start spending and investing again, correct?**

As I read it, the President's FY 2011 budget proposes an additional \$641 in new revenues over the next five years. Much, if not most, of this is in the form of higher taxes on individuals and businesses. Now if I'm a business owner, or an investor or consumer, why wouldn't these higher taxes deter me from investing or spending more next year and the next, knowing that I will have to pay more in taxes?

With a stagnant double digit unemployment rate, how will raising the marginal tax rates on a small business owner who pays taxes at the individual level affect the economy? How will these other tax increases serve to further the goal of restoring confidence in the economy?

Confidence and spending will go hand in hand as the economy recovers. When the worst part of the financial crisis hit in the fall of 2008, consumer confidence posted a nearly record decline and then reached a record low in early 2009, before uncertainty began to be resolved. The combination of the Recovery Act, the Financial Stability Plan, and our efforts to support the housing market has significantly enhanced financial stability and bolstered confidence in our economic recovery, which jumped in the months following the enactment of the Recovery Act and the outcomes of the stress tests. Since the middle of 2009, consumer confidence has stabilized and moved higher, interest rate spreads have narrowed and bond issuance is up, indicating easing credit market fears, and the VIX, the stock market's "fear index", has dropped. While the recovery remains in its early stages, and many Americans are still suffering from the effects of the financial crisis, we have begun to see indicators that consumers and businesses are increasing their spending. Real GDP growth averaged nearly 4 percent in the second half of 2009, and, in Q4 growth was recorded in nearly every major component of GDP, another sign that recovery is underway. Consumer spending rose in Q4, and business investment increased for the first time since 2008Q2, with purchases of equipment and software rising at the fastest pace in about a decade.

The President's FY 2011 Budget proposes both tax cuts and tax increases. The Budget proposes extending many of the major features of the 2001 and 2003 tax cuts, which benefit primarily middle-income and upper-middle income households and which provide over \$1.5 trillion in tax relief to individuals over the 10-year budget window. In addition, the FY 2011 Budget proposes a number of temporary tax reductions (over \$130 billion over the next three years) to spur the economic recovery. Finally, the FY 2011 Budget also includes over \$230 billion in additional permanent tax cuts for individuals and businesses over the 10-year budget window.

Many of the tax increases in the President's Budget modify or repeal inefficient tax breaks that can distort economic decisions. In addition, the Budget proposes higher tax rates on those taxpayers with the highest incomes. However, the Budget also includes tax cuts for many small business owners, such as expanded expensing and bonus depreciation with respect to certain capital purchases, elimination of capital gains on certain small business stock, and the permanent R&E tax credit.

We believe that the President's FY 2011 Budget, incorporating revenue increases (along with significant tax cuts), and restraints on spending is a prudent approach to addressing the major fiscal imbalances and restoring confidence in the Nation's economy.

- 2) Mr. Secretary, you also stated in your testimony that "deep and immediate cuts would damage growth, exacerbating our fiscal challenges." Why cannot the same be said for tax increases?**

The President's Budget includes hundreds of billions in tax cuts, including over \$130 billion (over the next three years) in temporary tax cuts intended to encourage economic recovery. In addition, the FY 2011 Budget includes over \$230 billion in additional permanent tax cuts for individuals and businesses over the 10-year budget window. The additional revenues in the President's Budget have generally been delayed until 2011, when the economy is expected to be on more secure footing. Finally, the entire Budget, containing tax cuts, revenue increases, and spending restraints is a responsible approach to getting our Nation's fiscal house in order and restoring long-term growth.

- 3) You mention in your written testimony that the budget's proposals to reform our international tax rules are designed to address those aspects that "disadvantage investment in the United States and encourage companies to ship jobs overseas." Can you be more specific about this and tell us exactly which current tax provisions do this?**

Also, you mentioned that allowing a company that moves jobs or investments overseas to gain a competitive advantage through our tax code against a competitor that chooses to expand investment and job growth in the United States is unfair and is bad tax policy. Based on my understanding, and what I am being told by U.S.-based multinationals, it is our companies that are operating abroad that face the unfair competition, from firms based in other countries that do not have worldwide taxation as the U.S. does.

Given that many U.S. firms must invest overseas to be competitive against foreign companies; shouldn't our tax policy be just as concerned with ensuring U.S. competitiveness in a global environment?

Please see the answer in Question 4 (below)

- 4) **Our system of worldwide taxation has already made the United States one of the least hospitable places in the world for a multinational company to locate. U.S.-based firms that compete with companies from practically anywhere else in the world find themselves with significant competitive disadvantages because of the way we tax international transactions.**

How would making U.S. companies facing an ever-more global economy less competitive through more onerous tax rules help achieve the President's goal of encouraging growth and recovery and creating jobs?

The Administration is focused on finding ways to encourage job growth through economic expansion and making America competitive in the global economy. Our Budget proposals seek to level the playing field by reducing the incentives in our current system to invest abroad and by closing loopholes that encourage income shifting to low-tax countries. The proposed international tax changes address specific problems in our existing tax laws. For example, deferring the deduction of interest expense allocated to deferred foreign income would reduce the tax incentive for U.S. companies to make investments offshore (as opposed to here in the United States). Other proposals address misuse of the foreign tax credit and aggressive transfer pricing. In addition, our Budget encourages investment here in the United States by proposing to permanently extend the research and experimentation credit.

- 5) **In the President's budget we see a proposal to raise \$39 billion in taxes on the oil and gas industry and the coal industry. This \$39 billion will be used to fund more expensive and less reliable energy sources, what the administration calls a clean energy challenge.**

When we are specifically talking about job creation in this sense, is it not true that the budget does not create jobs, but rather shifts jobs from one energy sector to another? Isn't the Administration making the judgment that green energy jobs are more preferable to this nation than are traditional oil and gas jobs? And, is it not true that despite the huge progress we have seen in the development of renewable energy, we are going to be relying on traditional fossil fuels for decades to come? It seems very short-sighted to me to denigrate high paying jobs in industries that this country will need to rely on for many years.

Tax subsidies that are not designed to correct an existing distortion or market failure lead to an over allocation of resources to the tax-favored industries and an under allocation of resources to other industries. These distortions in resource allocation result in inefficiency and generally reduce economic growth. The tax subsidies that are currently provided to the oil and gas industry lead to inefficiency by encouraging an overinvestment of domestic resources in this industry, to the detriment of other industries. Removing this distortion would improve overall economic efficiency.

The current set of tax subsidies for oil and gas production also work against the goal of reducing the negative externalities associated with oil and gas production and

achieving our goal of transitioning – over the long term – to cleaner energy sources. Oil and natural gas prices, for example, do not reflect the environmental harm caused by the release of greenhouse gases in the atmosphere associated with oil and gas production and consumption. In addition, the price of oil does not reflect the risks associated with U.S. oil dependency. Removing these subsidies and pursuing policies that efficiently address these negative externalities, such a comprehensive market-based climate change policy, will bolster our environmental and energy security.

We estimate that these policies will have only a small effect on output, prices, and jobs in the affected industries. Rather than being short-sighted, we feel these policies are a step toward the long-term transition to cleaner energy sources and the development of good jobs in those fields.

- 6) **The stated rationale for the Financial Crisis Responsibility Fee is to recoup taxpayer money used to bail out reckless behavior. However, it appears to me that the proposed tax will fall almost exclusively on institutions that either never received direct federal assistance or on those that have since repaid any assistance, in most cases with a considerable return for the taxpayer. At the same time, the proposal appears to exempt institutions such as the auto makers, AIG, and Fannie and Freddie, who all received a great deal of assistance also. This appears to me to be a pretty blunt tool.**

Can you tell me the reasons for exempting some of these other recipients of taxpayer assistance?

If the goal here is to recoup taxpayer money from institutions whose reckless behavior contributed to the financial crisis, and who therefore benefitted directly or indirectly from the bailout, rather than using this blunt tool, wouldn't it make more sense to target the tax at institutions engaged in the types of over-leveraging and other high risk activities that brought about the crisis?

It is important to understand that every major financial firm benefitted from the extraordinary actions taken by the government to stabilize the financial system.

Covered financial firms would include U.S.-based bank holding companies, thrift holding companies, other insured depository institution holding companies, and securities broker-dealers with total consolidated assets of at least \$50 billion (regardless of whether such U.S.-based firms are controlled by a foreign firm). These firms were recipients and/or indirect beneficiaries of aid provided through the TARP, the FDIC's Temporary Liquidity Guarantee Program, and other programs that provided emergency assistance to limit the impact of the financial crisis.

In regards to the auto companies, it is worth noting that auto financing companies that are bank holding companies will be included, so these firms would not be unaffected. In addition, unlike the large financial institutions targeted by the fee, the auto

companies were run through bankruptcy and received assistance conditioned on significant restructuring that has already occurred.

Treasury is very focused on recouping the taxpayers' investments provided under the Automotive Industry Financing Program and continues to work diligently to ensure this happens as soon as practicable.

As a point of clarification, thrift holding companies will be subject to the fee, and as such AIG would be covered.

The proposed fee does not cover Fannie Mae and Freddie Mac. The goal of this fee is to ensure a taxpayer return so that losses do not add to further debt. Given the current status of the GSEs under conservatorship and the ongoing process of reform, charging these institutions that fee would not likely accomplish the goal of reducing the debt created by the crisis or reducing excess size and leverage of these institutions. Moreover, the investment in Freddie and Fannie were authorized under the Housing and Economic Recovery Act (HERA) legislation, not TARP, and includes its own provisions for recouping taxpayer losses as practicable.

As designed, the fee applies to the largest, most highly leveraged institutions that finance themselves in the wholesale markets (as opposed to through insured deposits or insurance policy reserves). Thus, the fee will serve as a taxpayer reimbursement device and as a mechanism to force the major financial firms to internalize some of the externalities they generate – that is, to pay a pecuniary price for the damage that their failure or distress could impose on the broader financial system. As a result, the fee will provide an incentive for these firms to reduce their size, leverage, funding volatility, and overall risk.

- 7) **It appears to me that the bank tax proposal would apply to any thrift holding company and to any company that owns an insured depository as long as the company has more than \$500 billion in assets. Is it truly the Administration's intent to capture these companies – even if they engage in little or no banking activities?**

If so, the proposal would likely hit far more than the 50 companies the Administration has estimated would be affected. For example, mutual fund companies are often organized as thrift holding companies, even though they do not take consumer deposits. They don't make loans, and they do not engage in banking activities. They use the thrift charter to conduct other businesses, such as trustee and investment management services. These mutual fund companies do not engage in the types of risky activities that the Administration has been concerned about and they were not major contributors to the financial crisis.

Covered financial firms would include U.S.-based bank holding companies, thrift holding companies, other insured depository institution holding companies, and securities broker-dealers with total consolidated assets of at least \$50 billion

(regardless of whether such U.S.-based firms are controlled by a foreign firm). As designed, the fee applies to the largest, most highly leveraged institutions that finance themselves in the wholesale markets (as opposed to through insured deposits or insurance policy reserves). All firms in this category were substantial recipients of the extraordinary actions taken by the government to respond to the crisis. We note that the assets of mutual funds generally reside in legally distinct vehicles and are not consolidated onto the balance sheet of a financial institution for purposes of calculation of the fee. As such, our preliminary estimates continue to indicate that we expect the fee to apply to approximately 50-60 companies.

8) Doesn't the Administration anticipate that these bank fees would be simply passed on to the customers of the institutions in the form of higher fees and rates?

We believe that the firms subject to the fee—just the very largest financial institutions—are in a position to pay a modest assessment on qualified liabilities without passing the costs to their customers. However, given that over 99 percent of banks will not be subject to the fee, if certain institutions did pass on the impact to customers, we believe that smaller lenders would likely step up and gain share in the market. Further, the deposits and capital that banks traditionally use to make loans to consumers and small businesses are exempt from the fee. In a March 4 letter, CBO Director Douglas Elmendorf described the potential impact of the fee credit availability as “slight” and wrote that it could “improve the competitive position of small- and medium-size banks, probably leading to some increase in their share of the loan market.”

9) Is this Financial Crisis Responsibility Fee designed to punish America's largest financial institutions?

No. The fee is not about punishment. This fee reflects the President's commitment to the requirement under Section 134 the EESA legislation to put forward a plan to recover any losses from the TARP. The fee will be structured to fall most heavily on the very largest and most levered financial firms that rely on the most volatile funding sources. Thus, the fee will serve as a taxpayer reimbursement device and as a mechanism to force the major financial firms to internalize some of the externalities they generate – that is, to pay a pecuniary price for the damage that their failure or distress could impose on the broader financial system. As a result, the fee will provide an incentive for these firms to reduce their size, leverage, funding volatility, and overall risk.

10) Mr. Secretary, one of the proposals in the President's budget would repeal the last-in first-out or LIFO method of accounting for inventories. It is my understanding that this method has been allowed in the Internal Revenue Code for a very long time. Does the Administration really believe that this accounting method is a loophole that needs to be closed?

The estimated revenue that would be raised from repealing LIFO is estimated to be \$59 billion over ten years. A great deal of this amount would be paid by small businesses. How would this repeal and these higher taxes help the President with his goal of job retention and creation?

The tax deferral provided under the LIFO method is inconsistent with general income tax principles, which require gains be taxed when realized and recognized. The LIFO method allows these gains to be deferred indefinitely, despite the fact that inventory sales are realized and recognized annually.

Our analysis of tax data indicates that the LIFO tax benefit is concentrated among the larger taxpayers. Furthermore, while the prevalence of LIFO among small businesses may be higher within certain trades, only a minor share of the overall anticipated revenue will be paid by small businesses.

Under the Budget proposal, the tax due from LIFO repeal can be spread over a 10-year period, lessening any immediate effect. Moreover, the additional revenue will lower the deficit, instill greater confidence in the state of the economy, and possibly lower interest rates. These effects should help, not hinder, businesses in retaining existing jobs or creating new ones.

Questions from Senator Snowe

- 1) Based on my conversations with Maine entrepreneurs regarding the barriers to growing their enterprises, access to credit is among the issues cited most often. The fact is, we simply have to get a handle on the small business credit crisis once and for all if we are to emerge from this economic morass. Without adequate financing, small businesses, which have created 64 percent of net new jobs over the past 15 years and are the *lifeblood* of American enterprise and ingenuity, simply cannot grow or even sustain their operations. President Obama has now proposed to take \$30 billion out of TARP funds and redirect those resources to help community banks give small businesses the credit they so urgently require to stay afloat.

What is unclear about the Administration's new proposal is whether it will finally address the small business lending crisis once and for all. The fact is that our nation's small businesses cannot ill afford for this measure to fail. This program must work, and it must work swiftly. Can you please offer your justification for how effective this program would be if Congress were to make it law and how quickly it could be put into place once enacted? Put another way, what assurances can you make us today that this program will work?

Our proposal for a Small Business Lending Fund is designed with the goal of most efficiently leveraging federal dollars to make credit more available for small businesses. Under this proposal, the Administration would provide capital to community and smaller banks to support new lending. By reducing the dividends on this capital as banks increase lending over 2009 levels, the proposed program would support new lending. Indeed, by providing capital to banks that can be leveraged, this program could result in many multiples of the amount of Federal dollars invested in new lending. Moreover, by creating the program outside of TARP, we would be responding to concerns raised by community banks as to how to maximize participation under this program and increase its impact on expanding access to credit for small business. At the same time, we believe that – if passed – Treasury could implement this program very quickly, with applications processed and investments made on an accelerated timeline to ensure that capital is quickly deployed to increase new lending. Treasury is also working closely with Congress to identify other potential ideas for the Small Business Lending Fund.

In addition to the new SBLF, Treasury has worked closely with the SBA to support new lending to small businesses during this critical time. Treasury has worked closely with SBA on Recovery Act efforts to temporarily increase guarantees and reduce fees for SBA-guaranteed loans, and has continued to support efforts to extend these provisions. In addition, Treasury has taken steps to help unfreeze the secondary markets on which a share of SBA loans are bought and sold, helping to return activity and pricing on these markets to pre-crisis levels. Treasury and SBA continue to work together to support enacting measures to increase SBA loan sizes, to increase the

working capital loans, and to help address small business real estate issues by allowing refinancing through the 504 program.

- 2) **With 7.2 million jobs lost since the onset of the recession in December 2007, a 10 percent unemployment rate, and an effective 17.3 percent unemployment rate when those who would like more work but can't get it are factored in to the statistics, job creation must unquestionably be our primary focus. At the same time, our Federal budget picture is extremely dire. Just last week, the Congressional Budget Office projected baseline deficits of over \$6 trillion for the next decade, which will cause interest on the national debt to more than triple to over \$700 billion per year by 2020.**

Although I support taking additional steps to boost job creation, we must insist that any new incentives do not further aggravate the deficit. That's why I am particularly concerned that the House passed additional stimulus legislation that would be offset by cutting TARP's authorization levels. The fact is that further stimulus spending claimed to be offset by reducing TARP's authorization level would still increase the deficit relative to simply not using additional TARP funds at all.

Instead of using budgetary sleights of hand, I have long held that we must reexamine unspent stimulus funds to determine how they can be redirected to more effective job-creating programs and tax incentives in a way that maximizes each dollar spent. And on December 11, I wrote OMB Director Orszag a letter asking that he reevaluate unspent stimulus money for this purpose and provide Congress with recommendations. Because I have not received a response, I, joined by Senator Thune, have introduced legislation to require OMB to develop a list of recommended stimulus funds that can be redirected within 15 days.

Wouldn't you agree with me that we should put budget gimmicks aside and offset new stimulus spending? Wouldn't one logical place to find legitimate offsets be through reevaluating the stimulus given that just \$269 billion of the \$787 billion package has been spent, leaving hundreds of billions in unobligated funds still on the table? Do you have a sense of which of the funds in the stimulus have been most effective from the job-creation standpoint and any views regarding which should be redirected because they may not be as effective relative to other proposals now on the table?

The Administration shares your belief that in reviving the economy, job creation must be our primary focus. That is why the Administration has committed to take additional measures to support job creation. And that is why the Administration worked to pass the Recovery Act within a month of taking office – an effort that, as many private economists have affirmed, helped prevent us from falling into a deeper recession.

In just 12 months since passage, over \$450 billion of the Recovery Act has been committed, spent out, or distributed in the form of tax relief. This represents nearly 60% of the Act. Of the approximately \$330 billion left to be committed, the majority of that will come in the form of tax relief, and will for the most part be realized this year. This does not put tax relief provided by the stimulus behind pace—in fact, it was a deliberate design of the Recovery Act that was responding to a recession that we knew would be long and deep, and was a deliberate effort to provide sustained tax relief over a roughly 18 to 24 month time period.

The same is true of remaining spending. A year into the Recovery Act's implementation, uncommitted spending accounts for only about 20% of the Recovery Act. Approximately half of that is tied to mandatory or formula driven programs that are providing much needed fiscal relief to states, as well as providing aid to individuals who are in greatest need of help during the recession. These programs include ones like FMAP, State Fiscal Stabilization Funds, Unemployment Insurance, the Supplemental Nutrition Assistance Program (SNAP) program as well as others, and were meant to be spent and support new job creation over an 18 to 24 month period to provide sustained relief. For funds that go to states, Governors across the country have pointed to jobs they were able to retain that would not have been possible without these funds, most noticeably jobs for teachers. The portion of these funds that go to individuals are often funneled back into the economy faster and in a greater proportion than many other parts of the stimulus, thus leading to the multiplier effect that leads to much of the indirect and induced job creation that we see.

Of the non-mandatory or formula-driven programs, we expect to see a noticeable increase in spending in the coming months. Several of these programs support infrastructure and construction projects for which the outlay rates will increase, and as the weather gets warmer, more construction work will get underway or be completed. Keep in mind that many of these kinds of programs are reimbursable ones, such as most of the Department of Transportation Recovery Act projects. People are hired and the work begins once the funds are obligated, rather than outlayed, and the award recipients' are reimbursed after the work is completed.

Many of the rest of the non-formula programs are ones that, by design, the Recovery Act implemented to make additional long term investments in our economy -- including programs to support investments in high speed rail, broadband, and the smart grid. They are largely awarded already, and will see awards turn into obligations, and obligations turn into outlays as the year progresses. But it is also important to remember: the President has been clear that he not only wants to bring the country out of the recession that he inherited, but wants to do so in a way that would lay the foundation for a longer term recovery that would help the country stay competitive for decades to come. And several of these investments, whether in green energy, high speed rail, a more robust broadband infrastructure, or in health IT investments, were included in the Recovery Act to do exactly that.

- 3) I am the lead Republican cosponsor of the *Small Business Lending Enhancement Act of 2009* (S. 2919), which would raise the cap on credit union member business lending from 12.25 percent to 25 percent and exempt loans of under \$250,000 from being calculated towards this cap. This legislation is a critical way to help ease frozen small business lending markets, and the Credit Union National Association (CUNA) estimates that it could create 108,000 jobs and make available up to \$10 billion in credit to small businesses in the first year after enactment. Notably, all of this can be accomplished at absolutely no cost to the Federal government. And so I hope the Administration will join us in backing this legislation, particularly as National Credit Union Administration Chair Debbie Metz on November 24 wrote the Treasury Department in strong support of increasing the cap.

What is the Administration's view on increasing credit union lending to small businesses by increasing the member business lending cap to 25 percent?

The Administration supports increased small business lending, including by credit unions. There are a number of ways more lending can occur. We understand from the NCUA that most credit unions are not currently constrained from making more business loans; most credit unions are well within the current limit.

Still, we are open to all proposals. Treasury is committed to working with Congress, the NCUA and CUNA, and other stakeholders on proposals to increase small business lending.

- 4) **Mr. Secretary, one of the signature items in the President's budget is a mandatory automatic IRA for all employees not otherwise offered retirement savings vehicles. In the 2006 pension law changes, Congress authorized employers to automatically enroll employees in 401(k) plans. I want to understand how this experiment has been working and its effects on employee retirement savings. Furthermore, I'd like data on whether automatically enrolled employees who change jobs keep their savings in retirement vehicles or whether they withdraw these nest eggs and spend them for other purposes. If the data shows no increase in retirement savings of these employees from auto enrollment in 401(k) plans and that they just end up paying a 10 percent penalty for the use of their own money, then this policy is little better than usurious credit card interest rates.**

Mr. Secretary, what data do you have about the accounts of employees automatically enrolled in 401(k) plans? I want to know how many employees cash-out these accounts and pay the 10 percent penalty and how many employees either maintain accounts or roll them into IRAs. I'd also like to receive data on what types of employers have been enrolling employees, and whether employees affirmatively opt-out of these plans rather than participate.

The automatic IRA proposal builds on the success of automatic enrollment in 401(k) plans. It would make payroll deposit IRAs available at the workplace to tens of millions of employees who do not currently have access to a 401(k) or other employer-sponsored plan. Employees would be automatically enrolled but would be free to opt out if they wished. Employers would not make contributions and would receive a tax credit for enrolling employees in automatic IRAs. (Employers that instead adopted an employer plan would be entitled to a larger tax credit.) Beginning in 1998 and continuing through 2009, Treasury and the IRS have issued rulings and other guidance defining, permitting and encouraging 401(k) automatic enrollment. In the Pension Protection Act of 2006, Congress further encouraged automatic enrollment, in part by allowing plans to let automatically enrolled employees take back any automatic contributions penalty-free within 90 days after enrollment. This could have the effect of reducing the ultimate “leakage” of retirement benefits by eliminating accounts, from the outset, for those automatically enrolled employees who conclude within 90 days that they do not want to participate.

Recent GAO congressional testimony indicates that plan sponsors have increasingly been adopting automatic enrollment (see GAO, *U.S. Senate, 401(k) Plans, Several Factors Can Diminish Retirement Savings, But Automatic Enrollment Shows Promise for Increasing Participation and Savings*, GAO-10-153T (Washington, D.C.: Oct. 28, 2009)), and noted that, according to Fidelity Investments, 47 percent of 401(k) participants are in plans with automatic enrollment. In response to your question about the types of employers that are using automatic enrollment and whether employees affirmatively opt out, larger plan sponsors (which commonly make employer matching contributions) have adopted automatic enrollment with far greater frequency than small employers, and the vast majority of employees who are automatically enrolled stay enrolled rather than opting out. A recent GAO report (GAO-10-31) found that automatic enrollment can significantly increase participation rates (to as high as 95 percent) and that these high participation rates appear to persist over time. Moreover, the report found that automatic enrollment dramatically increased participation by workers with relatively low participation rates, such as lower-income and younger workers. For example, according to a 2007 Fidelity Investments study, automatic enrollment raised the percentage of workers aged 20 to 29 participating in plans from 30 percent to 77 percent.

An earlier GAO report (GAO-09-715) found that approximately 15 percent of 401(k) participants, before age 60, tapped into their retirement savings through loans or withdrawals while employed or cashouts after termination of employment. A 2009 report by the Employee Benefit Research Institute found that, in 2006, only about 17 percent of pre-retirement cash distributions were used for consumption, as opposed to uses such as non-tax-qualified savings, home purchases, education expenses, or starting a business.

An October 2009 study by Hewitt Associates found that 46 percent of 401(k) plan participants who terminated employment during 2008 took a cash distribution (as opposed to a direct rollover from their plan to another employer plan or IRA) when

they left employment, and that a greater proportion of younger participants and participants with low account balances took those cash distributions. However, the study did not include any analysis of the 46 percent to determine how many of those cash distributions were subsequently rolled over (in a 60-day indirect rollover) or instead were used for immediate consumption or, alternatively, for investments or other savings vehicles. In addition, the Hewitt study addressed the question of whether automatically-enrolled participants are more likely to cash out their accounts before retirement, perhaps because they had not affirmatively decided to save. The study concluded that, for any given size of account balance, "there is no indication that automatic enrollees are any more apt to cash out than active enrollees" and thus that, "holding things equal by plan balance, those participants subject to automatic enrollment did not have greater cash-out behavior than those participants who actively enrolled."

Moreover, while some plan participants take pre-retirement distributions without rolling them over, many continue to work and build their retirement security over time at the same job, and many who change jobs choose not to take or spend a cashout, especially as their accounts grow. Accordingly, the existence of some leakage does not mean we should stop encouraging increased participation by younger and lower-paid workers, as well as minorities, who are the groups that tend to participate least and to benefit most from automatic enrollment.

Finally, in a 2007 survey of over 10,000 adults, Harris Interactive Inc. found that 98 percent of those automatically enrolled -- and even 79 percent of those who opted out of automatic enrollment -- agreed with the statement, "You are glad your company offers automatic enrollment." The survey also found that high percentages of the employees surveyed agreed with statements to the effect that automatic enrollment helped them start saving for retirement earlier and made retirement saving easier.

The Administration's automatic IRA proposal would harness the power of automatic enrollment in payroll deposit workplace savings for tens of millions of working families who lack access to an employer-sponsored retirement plan. I look forward to working with you and your colleagues on enacting this proposal.

- 5) **Mr. Secretary, I want to follow up with you on a discussion we had during your testimony regarding the number of small businesses organized as sole proprietorships, partnerships or Subchapter S corporations -- known as flow-through or pass-through entities- that will be affected by increasing the top two income tax rates.**

These are not big businesses, and the Treasury Department may not be as familiar with them as they are with the current problems of companies such as General Motors or AIG. Flow-through businesses are the job generators in this country. Data from the Bureau of Labor Statistics shows that "Firms with fewer than 500 employees accounted for 64 percent (or 14.5 million) of the 22.5 million net new jobs between 1993 and the third quarter of 2008." Further, the current

Council of Economic Advisers found in July 2009 that “Firms with fewer than 20 employees accounted for approximately 18 percent of private sector jobs in 2006, but nearly 25 percent of net employment growth from 1992 to 2005.” The owners of these businesses are the entrepreneurs that take risks and create jobs. When a business with 5 or 10 employees fails, the Treasury is not there with loan guarantees or capital to help sustain them.

Mr. Secretary, you may have been using data provided from the Tax Policy Center when you stated that only 2 to 3 percent of small businesses would be affected by the upper income tax increases. A Treasury study from 2007 regarding tax issues and small business showed that for small business owners – people for who flow-through income amounts to at least 50 percent of their income – that only 9 percent of them earned 69 percent of all this income but paid a disproportionate 81 percent of the taxes on this income.

In this economy, at this time, we need to focus on small businesses that are generating jobs. One consistent source of information about small business is in the form of a poll conducted by Gallup for the National Federation of Independent Business, NFIB. When surveyed, 21.7 percent of small business owners who employed 20-249 employees responded that the income earned from their business would be greater than \$250,000. When looking at firms with between 20 and 500 employees, Senator Grassley has found that number jumps to half of all small business. It is these job creators that we need to protect from increasing taxes.

Last year, during the debate on the budget I offered an amendment that was adopted by the Senate. My amendment would have maintained tax rates at current levels for individuals who earn at least 50 percent of their income from flow-through sources. So that we do not harm this nation’s job generators, can we work together on extending tax rates in effect in 2010 for all individuals who earn at least 50 percent of their income from flow-through sources?

The Administration shares your concerns about the viability of small businesses and recognizes the important contributions that these businesses make to the economy.

The Administration shares your goal of providing small businesses with incentives to invest and hire new workers, and has proposed several measures to achieve that goal. However, a proposal to put in place lower individual income tax rates for individuals who receive more than half their income from flow-through sources raises several concerns. The proposal would benefit only a very small fraction of owners of flow-through businesses, would create economic distortions and inequities among high income taxpayers, and would be complicated for the IRS to administer and subject to abuse. We estimate that at most 1 percent of owners of flow-through businesses

would benefit from the lower income tax rates.² And the beneficiaries would include those who are not normally considered small business owners, such as partners in large law firms, accounting firms, and investment banks, hedge funds and private equity funds. The distinction in rates based on source of income would encourage taxpayers not reporting income from flow-through entities to switch their investments or other sources of income, or seek to recharacterize existing investments, simply in order to qualify for the lower rates, whether or not such rearrangement made economic sense for reasons other than taxes. Finally, this proposal would add complexity to the tax code, and the revenue foregone would need to be raised elsewhere.

² These are defined as taxpayers whose flow-through income represents at least half of their AGI and who would otherwise see their taxes rise with the increases in the top 2 individual income tax rates as proposed in the FY 2011 Budget.

Questions from Senator Kyl

- 1) **Congress has yet to approve pending trade agreements with Colombia, Panama, or South Korea. Colombian goods already enter the U.S. duty free, but U.S. manufactured goods entering that country face tariffs ranging from eight percent to as high as 15 percent. If enacted, the Colombia Free Trade Agreement would lift tariffs immediately on over 80 percent of U.S. consumer and industrial goods, and all goods would be duty free in 10 years.**

- a. **Have exports contributed or subtracted to economic growth over the course of this recession?**

In 2007 and 2008, U.S. net exports, *i.e.*, exports minus imports, contributed positively to U.S. real GDP growth as exports grew faster than imports. As the global recession intensified, trade volumes fell around the world. In the U.S., imports fell more sharply than exports. As a result, U.S. net exports still made a positive contribution to U.S. real GDP growth in 2009, even though exports in isolation were falling in 2009. As the global economy recovers, we expect to see both exports and imports rise.

- b. **Rather than passing a third economic stimulus bill in as many years wouldn't it make more sense to work to open up foreign markets for our goods and services in places like Colombia?**

Increasing U.S. exports is a key part of the President's broader economic recovery and jobs strategy. The National Export Initiative (NEI) announced by President Obama in his State of the Union address is designed to marshal the resources of the U.S. government to ensure that U.S. businesses take full advantage of opportunities abroad and overcome obstacles to exporting. Exports are essential to a strong U.S. economy and the President has set a goal of doubling U.S. exports over the next five years, which would help support two million U.S. jobs. Creating new market opportunities through vigorous enforcement of existing agreements and through strong free trade agreements (FTAs) are top priorities and key components of the NEI. The pending FTAs with Colombia, Korea, and Panama would give U.S. exports preferential access in these markets, further boosting export growth. To this end, I understand that USTR is working to address our outstanding concerns with each agreement, which will be an important step in determining when, in close consultation with the Congress, this agreement should be considered.

- 2) **The President's Budget documents include a line item entitled, "Deposit earnings of the Federal Reserve." That line item indicates collections remitted by the Federal Reserve to the Treasury will more than double from \$34 billion in 2009 to \$77 billion in 2010. Federal Reserve earnings are then projected to remain at a relatively high level thorough out the remainder of the budget window averaging nearly \$60 billion a year.**

a. Why will earnings double this year?

The Federal Reserve significantly expanded its balance sheet over the past few years to combat the financial crisis. In part, it expanded lending through a variety of emergency programs, which have generated substantial income. In addition, the Federal Reserve expanded and extended the duration of its portfolio through asset purchases, including approximately \$300 billion of long-term Treasury securities, \$1.2 trillion of GSE mortgage-backed securities, and \$170 billion of GSE debt. The projected increase in earnings in FY 2010 reflects additional returns from the Federal Reserve's emergency lending programs and asset purchases.

b. How much of the increase in earnings is generated by regular monetary policy operations versus the extraordinary measures the Fed has taken over the last two years?

The majority of the projected increase in earnings is attributed to returns from the Federal Reserve's extraordinary lending programs and asset purchases, including both the increased level and duration of assets in its portfolio.

c. Does the fact that the President's Budget assumes an above average amount of earnings will be remitted to Treasury from the Federal Reserve suggest that it will continue its extraordinary measures for the foreseeable future?

Deposit earning projections in the President's Budget are consistent with recent announcements by the Federal Reserve regarding its plans for exiting lending and asset purchase programs it put in place to combat the financial crisis and support economic activity.³ The projections in the President's Budget are also roughly consistent with recent estimates from the Congressional Budget Office (CBO).⁴ For example, the President's Budget expects that the Federal Reserve will remit \$578 billion of earnings on deposits between FY 2011-2020, while the CBO expects such remittances to be \$511 billion over the same Budget window. However, the Federal Reserve is responsible for managing its portfolio and determining the timing for exiting its programs. How it does so will have a material impact on actual earnings remitted to Treasury and applied to the Federal Budget.

Most of the Federal Reserve's extraordinary lending programs have already terminated, and the remainders are winding down. The only facility still in operation that offers credit to multiple institutions, other than the regular discount window, is

³ See, e.g., Chairman Ben S. Bernanke, Federal Reserve's Exit Strategy, Testimony Before the Committee on Financial Services, U.S. House of Representatives, Feb. 10, 2010, available at <http://www.federalreserve.gov/newsevents/testimony/bernanke20100210a.htm>.

⁴ Congressional Budget Office, The Budget and Economic Outlook for Fiscal Years 2010-2020, Jan. 2010, available at <http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf>

the Term Asset-Backed Securities Loan Facility (TALF). The TALF closed on March 31 for loans backed by all types of collateral except newly issued commercial mortgage-backed securities (CMBS), and is scheduled to close on June 30 for loans backed by newly issued CMBS. The Federal Reserve has stated that it expects its exposure through investments in Maiden Lane LLC, AIG, and Maiden Lane II and III will decline gradually over time.

The Federal Reserve also announced that it anticipates that its balance sheet will shrink toward more historically normal levels and that most or all of its security holdings will be Treasury securities. Between December 2008 and March 2010, the Federal Reserve purchased \$1.25 trillion of agency MBS and \$172 billion of agency debt securities. It has stated that it does not anticipate selling any of its security holdings in the near term, and that it will allow agency debt and MBS levels to shrink as they mature or are prepaid. The Federal Reserve is also currently rolling over all maturing Treasury securities. However, the Federal Reserve announced that it may sell securities in the medium or long term when the economic recovery is sufficiently advanced and the Federal Open Market Committee (FOMC) has determined that the associated financial tightening is warranted. It stated that any such sales would be at a gradual pace, would be clearly communicated to market participants, and would entail appropriate consideration of economic conditions.

- 3) **A number of Senators including myself and Chairman Baucus support extending the active financing exception and what is called the controlled foreign corporation look thorough in order to prevent placing U.S. firms operating abroad at a competitive disadvantage. However, the Administration's Budget request only proposes to extend these two provisions for another two years through the end of 2011. The Budget also proposes to impose 11 new tax increases on U.S. corporations that operate abroad raising \$122 billion.**

- a. **If Congress implemented the Administration's proposals to curtail deferral, let active financing and CFC look through expire would the effective corporate tax rate rise or fall?**

The average effective tax rate is defined as taxes paid divided by book or financial statement income (as opposed to taxable income). According to GAO, the average corporate effective U.S. tax rate paid on foreign earnings of large U.S. corporations was only about 4 percent in 2004. (The GAO also estimated that the worldwide effective tax rate on the income of CFCs was about 16 percent.) The Administration's proposals would increase the U.S. tax that U.S. multinationals pay on their foreign income after foreign taxes to 5 - 6 percent, which, after taking into account foreign taxes, results in a worldwide effective tax rate of large U.S. corporations that is still lower on their foreign income than on their U.S. income. Reducing the tax advantage for overseas income is an important piece of the President's plan to eliminate incentives for U.S. businesses to invest overseas.

- b. **According to the National Association of Manufacturing (NAM), 22 million people in the U.S. or more than 19 percent of the private sector and 53 percent of all manufacturing employees are employed by companies with operations overseas. Rather than raising taxes on U.S. companies with overseas operations wouldn't it make more sense to help these firms become even more competitive?**

The Administration is focused on finding ways to encourage job growth through economic expansion and making America competitive in the global economy. Our Budget proposals seek to level the playing field by reducing the incentives in our current system to invest abroad and by closing loopholes that encourage income shifting to low-tax countries. The proposed international tax changes address specific problems in our existing tax laws. For example, limiting the deduction of interest expense allocated to deferred foreign income would reduce the tax incentive for U.S. companies to make investments offshore (as opposed to here in the United States). Other proposals address misuse of the foreign tax credit and aggressive transfer pricing. In addition, our Budget encourages investment here in the United States, by proposing to permanently extend the research and experimentation credit. The goal of these proposals is to limit the role taxes play in business investment decisions by reducing implicit tax incentives to invest overseas.

- 4) **Confidence in the value of the U.S dollar is vital to American financial competitiveness. A weak dollar makes investment in foreign markets more attractive, particularly for those who seek to diversify their portfolios as our economy slows. Further dollar weakness could precipitate a dramatic shift of money from domestic to foreign markets.**

See response to question #5 below.

- 5) **The key idea to understand here is that the value of our American dollar is an important consideration to the investor and consumer confidence. Without this confidence, our economy will have a difficult time recovering.**
- a. **According to CBO, Treasury will need to issue an additional \$1.6 trillion in debt to finance our government's operations in FY 2010. As a result, debt held by the public will rise nearly 10 percentage points to 63.6 percent of GDP. Does issuing more government debt make the dollar stronger or weaker?**

We agree with you that a strong dollar is in our nation's economic interest. We also agree with you that it is important to ensure that the United States is and remains an attractive economy in which to make investments.

With respect to your specific question, the dollar is the most frequently traded currency in the international financial system. The dollar is on one side of 87 percent of all international transactions in the foreign exchange market, which handles

roughly \$3 trillion of transactions per day. The attractiveness of the dollar is determined by confidence in the U.S. economy and by the depth and liquidity of U.S. financial markets. We have already made significant progress in putting the U.S. economy and financial system on the road to recovery, but more remains to be done. I am strongly committed to seeing through further improvements.

As for the budget deficit, our immediate goal is to support recovery of the economy following a very deep recession and to assist a return to job growth. The Administration is committed to significant federal government deficit reduction over the next several years. Putting the federal government budget on a long-term sustainable path would be a significant contribution to enhancing the overall strength and attractiveness of the U.S. economy.

b. As Secretary of the Treasury you have responsibility for managing dollar policy, do you support a strong dollar?

Yes, a strong dollar is in our nation's economic interest.

c. What do you intend to do to strengthen our nation's currency?

Our policies are targeted to further strengthen the American financial system and economy. We have moved aggressively and we are making steady progress.

6) [Additional question asked in hearing – Question incorporated from transcript] Secretary Geithner, first let me talk about the bank tax or fee. How many firms will pay the tax that did not directly receive TARP funds?

GEITHNER: I don't think I can give you the exact number today. I'd be happy to respond in writing on this, set it to make sure that it only hits firms that are above \$50 billion in assets. And again, those were the firms that we think were the principal beneficiaries of what we had to do to fix the financial system, even though not all of them were direct recipients of taxpayers' money....

KYL: Thank you. And I will appreciate getting the number of those that directly received the funds.

On a preliminary basis, we have estimated that approximately 50 to 60 major institutions with assets in excess of \$50 billion will be subject to the fee. Of these institutions, many were TARP recipients. However, it should be noted that some firms that did not receive TARP capital were direct recipients of other forms of government assistance, such as the FDIC's Temporary Loan Guarantee Program. More importantly, all of the institutions subject to the fee were direct or indirect beneficiaries of the broad suite of government programs that were implemented in the crisis.

Questions from Senator Kerry

- 1) **I am pleased the budget includes addressing the misclassification of workers. Addressing this issue is long overdue. The proper classification of workers will provide a level playing field to America's workers to ensure they are afforded protections already in the law, such as workers' compensation, Social Security, Medicare, payment of overtime, unemployment compensation, and the minimum wage. Federal and state revenue is lost when businesses misclassify their workers as independent contractors. One of the reasons that I introduced legislation on this issue was the section 530 of the Revenue Act of 1978 creates a safe harbor and the IRS is prohibited from issuing guidance addressing the proper classification of workers. It is my understanding that your proposal would allow the IRS to issue guidance, but would not make specific changes to the section 530 safe harbor. Is this correct? I would like to work with you on this issue and work on solution that does not allow employers to base classification on industry practices. We should not allow misclassification of workers to continue just because a worker was classified based on industry practice which could be erroneous.**

The Administration's worker classification proposal would permit the Treasury Department and the IRS to issue guidance on the proper classification of workers, including with respect to the safe harbor. In addition, the proposal would permit the IRS to prospectively reclassify workers who are currently misclassified and whose reclassification has been prohibited under the current law (section 530). The Administration proposal is intended to recognize that many workers are appropriately classified as independent contractors. Where independent contractors properly report their income and expenses, there generally is not a loss of Federal and State revenue. The Administration's proposal is designed to ensure the proper classification of workers, as well as to ensure that, where workers are properly classified as independent contractors, their related income and expenses are properly reported.

- 2) **Since 2004, I have advocated that we need to change our international tax system. We have to end perverse incentives that encourage U.S. multinationals to shift investments and jobs offshore to tax havens. Your proposals have changed from last year. The budget addresses deferral by deferring the deduction of interest expense that is properly allocated and apportioned to a taxpayer's foreign source income that is not currently subject to U.S. tax. Last year's proposal deferred the deduction of expenses except for research expenditures.**

a. **Why is the provision more narrow this year?**

Our package of international tax reforms has been modified from last year to better meet the goals of taking on international tax evasion and cutting back tax incentives for shipping jobs overseas. The proposal to deny an immediate deduction for deferred expenses has been modified to increase its focus on eliminating the incentive

to create jobs overseas. Under current law, businesses that borrow money and invest it overseas can claim the interest they pay as a business expense and take an immediate deduction on their U.S. taxes, even if they pay little or no taxes on their overseas profits. The Budget would eliminate this tax advantage for overseas investment by requiring that the deduction for the costs of overseas investment be delayed.

b. Can you explain the reason behind including the new proposal that addresses abuses associated with transfer pricing?

Increased globalization and technological advances have resulted in an economy where intangible assets play an increasingly important role. Valuable intangible property can be easily moved across borders, resulting in multinational corporations transferring intangible assets to subsidiaries in overseas tax havens, thereby shifting profits overseas and avoiding U.S. tax. Recent empirical analyses raise concerns that income shifting through transfers of intangibles to low-taxed affiliates has resulted in a significant erosion of the U.S. tax base (see e.g., Government Accountability Office, *U.S. Multinational Corporations: Effective Tax Rates are Correlated With Where Income is Reported*, GAO-08-950, 2008; Department of the Treasury, *Report to Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties*, 2007).

The potential significant tax savings achieved by shifting income to offshore affiliates puts significant pressure on the enforcement and effective application of current transfer pricing rules. The proposal is intended to serve as a backstop to current rules for valuing intangible property rights transferred to a related person, and to prevent the inappropriate shifting of income resulting from the transfer of high-value intangibles offshore to low-tax environments. It is consistent with and complementary to the principles of the current transfer pricing rules.

c. I commend the administration for including reforms to our international tax system. The proposals total approximately \$122 billion over ten years. The international tax legislation that I have proposed in the past would use the savings to reduce the corporate tax rate.

Have you considered a reduction in the corporate tax rate? I think it would help with competitiveness to lower our corporate tax rate and offset it by eliminating loopholes and deductions.

While the U.S. does have a higher statutory corporate tax rate than some other industrialized nations, statutory corporate income tax rates do not necessarily reflect the true burden of corporate taxation. Effective marginal tax rates, which take into account, for example, depreciation allowances and investment credits, give a more accurate picture of the incentive for corporations to invest at the margin. Because the U.S. offers relatively generous depreciation allowances, its effective marginal tax rate on corporate capital is about average for OECD countries. However, the

Administration shares your interest in international tax reform and promoting the competitiveness of U.S. firms, and looks forward to working with you and your colleagues on this issue.

- 3) **The Administration with the creation of the Pay Czar has addressed the issue of executive compensation. I commend your efforts, but I think that more can be done. As you know, the tax code limits the amount of executive pay that can be deducted to \$1 million. This limitation is limited in its scope and has loopholes. Performance based pay and nonqualified compensation are not included in this limitation. As part of the TARP legislation, we limited the tax deductibility of compensation for executives of TARP recipients. I am working on executive compensation legislation with Senators Baucus and Grassley. I don't think taxpayers should have to subsidize excessive compensation. Have you considered further limiting the tax deductibility of executive compensation?**

We have consistently held and expressed the view that pay should reflect long-term value creation and financial soundness that benefits the economy at large as well as corporate stakeholders. As experience has shown, compensation arrangements that offer corporate executives incentives to take excessive risks or other actions in order to generate rewards they can capture in the short term, regardless of the long-term consequences, can distort decisions with adverse consequences to us all. Specifically, we believe that measures such as requiring holding stock compensation for longer periods, requiring clawbacks where financial statements were materially incorrect, and prohibiting executives from avoiding personal risk with respect to their compensation through hedging or similar activities, should be encouraged. To the extent that sound compensation policies like these can be encouraged by proposed revisions to the tax code, we would certainly consider them.

At the same time, except where (as with TARP recipients) the government has a major stake in a company, we are reluctant to put the government in the business of setting pay caps for executives or anyone else. Moreover, changes to the tax code may not always be the most effective way to deal with the problems that have given rise to excessive compensation. Many efforts are currently underway to address the issue of excessive compensation. Treasury last year set out legislative proposals for strengthening compensation committee independence and providing shareholders with a "say on pay." In addition, a number of coordinated steps have been taken by the SEC and, with respect to financial institutions, the Federal Reserve to address problems with executive compensation.

Experience suggests that using tax measures to limit compensation, unless very carefully crafted, may prove to be counterproductive, adversely affecting shareholders or others who are not the intended targets. In other words, in considering proposals to further limit the right to deduct executive compensation in the same manner as other business expenses, we must take into account the risk of the unintended adverse consequences that have arisen from other changes in the past.

- 4) **Recently, the Administration unveiled a Financial Crisis Responsibility Fee. I think this is a fair way to recover TARP funds. I have heard from mutual funds that they will likely be covered by this fee. Should this fee be designed in a manner in which it only impacts TARP recipients?**

We do not believe the fee should apply only to TARP recipients. All the institutions covered by the fee were direct or indirect beneficiaries of the government's emergency response to the financial crisis. Covered financial firms would include U.S.-based bank holding companies, thrift holding companies, other insured depository institution holding companies, and securities broker-dealers with total consolidated assets of at least \$50 billion (regardless of whether such U.S.-based firms are controlled by a foreign firm). As designed, the fee applies to the largest, most highly leveraged institutions that finance themselves in the wholesale markets (as opposed to through insured deposits or insurance policy reserves). All firms in this category were substantial recipients of the extraordinary actions taken by the government to respond to the crisis.

We note that the assets of mutual funds generally reside in legally distinct vehicles and are not consolidated onto the balance sheet of a financial institution for purposes of calculation of the fee. Based upon preliminary estimates, we expect the fee to apply to approximately 50 to 60 companies.

Questions from Senator Bunning

- 1) **The President's budget once again calls for the repeal of the LIFO accounting method, which would disrupt long-established business practices and require employers to pay an onerous tax over a 10-year period. In anticipation of paying this tax, do you expect that employers will be more or less likely to expand and create jobs?**

Most of the revenue associated with repealing the LIFO accounting method is derived from ending deferrals of tax payments with respect to inventory gains realized in prior years. The proposal allows the tax owed with respect to those past gains to be paid over a 10-year period, reducing the effect on business cash flow. Moreover, the proposal will have a minimal effect on current business decisions to invest in equipment or to hire workers. At the same time, the additional revenue will lower the deficit and instill greater confidence in the state of the economy. This should help businesses in retaining existing jobs and creating new ones, as will other proposals in the budget, such as permanent extension of the R&E credit, increased expensing, and bonus depreciation.

- 2) **The President's budget contains a number of tax increases that will increase the cost of American energy sources, including oil, natural gas and coal. At what point in the future does the Administration expect that our economy will not be reliant on these sources of energy, and why is it not in the interests of job creation and energy security to have less expensive sources of American-made energy in the meantime?**

The Budget contains a number of provisions to reduce our reliance on traditional fossil fuels and transition the United States to a 21st century clean energy economy. As part of that effort, we are proposing to eliminate inefficient subsidies for oil, gas, and coal production.

Over the long term, reducing tax preferences will result in a more efficient allocation of capital, which will tend to increase national output. In other words, eliminating these tax subsidies will make our overall economy stronger over time.

In addition, our analysis indicates that the elimination of tax subsidies for fossil fuels will have only a small effect on output and prices in the affected industries. The tax subsidies for the fossil fuel industry amount to a tiny fraction (approximately one percent of average total revenues from coal production). The overall market impact on consumption and production is likely to be very small. Regional production impacts may vary based on the relative size of the subsidies received by the industry in each region.

The current tax subsidies for fossil fuels also work against the goal of reducing the negative externalities associated with fossil fuel production and achieving our goal of

transitioning – over the long term – to cleaner energy sources. Fossil fuel prices, for example, do not reflect the environmental harm caused by the release of greenhouse gases in the atmosphere associated with oil and gas production and consumption. In addition, the price of oil does not reflect the risks associated with oil dependency. Removing these subsidies and pursuing policies that efficiently address these negative externalities, such as a comprehensive market-based climate change policy, will bolster our environmental and energy security.

We must build a new, clean-energy economy, reduce our dependence on fossil fuels, and limit emissions of greenhouse gases. It is no longer sufficient to address our energy needs by finding more fossil fuels. Instead we must take dramatic steps towards becoming a clean-energy economy. These include encouraging the use of, and investment in, clean energy infrastructure and energy efficient technologies and the development of good jobs in those fields.

Questions from Senator Lincoln

- 1) Secretary Geithner, the Administration has included an extension of the tax incentives for empowerment zones and renewal communities in both the FY 2010 Budget, as well as the FY 2011 Budget. The tax incentives for these programs expired at the end of 2009, despite the dramatic need for economic development and job creation. These programs stand ready to create jobs and boost the economy -- but they stand stalled without any extension and they need better tools to do so. The programs offer wage credits, they can offer lending through bonding authority, and yet some of the incentives do not work as well as intended.

The incentives they use should be refined, as I have proposed with Senator Snowe in S. 1222, to make them more effective. For example, according to HUD only 16% of the bonds authorized for empowerment zones have ever been issued because of unintentional effects of certain rules; my bill would help address that and also extend credit in other areas to help create jobs. The zones and communities also offer wage credits, but those could be more flexible to help create jobs across a broader spectrum. This bill is supported by 13 of my Senate colleagues, and was cosponsored by then-Senator Obama in the 110th Congress. HUD has testified that "[w]e look forward to working with Congress to continue and improve the EZ/RC Initiative in anyway necessary to best ensure the continued expansion of economic opportunities for the over 5 million residents of these high poverty, unemployment EZ and RC area census tracts."

Will the Administration support extending the incentives through at least 2011, as called for by the Administration's budgets, and work with me and the Finance Committee on improving the incentives so they are more effective in delivering wage credits and spurring lending and ultimately creating jobs?

The Administration supports extending empowerment zone and renewal community designations through 2011. We agree that these programs, although successful, should be reviewed and look forward to working with you and other members of Congress to make the incentives they provide even more effective.

Questions from Senator Wyden

- 1) **It seem to me that one of the benefits of tax-credit bonding – over the blunt instrument of tax exemption – is that it allows us to tailor the amount of subsidy to fit the public benefit of the projects. Wouldn't it make sense to create a few different flavors of Build America Bonds, with different subsidy rates, for different types of projects? That way projects that create the most jobs and other public benefits – specifically transportation infrastructure – could have a higher subsidy. And uses like refinancing or operating expenses could get a lower subsidy.**

It is correct that, unlike traditional tax-exempt bonds, both the Build America Bond “direct payment” subsidy program and the “tax credit” bond programs can be tailored to provide, for policy reasons, different levels of Federal borrowing subsidies to State and local governments for different types of projects (e.g., the existing deeper borrowing subsidies of 100 percent and 70 percent, respectively, of the borrowing costs with respect to certain school and energy bond programs under Code Section 54A). While it may be appropriate to consider different borrowing subsidy rates to encourage certain favored State and local governmental programs over others, we must also consider the complexity such an approach entails. In addition, we should promote greater uniformity in the bond market while providing State and local governments with appropriate discretion and flexibility to address disparate local needs. Some localities may need schools, others may need bridges, and others may need to temporarily finance operating expenses, such as teachers’ salaries. Further, State and local governmental financing practices often involve financing of consolidated costs for traditional governmental purposes (e.g., capital costs, refinancing costs, and operating expenses) within the same bond issue to facilitate efficient borrowings. Having a single, simple, subsidy rate promotes this activity in an efficient manner.

- 2) **A Treasury official was recently quoted as saying the proposal wouldn't increase the cost to the federal government, because the cost of making the Build America Bonds permanent would be equal to the tax revenues foregone if the program were to expire and state and local governments were to issue tax-exempt bonds instead. Can you provide the Committee with the Treasury's analysis showing that extending Build America Bonds would have a revenue neutral impact on the Budget?**

The Administration’s Fiscal Year 2011 Budget proposal to make the Build America Bond program permanent at a Federal subsidy level equal to 28 percent of the coupon interest on the bonds is intended to be approximately revenue neutral relative to the estimated future Federal tax expenditure for tax-exempt bonds already provided for in the tax code. A basic principle associated with this revenue impact analysis is that Build America Bonds would displace tax-exempt bonds that otherwise might be issued. The analysis underlying the Administration’s Budget proposal incorporates two primary factors. First, the proposed Federal subsidy rate for Build America

Bonds should, in many instances, lessen borrowing costs to State and local governments compared to tax-exempt bonds due to inefficiencies inherent in the tax-exempt bond market. In part, this occurs because Build America Bonds can tap the investments pools of many types of investors who are uninterested in traditional tax-exempt bonds (e.g., pension funds). Second, since the interest paid on Build America Bonds is taxable income to the recipient, these interest payments would increase Federal receipts for individual and corporate income taxes, offsetting to some extent the Federal subsidy payments to State and local governments on these bonds. It is these factors considered together that leads us to the conclusion that making the Build America Bond program permanent at a Federal subsidy level equal to 28 percent of the coupon interest on the bonds would be approximately revenue neutral relative to current law.

- 3) **[Additional question asked in hearing – Question incorporated from transcript] Secretary Geithner, the banks are getting bigger and lines of credit to Main Street employers are getting smaller. And it looks like a vicious cycle. The taxpayers bail out the too-big-to-fail institutions only to be more vulnerable to them.**

Now, a few minutes ago, you told the chairman that the banks that got bailout money were increasing lending. Your own Treasury data, however, paints a different picture. Your Treasury data demonstrates that the 22 banks that got the most help from Treasury bailout programs have actually been decreasing small business lending. The inspector general's report on January 30th, the TARP report, says exactly the same thing.

So my first question to you picks up on the chairman's point about the urgency of small business lending. Tell me, if you would, how the new program that is being discussed is going to be an improvement on the two programs that your own data and the inspector general have said are not working? I'd like a more detailed answer in writing, if I could get that, because I continue to be uncertain with respect to how this new program is going to improve on two others that your department inspector general has criticized.

The proposed Small Business Lending Fund is open only to community banks under \$10 billion in total assets and not to the largest TARP participants. These banks are the lenders most focused on small businesses. We have taken the approach of providing strong incentives for banks to augment their lending – reducing dividend rates on capital as they lend more. At the same time, we are working with Congress to identify additional ideas that could be included in the Small Business Lending Fund.

We have seen consistently that smaller banks have elected not to participate in TARP programs in part because of their fear of stigma and retroactivity – for example, the decision to deny NOL carrybacks to TARP recipients. Hundreds of small banks withdrew their applications for TARP's Capital Purchase Program following controversy regarding TARP-related restrictions. These concerns motivated our decision to propose a program outside of TARP.

Questions from Senator Stabenow

- 1) **As you know, I have been concerned about the Administration's LIFO (Last In First Out) repeal proposal, which is again included in the budget. One of the aspects that I find most troubling about the proposed repeal is the degree of retroactivity associated with the proposal. As I understand it, the LIFO reserves that would be taken into income over 10 years under the proposal amount to the difference between the deductions taken by a business over many years under LIFO and the deductions that would have been available over those years under FIFO. It has been argued to me that by requiring that those "excess" deductions now be taken into income, the proposal would effectively repeal LIFO deductions that were taken as many as 50 or 60 years ago. How would you respond to these concerns? I'd specifically like you to address the degree of retroactivity and the effects it would have on businesses.**

Most of the revenue increase associated with repealing the LIFO accounting method is derived from ending deferrals of tax payments that arose from inventory gains realized in prior years. We realize that the proposal requires tax be paid on long deferred gains, which is why the proposal allows the tax owed to be paid over a 10-year period, essentially allowing continued deferral of these gains for a transition period. At the same time, the additional revenue will lower the deficit and instill greater confidence in the state of the economy. This should help businesses in retaining existing jobs and creating new ones, as will other proposals in the Budget, such as permanent extension of the R&E credit, increased expensing, and bonus depreciation.

- 2) **Mr. Secretary, thank you for your welcome comments on the need to pass health insurance reform. One area that has great bipartisan support is investing in our nation's community health centers. Each year, Senator Bond and I have championed a letter in support of funding for our nation's health centers that has the overwhelming support of Senators on both sides of the aisle.**

Community health centers and other safety-net providers such as rural health clinics, community mental health centers, and school-based health centers though are in desperate need of capital improvements. As more people lose their insurance, we are seeing more and more people turn to community health centers and other safety-net providers to get their primary care.

While we have provided construction grants for health centers in both the economic recovery act and again in the Senate health reform bill, these aren't enough to meet our centers' long-term needs. For example, the recovery act included \$1.5 billion for construction, but according to a study commissioned in 2008 by the National Association of Community Health Centers, overall health center capital needs are in excess of \$10.5 billion between now and 2015. I have centers in Detroit and other parts of Michigan that have not been able to access these construction dollars, and their needs continue to grow.

And in the current credit crisis, there are few places for safety-net providers to look in the private market for capital. To paraphrase what the President himself said when he announced grant funding last December, finding a creative solution would not only create new job opportunities in construction and health care but also help provide care for additional patients in underserved communities.

In fact, the noted journal *Health Affairs* is releasing a report today about how successful the construction dollars were and that more public-private investment truly pays off. The study authors found that these and other public dollars helped increase virtually all services, especially mental health treatment and counseling. The authors predict that an additional \$500,000 in federal grants to federally qualified health clinics would help provide \$135,000 worth of free or discounted care and could translate into 540 more uninsured patients who receive treatment. If federally qualified health centers leveraged their federal grant support to gain additional state, local, and private grant dollars, this could lead to higher levels of service and more care for the uninsured, the researchers conclude.

Would you be willing to work with me and my staff on thinking creatively of ways that the federal government can help leverages private capital to renovate and modernize our nation's safety-net providers?

Community health centers can play an important role in delivering much needed care to at-risk populations. I would be happy to have Treasury staff work with your office to try to find ways to encourage the renovation and modernization of community health centers.

- 3) I strongly support the Administration's efforts to redirect TARP funds from Wall Street to Main Street. However, it's imperative that any new program to redirect these funds also provides relief to the unique challenges facing small-to medium-sized manufacturers. We can pass all the tax credits we want, but if manufacturers don't have access to capital then it won't make any difference in their ability to hire or expand operations.

Parts manufacturers directly employ nearly 700,000 people-making them the largest employer of manufacturing jobs in the U.S. In fact, every direct job with a parts supplier contributes to an additional 4.8 jobs, which means that the industry supports more than 3.29 million jobs throughout the country.

When we talk about jobs, we should be focusing on the industries that make things in this country and support millions of good-paying jobs in the process.

The two largest problems manufacturers and small businesses currently face is reduced cash flows and undervalued collateral, stemming from the financial

crisis and subsequent downturn in sales. In order to maximize job creation in new growth industries and prevent a disorderly restructuring of the manufacturing supply base, it is critical that manufacturers have access to credit as they diversify their operations and consolidate with other firms.

I have written you in the past in support of the creation of a program similar to Michigan's Supplier Diversification Fund that would target businesses that may be good credit risks, but have collateral or cash flow shortfalls. Governors from North Carolina, Illinois, Michigan, Ohio, Pennsylvania and Wisconsin have also contacted you in support of similar initiatives.

What actions are you taking to ensure manufacturers have access to credit in order to preserve our manufacturing capability, accelerate job creation and transition our economy into growth sectors, such as health, defense and clean energy?

Specifically, what are you doing to address the collateral and temporary cash flow shortfalls facing small businesses and manufacturers without weakening underwriting standards or regulatory requirements?

As you know, the President recently announced a package of initiatives to increase credit to small businesses, which will increase caps for existing SBA loans and give small banks better access to capital, with incentives to encourage more lending to small businesses, including manufacturers.

Under the new initiatives, Treasury will take steps to improve access to credit for small businesses through its Small Business Lending Fund and through the Community Development Capital Initiative it has established under TARP. These new initiatives will support small business lending by providing lower-cost capital to small banks and to CDFIs that lend to small businesses in the hardest-hit rural and urban areas. The Administration is also seeking legislation that will increase the maximum size of three types of SBA loans available. This increase would help small businesses get access to the capital they need to grow and thrive.

Additionally, we have worked to address the temporary cash flow shortfalls by previously putting forward several initiatives designed to address small businesses. These initiatives include: Treasury facilitating the purchase of SBA-backed securities under the Term Asset-Backed Securities Loan Facility (TALF); purchasing SBA securities directly to provide secondary market liquidity; and requiring the largest TARP recipients to publicly report their small business lending.

- 4) I am pleased to hear the Administration's commitment to spur economic growth by investing in small businesses. Small businesses have created 64 percent of all new jobs in the last fifteen years. However, in the last year almost 85 percent of the jobs lost have come from small businesses.**

As the engines for job growth in this country, it is critical that we provide credit to struggling small businesses to accelerate our economic recovery.

We continue to hear that banks are restricting credit to small businesses. However, it's important to separate the large TARP recipients from the vast majority of banks. The smaller banks, who did not receive nearly as much support from TARP as the larger banks, originate the vast majority of small business loans.

Based on the FDIC call reports, banks with less than \$10 billion in assets had made two-thirds of small business loans outstanding and held 62 percent of outstanding loan balances.

In contrast, banks with more than \$100 billion in assets had made only 22% of small business loans outstanding and held only 25% of outstanding balances.

Community banks are still lending despite being faced with increased lending risk in a troubled economic environment and despite increased regulatory pressure to increase capital, and reduce risk-taking.

Any efforts to help small businesses must also include efforts to help community banks overcome the current risk to further increase small business lending. I would like to get your thoughts on what additional incentives we should consider for community banks to help them overcome the greater economic risk levels and regulatory pressures now curtailing small business lending?

Demand is an integral part of the small business lending equation. Many small businesses are taking less risk and borrowing less. However, supply is also constrained. A recent survey by the National Small Business Association (NSBA) found that 39% of small businesses report being "not able to get adequate financing." Similarly, the Fed Senior Loan Officer Survey has shown net tightening for small firms for 13 straight quarters.

Part of the reason we took the approach proposed for the Small Business Lending Fund is we believe this program can help stimulate loan supply and demand. The incentives to increase lending should encourage banks to get more borrowers in the door by offering more attractive terms and increasing marketing. The capital provided under this program can be leveraged to support new lending, while also serving as a back stop for new losses. In addition, the reduced dividend rate may be used to help offset any loan losses or, alternatively, may be passed on to borrowers through lower interest rates.

We have also sought to stimulate demand for small business loans by supporting small businesses. Through the Recovery Act, we have enhanced several SBA programs – increasing loan guarantees and reducing fees for the 7(a) and 504 loan programs as well as expanding 7(a) eligibility. We enacted tax cuts for small

businesses, providing enhanced expensing of qualified investments, a five-year carryback of net operating losses, an exclusion of small business capital gains, and estimated tax payment relief. Further, the inclusion of SBA securities into the TALF program has assisted in the recovery of SBA secondary markets.

The federal banking regulators recently issued guidance on CRE loans and small business loans that should yield greater consistency among the agencies and help banks to realize their full potential to contribute to recovery with prudent small business lending. We must continue to respect the independence of the banking regulators, which helps protect the taxpayer and the stability of the financial system. At the same time, we recognize that their actions have real economic effects so we are working with them to ensure a balanced and consistent approach.

Questions from Senator Enzi

- 1) **I appreciate your willingness to work with me on the Abandoned Mine Land Trust Fund. The Administration has cited a lack of reclamation work as a reason for terminating funding to certified states. Is the Administration aware that some certified states, including Wyoming and Montana, have a substantial amount of high priority abandoned coal mines that need to be reclaimed and that the Administration's proposed \$10 million fund is insufficient to ensure that reclamation of those high priority abandoned mines occurs? If the Administration proposes to end payments to certified states, will you support eliminating the AML tax that companies pay in states that do not receive funding?**

The Abandoned Mine Land Trust Fund is supported by a fee administered by the Department of the Interior rather than by a tax administered by the Department of the Treasury. Although the Treasury Department does not administer the fee, it is my understanding that the fee was intended to support reclamation of abandoned coal mines around the country. The fee was structured so that the coal industry as a whole would be responsible for cleaning up coal mines that could not be attributed to a particular producer, regardless of where the fees were collected or where the mines were located. Certified states are likely to have benefited from the national character of the abandoned mine reclamation program because the reclamation efforts in those states could be financed with fees collected in other states. It is my understanding that the Administration believes it is important to continue addressing abandoned mine reclamation through a national, industry-wide program.

To address coal mine reclamation projects discovered or developed after states or tribes become certified, the Administration's FY 2011 Budget sets aside \$10 million annually. The cost of reclaiming the Interior Department's current inventory of high priority coal projects in certified states and tribal reservations is estimated at \$13 million, meaning much of this inventory could be reclaimed with funding from a single budget year.

- 2) **In response to my suggestion that ending tax preferences for traditional energy sources like oil, natural gas, and coal would increase energy prices, you said that you did not believe there would be any price increase. You stated, "We don't think they are going to have any effect on prices. We don't think they will. They have been carefully designed not to do that." However, it appears to me that you simply proposed eliminating all tax preferences. Rather than going through the budget with a scalpel as the President suggested should be done, you have taken a hatchet to the coal, oil, and natural gas sections. Can you explain how you carefully structured the proposals to ensure that energy prices will not increase?**

The President agreed at the G-20 Summit in Pittsburgh to phase out subsidies for fossil fuels so that the United States can transition to a 21st century energy economy. The fossil fuel tax preferences the Administration proposes to repeal distort markets

by encouraging inefficient investment. To the extent these subsidies encourage the overproduction of oil; they are detrimental to long-term energy security and inconsistent with the Administration's policy of reducing carbon emissions and encouraging the use of renewable energy sources. Moreover, the subsidies must ultimately be financed with taxes that result in underinvestment in other, potentially more productive, areas of the economy.

When considering the elimination of these subsidies the Administration carefully considered the impact that these subsidies would have on the overall economy. In a competitive market, a tax system free of subsidies will promote investment decisions that reflect an investment's economic returns rather than its tax benefits. Over the long term, reducing tax preferences will result in a more efficient allocation of capital, which will tend to increase national output.

Regarding oil, the domestic price of oil is determined by global supply and demand because oil is an internationally traded commodity. The U.S. contribution to world oil supply is relatively small. Thus, any changes likely will not significantly change the world oil price, and thus U.S. consumers would feel little or no impact from removing oil tax preferences. As Assistant Secretary Krueger stated in his testimony to the Senate Finance Committee last year, we estimate that removing the subsidies for the oil industry would be equivalent to increasing total oil finding and lifting costs by less than two percent. Based on this, we estimate that the decrease in domestic production due to these proposals will be less than one half of one percent, even in the long run.

Regarding coal subsidies, our analysis indicates that changes in domestic coal production costs resulting from loss of these subsidies will have little effect on U.S. prices. The subsidies for the coal industry amount to less than one percent of average total revenues from coal. The final market impact on consumption and production is likely to be very small. Similarly, the subsidies for the natural gas industry are equal to about one percent of average total revenues from natural gas over the last two years. The final market impact on consumption and production from elimination of gas subsidies is thus likely to be very small.

3) If the Administration is successful in eliminating tax preferences for fossil fuels, do you anticipate that the energy industry will absorb the tax increases in their internal budgets or do you believe that those costs will be passed along to consumers?

Over the long term, reducing tax preferences will result in a more efficient allocation of capital, which will tend to increase national output. In other words, eliminating these tax subsidies will make our economy stronger over time. The President is committed to making our tax code more efficient and strengthening our economy.

The domestic price of oil is determined by global supply and demand because oil is an internationally traded commodity. Although the U.S. constitutes a significant share of world demand, the U.S. contribution to world oil supply is relatively small. If the world oil price does not change significantly, U.S. consumers would feel little or no impact at the pump from removing these tax preferences. Because the world supply and price of oil will not change appreciably as a result of eliminating these tax preferences, consumers will not change their demand for petroleum products. As Assistant Secretary Krueger stated in his testimony to the Senate Finance Committee last year, any reduction in domestic oil supply would likely be minimal and because domestic crude oil output is not expected to change appreciably, employment in the oil extraction sector would likewise not be expected to change.

As detailed in Assistant Secretary Krueger's testimony on oil and natural gas subsidies, the subsidies for the natural gas industry are equal to about one percent of average total revenues from natural gas over the last two years. The subsidies for the coal industry currently amount to less than one percent of total revenues from coal. Thus the effect on prices should be small. Moreover, the final market impact on consumption and production is likely to be less than the change in prices, and, over the long term, employment in the natural gas and coal supply industries could change by an amount similar to the change in production.

- 4) **In my experience as a business owner, if you incur additional costs, you need to find areas to cut costs. It is estimated that the repeal of tax preferences for fossil fuels will raise approximately \$39 billion over 10 years, which would be paid for by the companies who work in those industries. I am concerned that the companies would choose to absorb the tax increases by cutting jobs to lower operating costs. If the Administration is successful in eliminating tax preferences for fossil fuels, do you anticipate job losses in the impacted industries?**

See response to Question # 3 above.

- 5) **The FY 2011 budget includes what many describe as a placeholder for cap and tax legislation. In the FY 2010 budget, the Administration showed that such a bill would raise over \$600 billion in revenue. Why didn't the Administration include the amount of revenue that implementing a cap-and-tax program will raise in the fiscal year 2011 budget? It appears to me that you are trying to hide the fact that a cap-and-tax bill costs money.**

In his State of the Union address, the President once again called on Congress to pass comprehensive energy and climate legislation to put America back in charge of its energy future and lay the foundation for a new clean energy economy.

Consistent with previously expressed positions, the Administration still believes this legislation should be deficit neutral and should: include a market-based policy to reduce greenhouse gas emissions; protect vulnerable families, communities and

businesses during the transition to a clean energy economy; and provide funding to support investments in clean energy technologies and adaptation to climate change.

Recognizing that the total amount of any receipts made available under such legislation will depend on the specifics of the policy adopted, the Fiscal Year 2011 Budget does not attempt to estimate these receipts but does assume that overall policy design will be budget neutral.

- 6) According to the Administration's FY 2011 Budget documents released this week, the Pension Benefit Guaranty Corporation has a deficit close to \$17 billion. What is the Administration's proposal to reduce the deficit and in what time frame?**

As of September 30, 2009, PBGC's combined single-employer and multi-employer programs had a negative net position "deficit" of \$21.9 billion, which represents a long-term actuarial deficit. The PBGC has sufficient liquidity to meet its obligations for a number of years.

There are multiple factors that affect the PBGC deficit. The investment policy is set by the PBGC Board, and in 2010, the PBGC Board began a comprehensive PBGC investment policy review process that includes consulting with experts. While it is early in this review process, there seems to be broad consensus that the PBGC deficit is the result of structural problems that cannot be resolved fully only by an investment policy change. Other factors are outside of the control of the PBGC. For example, premium setting, benefit levels, and funding rules are determined by Congress. Moreover, the future path of the deficit is highly uncertain.

Going forward, further study of prior plans to reduce the PBGC deficit, the findings that result from the current investment review process and efforts to identify other alternatives will inform the process of developing a plan to reduce the existing PBGC deficit.

- 7) Does the Administration support relief from the pension funding laws for single employer and multiemployer pension plans in light of the recent economic downturn? What empirical data does the Administration use to base its decision? Does the Administration support relief for the years 2008, 2009, 2010 or 2012?**

Recent investment losses and current low interest rates have forced many employers to increase their pension contributions significantly, even while many businesses continue to struggle in a recovering economy. The Administration supports targeted legislation that allows plan sponsors to temporarily delay pension contributions resulting from these unique circumstances, giving them more time to make up these extraordinary losses while requiring the same funding levels by the end of a defined period. By making pension commitments more affordable for employers, this legislation could encourage employers to continue to offer retirement benefits and

free up resources for business investment and job creation. At the same time, the legislation should not allow employers who take advantage of this relief to use their resulting improved temporary cash flows to put payments to shareholders and executives ahead of the security of workers' pensions.

The Administration bases its position, in part, on information about plan assets and liabilities reported to the regulatory agencies as part of the annual disclosure requirements set forth in ERISA and the Internal Revenue Code. The detailed additional information that some plan sponsors are required to provide to the PBGC pursuant to section 4010 of ERISA is also used to aid in understanding the liabilities the PBGC is potentially facing. We also review data surveys and analysis and projections from the PBGC, actuarial consulting firms, business groups, labor organizations and other sources.

- 8) **Under current Internal Revenue Service regulations, companies may petition for funding waivers for minimum funding requirements. Companies and pension plans that have filed for waivers in the past have stated that the process is long, drawn out and overly cumbersome. In light of the recent economic downturn, what has the Department of Treasury and the Internal Revenue Service done to expedite and/or make more efficient the funding waiver process?**

The Internal Revenue Service is currently reviewing its procedures and its existing Memorandum of Understanding with the PBGC relating to the processing of petitions for waivers of the minimum pension funding requirements. The purpose of this review is to identify steps that might be taken to expedite the processing of waiver requests or to make the process more efficient. In addition, the IRS has trained additional staff that can be assigned to process petitions for waivers of the minimum funding requirements in the event of an increase in the number of petitions.

- 9) **Recently, the Senate HELP Committee held a hearing on defined benefit plans. At the hearing, a witness testified regarding the Delphi pension plans and GM bankruptcy proceedings. According to a December 24th press article, "A Treasury spokesman said the administration did not make the decision or play a central role in it." Could you please explain the Department's role, including the Auto Czar's role, in the bankruptcy proceedings of GM? Who was the Administration's primary liaison for the GM bankruptcy proceedings as well as the liaison for GM's creditors and stakeholders?**

The termination of the Delphi Retirement Program for Salaried Employees and its placement under the PBGC's trusteeship are currently the subject of litigation in [Black et al. v. PBGC et al. in Michigan](#). Treasury cannot comment on the specifics of any pending litigation.

- 10) **Can you confirm that the "administration did not make the decision or play a central role" regarding Delphi's pension plans? Did the Administration's Auto Czar have any discussions regarding Delphi's pension plans with anyone?**

The termination of the Delphi Retirement Program for Salaried Employees and its placement under the PBGC's trusteeship are currently the subject of litigation in Black et al. v. PBGC et al. in Michigan. Treasury cannot comment on the specifics of any pending litigation.

- 11) As part of GM's bankruptcy and related proceedings, a new Voluntary Employee Benefit Association (VEBA) was established. The VEBA consists of 17.5 percent of GM stock and \$6.5 billion in GM preferred stock with a 9% interest rate. The Department of Labor in the fall approved an exemption to fund the VEBA with company stock. Do you agree with the Department of Labor's decision?**

It is not Treasury's role to comment on the exemption process of the Department of Labor.

- 12) As the majority shareholder in GM, what is the federal government's funding obligation with respect to VEBA? Does the Administration anticipate future funding and budgetary obligations for the VEBA within the next 5 years?**

No, the Federal government does not expect to fund the VEBA. The VEBA is an independent trust, which has responsibility for healthcare for the UAW retirees.

- 13) As the majority shareholder in GM, what actions have been undertaken to ensure that GM's pension plans remain viable? What is the Administration doing to ensure that GM contributes its minimum funding obligations for its pension plans? What are the current funding percents of GM's pension plans? Is there a chance that GM's pension plans could become a liability to the Pension Benefit Guaranty Corporation within the next 5 or 10 years?**

We are not intervening in the day-to-day management of the company and are confident in the company's ability to contribute the minimum funding obligations for its pension plans. Following its emergence from bankruptcy, the New GM is being run as a commercial enterprise by their management team, which reports to a new, independent Boards of Directors. In acting as a lender and investor in New GM, the Auto Task Force closely monitors the loans and investments made in both companies, but as previously stated, are not involved in the operational decisions of the companies. That said, the questions of the current funding percents of GM's pension plans and whether or not they could become a liability to the PBGC within the next decade can be best answered by the company.

- 14) As the majority shareholder in GM, does the federal government have a seat on the VEBA or participate in the decisions of GM's pension plans? What are the investment policies for the VEBA and GM's pension plans?**

We are not intervening in the day-to-day management of the company and are confident in the company's ability to contribute the minimum funding obligations for its pension plans. Following the emergence from bankruptcy, the New GM is being run as a commercial enterprise by their management team, which reports to a new, independent Boards of Directors. In acting as a lender and investor in New GM, the Auto Task Force closely monitors the loans and investments made in both companies, but as previously stated, are not involved in the operational decisions of the companies.

Questions from Senator Cornyn

- 1) In your testimony, you mention that the projected cost of TARP is now \$117 billion. But as you know there are a number of programs and recipients within TARP. Could you please tell the Committee which part(s) of TARP will be a revenue generator for the Treasury and a revenue loser?**

The FY2011 Budget (the Budget) includes detailed data by program, both in Chapter 4 of the Analytical Perspectives Volume, and in the Federal Credit Supplement. The budget included expected returns for the following TARP programs:

- Capital Purchase Program
- Targeted Investment Program
- Asset Guarantee Program
- Term Asset-Backed Securities Loan Facility
- PPIP Debt

The Budget also reported expected losses for the following TARP programs:

- AIG Investment Program
- Automotive Industry Financing Program
- Future activity (Other Section 101), excluding TALF (\$3 billion)
- PPIP equity

The Home Affordable Modification Program (HAMP) was not designed to recoup money spent on loan modifications to keep people in their homes. The Budget reported expected outlays of \$49 billion through HAMP.

However, the ultimate cost of each TARP program is uncertain and will not be known for some time. The estimates reported in the Budget were based on economic and financial projections made the end of 2009. Recent news concerning individual institutions and the financial sector generally suggests that the ultimate cost of TARP may be lower than what was reported in the Budget. However, circumstances could change, and actual costs may in fact be higher.

- 2) I have been told that many of the major financial institutions have paid or will expect to pay their TARP money back to the government with interest. Is this the case?**

Over 60 institutions have repaid the TARP investments and associated dividends with repayments in the amount of nearly \$170 billion.

- 3) Which TARP recipients are not expected to fully repay their money back to the Treasury?**

As indicated in the response to Question 1, the Budget reported expected losses from TARP investments in AIG and in the auto industry. In addition, we expect that some financial institutions that participated in the Capital Purchase Program (CPP) will likely not repay the full value of Treasury's investment. On November 1, 2009, a CPP participant, CIT Group, filed for Chapter 11 Bankruptcy. The OFS had invested \$2.3 billion in senior preferred stock of CIT Group and received a warrant for the purchase of common stock. The OFS does not expect a significant recovery of its preferred stock investment. As such, this investment has been reduced to zero in Treasury financial statements. The ultimate amount received, if any, from this investment will depend on the outcome of the bankruptcy proceedings.

On November 6, 2009, a subsidiary of UCBH Holdings, Inc. (a CPP participant), United Commercial Bank, was closed by its regulators. The OFS had invested approximately \$298.7 million in senior preferred stock and received a warrant for the purchase of common shares. The value of these shares, including the warrant, reflected in these financial statements was approximately \$22.5 million as of September 30, 2009. The ultimate amount received, if any, from this investment will depend on the outcome of the receivership.

On November 13, 2009, a subsidiary of Pacific Coast National Bancorp (a CPP participant), Pacific Coast National Bank, was closed by its regulators. The OFS had invested approximately \$4.1 million in senior preferred stock and received warrant preferred stock in the amount of \$206 thousand. The value of the shares, including the warrant preferred stock, reflected in these financial statements, was approximately \$154 thousand as of September 30, 2009. The ultimate amount received, if any, from this investment will depend on the outcome of the receivership.

Beyond these cases, the TARP cost estimates recognize some general risk that not all TARP investments will be repaid. As stated above, the FY2011 budget projects CPP will have an overall return of approximately \$4 billion.

- 4) **Mr. Secretary, I also have a few questions about the TARP Special Inspector General's report that was just issued at the end of January. From its inception, the Inspector General's most fundamental recommendation with respect to basic transparency in the operation of TARP has been that Treasury should require all TARP recipients to report periodically on their use of TARP funds.**

The Inspector General now reports that your department has finally agreed with this recommendation and will now be obtaining and reporting to the public qualitative responses from each TARP recipient on its use of TARP funds, backed by quantitative data obtained from the recipients' regulators and Treasury's own analysis.

- a. **Why did your department initially refuse to follow the Inspector General's recommendation—a recommendation that will finally give the American people the basic transparency they deserve?**

The Department of the Treasury has committed to determining the effectiveness of all of the programs of the Office of Financial Stability (OFS). To this end, we will collect and analyze information from a number of sources to gauge the effectiveness of the Capital Purchase Program (CPP), including through an annual Use of Funds Survey.

We collaborated with SIGTARP on the format of the Use of Funds Survey. After reviewing the format of the Use of Funds Survey, SIGTARP confirmed in its January 2010 Quarterly Report to Congress that Treasury's planned Use of Funds Survey, when implemented, will constitute an adoption of its recommendation on reporting use of funds. The Use of Funds Survey form was approved by the Office of Management and Budget on January 7, 2010.

The purpose of the survey is to obtain insight into the lending, financial intermediation, and capital building activities of all financial institutions participating in CPP. This survey is designed to capture generally how CPP participants have used their CPP funds without imposing excessive burdens on financial institutions for tracking precisely how many CPP dollars were allocated to each use.

Because of the fungible nature of money, it is not possible to say that funds invested as capital were used for a particular purpose. We could in theory mandate that the funds are used only for particular purposes that were not in the design of the CPP. The terms of the CPP do not require an institution to engage in a particular level of lending, nor do they mandate what an institution can or cannot do in its business generally or specifically with the proceeds of the TARP investment.

b. When will your department begin to collect and report this information to taxpayers?

Treasury is in the process of developing the Use of Funds Survey form, and expects to send the survey to CPP recipients in March 2010. CPP participants will have 30 days to submit their responses to the electronic survey questions.

We will post the survey responses on an individual-by-individual basis on the *FinancialStability.gov* website, along with a summary of quantitative data prepared by OFS based on certain balance sheet and other financial data submitted to the participant's primary banking regulator. Additionally, we will publish the names of any financial institutions that fail to submit a survey response to the Treasury Department on the *FinancialStability.gov* website.

c. Mr. Secretary, do you think requiring your agency to provide the TARP Inspector General, and other oversight bodies with ongoing, continuous, and close to real-time updates of the status of the use of TARP funds would improve transparency and accountability and allow taxpayers to know how their money is being used?

We have taken many steps to communicate in a fully transparent and timely manner on the use of TARP funds. As of April 19, 2010, Treasury has published 130 Transaction Reports, 15 Section 105(a) monthly Congressional Reports, 8 Tranche Reports, 8 dividend and interest reports and 6 MHA Program Reports, all of which are posted on our website. The monthly Section 105(a) reports present updates on our investments and programs as well as background information in a clear and concise manner, including answering basic questions that many Americans have, such as how TARP monies are invested.

We have also published a monthly lending survey that contains detailed information on the lending and other activities of over 500 banks that have received TARP funds, as well as separate, more detailed information for the largest 22 banks. These reports are intended to help the public easily assess the lending and intermediation activities of participating banks. More broadly, they also help answer the question of what banks are doing with their TARP funds. We believe the detailed quantitative information contained in these reports addresses the fundamental concern underlying that question, which is whether TARP has helped restore our banks to health so that they can lend to creditworthy families and businesses. We also expanded the report in response to suggestions from SIGTARP for reporting on use of funds.

Additionally, we post program guidelines on our website, www.financialstability.gov, within two business days of any program launch. We also post for public review all obligations made under TARP, including all contracts for TARP investments of funds, descriptions of TARP programs, and service agreements. Indeed, within two days of every purchase, trade or disposition of assets, a TARP Transaction Report is posted online, providing transaction descriptions and amounts and information regarding the pricing of assets.

Attempting to institute “real-time” updates would require a new and expensive data collection process that would present significant additional costs for taxpayers and take many months to implement – without providing any substantial benefit over current systems. Further, such a system could compromise the confidentiality of bank supervisory information and possibly infringe on the independence of federal regulatory agencies.

We recognize that transparency is paramount when managing taxpayer funds and, as discussed above, have strived to reach the highest standards.

- 5) **In previous quarterly reports to Congress, the TARP Inspector General has made a series of recommendations related to the design of the Public-Private Investment Program (“PPIP”) within TARP. One of SIGTARP’s most important recommendations with respect to PPIP has been that Treasury should require strict information barriers or “walls” between the PPIF managers making investment decisions on behalf of the PPIF and those employees of the fund management company who manage non-PPIF funds trading in the same kinds of securities.**

The Inspector General has said that your department is overstating the practical difficulties walls present, underestimates the efficacy of walls, and overestimates the ability to predict the ways that fund managers can devise to take advantage of the very valuable information they have due to the fact that they are operating a PPIF that has the ability to affect prices in these relatively illiquid markets.

- a. Why has your department rejected the Inspector General's recommendation, even as some PPIF managers have imposed an ethical wall or informational barrier on their own initiative because they felt that it was best practice to do so?**

We believe that the PPIP compliance rules we have implemented to monitor trading activity effectively protect taxpayers without the need for segregated investment teams. We also believe that a requirement to have segregated investment teams is not necessary given the structure of the program and would be detrimental to the program because it would reduce our ability to retain experienced PPIP fund managers, and as a result, would reduce performance of the PPIP funds. While we respect the concerns that underlie SIGTARP's prior recommendation, we continue to believe that they are better addressed through the surveillance monitoring and other requirements that we have incorporated in our PPIP compliance program.

Additionally, SIGTARP does not include in their recent Quarterly Report to Congress any discussion of the significant distinction between the role of PPIP fund managers and the referenced activities that fund managers perform for other Government programs. For example, we understand that the Federal Reserve Bank of New York (FRBNY) has required in certain of its programs a dedicated investment team separated by an informational wall from other employees at that fund manager partly because the investment team is in possession of material non-public information from FRBNY which could be inappropriately shared with other members of the fund manager's organization and possibly impact the market. The program is also different because the manager receives direct instructions from FRBNY prior to executing trading activity. By contrast, PPIP fund managers are not in possession of any material non-public information from Treasury and Treasury does not direct the fund managers to purchase and sell eligible assets in the PPIF. Fund managers must also adopt and follow a fair and equitable trade allocation policy, including executing trading activity through unaffiliated broker dealers, which Treasury monitors through its compliance surveillance program.

- b. In an environment in which the public already views the fairness of Government program with skepticism, doesn't it make sense to make sure that your agency closely monitors TARP?**

Treasury's OFS does closely monitor TARP. It has strong compliance and risk capabilities to ensure that recipients of TARP funding comply with their obligations under the Emergency Economic Stabilization Act, the transaction documents related

to the TARP funding and applicable rules and regulations. Due to the possibility of actual or potential conflicts of interest inherent in any market-based investment program, Treasury has worked very closely with SIGTARP to develop a robust conflicts and compliance process for the PPIP.

We note that SIGTARP initially became aware of the circumstances of the trading activity described in its recent Quarterly Report to Congress because Treasury discovered them through its PPIP compliance surveillance program and subsequently informed SIGTARP. Under the compliance rules, PPIP fund managers are required to provide updates on a short timeframe that detail, among other things, all transactions involving eligible assets across their entire fund complex. This requirement permits Treasury to detect and investigate unusual trading patterns, suspicious transactions and any other potential instances of fraud, collusion or violations of the compliance rules by the fund managers, regardless of whether or not fund managers employ information sharing walls.

The fact that SIGTARP learned about the activity mentioned above is a testament to the fact that our compliance rules and associated procedures appropriately flagged the trading activity by the fund manager for further review. After a detailed examination of the facts and circumstances surrounding the trade, including further discussion with the fund manager and review of supporting documentation, we concluded that the fund manager adhered to the PPIP compliance rules when executing the trade. Our view of the example described in the recent SIGTARP report is that the comprehensive controls established in our PPIP compliance rules are working properly.

c. In addition, the Inspector General states that if there was an effective barrier between those managing the PPIF and the managers' non-PPIF funds, we would not have to worry whether the portfolio managers were acting to benefit one fund over the other. Do you agree with the Inspector General?

We respectfully disagree with the Inspector General's statement. While "walling off" investment professionals could further limit the risk that bad actors could inappropriately share material non-public information, doing so would not eliminate such risks. Only by continuing to closely monitor the trading activity of fund managers and their adherence to fair trade allocation policies can we protect the interests of taxpayers. This monitoring will ensure protection against inequitable behavior whether the fund manager chooses to employ an information sharing wall or not.

For example, our requirement that each fund manager report on all transactions involving legacy securities across its entire fund complex gives us (and SIGTARP) the ability to spot and investigate unusual trading patterns, suspicious transactions and other indications of fraud, collusion or other bad behavior by the manager or its employees. Similarly, any concern that a fund manager might cause the PPIF to overpay for legacy securities in order to benefit investors in its other funds is

addressed by our requirement that the manager maintain and adhere to an allocation policy that requires all transactions involving legacy securities to be allocated fairly among all of the manager's funds that invest in such securities. Our procedures also require fund managers to invest their own capital in the PPIF and to demonstrate that their compensation systems align the financial interests of the personnel who manage the PPIF with the interests of the PPIF investors, including Treasury. We believe these procedures, as well as the many other requirements set forth in the PPIF operative documents, effectively protect taxpayers without imposing the significant costs of requiring a segregated investment team.

d. Mr. Secretary, do you agree with the TARP Special Inspector's statement that the market is more convinced than ever that the Government will step in as necessary to save so-called "systemically significant institutions" and that this perception was reinforced when you extended your TARP authority until October 2010?

No. The extraordinary measures the government took to shore up confidence in our financial system were always designed to be temporary. I extended the authority granted under EESA until October 3, 2010 in order to enable us to continue to address the housing markets and the needs of small businesses and small banks. Beyond these limited new commitments, it was important to maintain capacity to respond if financial conditions worsen in the near term and threaten the nascent recovery that the Administration and the Congress have worked so hard to achieve.

More importantly, the way to avoid a repeat of what happened in the financial crisis is not to prematurely terminate the authority to respond to near-term threats, but to reform our laws to address the moral hazard challenges posed by large, interconnected financial institutions that have been labeled by many as "too-big-to-fail." The Administration has proposed comprehensive financial reforms that seek to address this moral hazard by forcing these institutions to internalize the risks they impose on our financial system and to remove expectations of government support. Recent statements by market participants and rating agencies have demonstrated the beneficial impact that regulatory reform and other Administration proposals have had in this area.

First, the government needs the ability to limit risk-taking by institutions that threaten the overall stability of the system and can cause extraordinary damage to the American economy. Under the Administration's proposals, major financial firms would be required to report regularly to supervisors the nature and extent to which other major financial firms are exposed to it, as well as firm-wide risk concentrations, so that the government can identify firms whose failure could pose a threat to overall financial stability and our economy. Major financial firms would be subject to more stringent capital requirements, tough new liquidity requirements, and constraints on interconnectedness with other major firms and markets. Higher levels and quality of capital would be required for all banking firms. To prevent the emergence of firms whose relative size alone could pose a threat to financial stability, the proposals

supplement the existing cap on the ability of a single banking firm to control more than ten percent of national deposits. And, to ensure that the taxpayer-backed safety net for banking firms is not extended to high-risk activities unrelated to serving customers, banking firms would be prohibited from engaging in proprietary trading—trading for the banking firm’s own account and not in connection with client business—and from owning or sponsoring hedge funds and private equity funds.

Second, the government must have the ability to seize and wind down failing major financial institutions in an orderly manner, minimizing the company’s risk to our financial system, economy, and taxpayers. The Administration’s proposals provide this resolution authority, subject to strict governance and control procedures, with losses absorbed not by taxpayers but by equity holders, unsecured creditors and, if necessary, through a fee on other major financial institutions, similar to the financial crisis responsibility fee.

We share SIGTARP’s concern that better tools were not available for the government to confront this crisis. For that reason, I look forward to working with you to make sure we put in place a set of financial reforms that create a safer, more stable financial system, where risk can be mitigated and there are stronger protections for consumers, investors, and taxpayers.

e. As you know, the economic crisis was fueled in part by a “bubble” in the housing market. Do you believe the current efforts of the Federal Government’s to support home prices risk re-inflating that bubble in light of the Government’s effective takeover of the housing market through purchases and guarantees, either direct or implicit, of nearly all of the residential mortgage market?

Given the significant decline in home prices since their peak, we believe the biggest risk to the US housing market is additional price declines, rather than price increases at this point in time. For that reason, the Administration has taken broad action to stabilize the US housing market.

The Administration has provided broad support to Fannie Mae and Freddie Mac to ensure continued confidence in those institutions and continued access to affordable mortgage credit across the market. Together, the Treasury Mortgage-Backed Securities (MBS) purchase program and the Federal Reserve have purchased over \$1.4 trillion in Government-Sponsored Enterprises (GSEs) MBS, helping to keep interest rates at historic lows. Millions of Americans have been able to refinance their mortgages into lower rate, 30-year fixed-rate mortgages, saving an average of \$1,500 per year on a refinance. Thanks to the recently extended homebuyer tax credit, more Americans are now able to re-enter the housing market and stem the slide in home values. Through HUD’s Neighborhood Stabilization Program, hundreds of communities across the country are taking important steps to restore and maintain properties in neighborhoods hardest hit by concentrated foreclosures and home price

declines. Finally, the Administration has implemented a number of initiatives in the past several months to further support housing stabilization. On February 19, 2010, the Administration announced that it will allocate \$1.5 billion towards a Hardest-Hit Fund to provide support to state Housing Finance Agencies (HFAs) to help address the foreclosure problems in the five states that have been hit the hardest by the aftermath of the burst of the housing bubble (Arizona, California, Florida, Nevada and Michigan). On March 26, 2010, we announced (i) changes to our Home Affordability Modification Program (HAMP), which emphasized the focus on principal forbearance and forgiveness, (ii) the expansion of the FHA refinancing program, which provides more opportunities for qualifying mortgage loans to be responsibly restructured and refinanced, and (iii) the adoption of the Home Affordable Foreclosure Alternatives (HAFA) program, which helps short sale/deed-in-lieu transactions. On March 29, 2010, we also announced a \$600 million expansion of the Hardest-Hit Fund program to provide support to HFAs in Ohio, Oregon, North Carolina, Rhode Island and South Carolina.

There are clear signs that our efforts are having a substantial impact. While there are still risks, we are seeing signs of stabilization in housing, as housing inventories continue to fall. House prices measured on a year-over-year basis are declining less rapidly, with some house price measures posting increases in recent months. As of March 2010, single-family housing starts were up 47.1% from a year earlier, a sign that, while still very low, the outlook for builders is improving. According to data released by the Mortgage Bankers Association on February 19, 2010, 30-day delinquency rates on one-to-four unit residential mortgages fell in the fourth quarter along with the number of new foreclosures started.

- 6) **President Obama has made “jobs” his Administration’s top priority for this year. The oil and natural gas industry as a whole saw a 9% job growth from 2002-2008, according to Department of Labor’s Quarterly Census on Employment and Wages. According to the same statistics, oil and natural gas producers in the State of Texas saw a 34% increase in job growth. Breaking it down further, specifically the upstream component of the industry, there was a 64% and 65% increase respectively for the entire United States and Texas.**

Regarding the tax proposals included in this budget that are aimed at America’s oil and natural gas producers, which of the provisions will help continue those current job growth trends?

The Administration has taken strong action to encourage job creation, and will continue to do so. Regarding the elimination of oil and gas subsidies, in a competitive market, reducing tax subsidies will promote investment decisions that reflect an investment’s economic returns rather than its tax benefits. Over the long term, reducing tax subsidies will result in a more efficient allocation of capital, which will tend to increase national output. In other words, eliminating these tax subsidies will make our economy stronger over time. The President is committed to making our tax code more efficient and strengthening our economy.

It should be noted that from January 2002 to December 2008 oil prices rose by over 100 percent and natural gas prices rose by almost 170 percent. These dramatic increases in fuel prices led to a significant expansion in these sectors of the economy. The proposed tax changes are likely to have only small effects on consumer prices and domestic output.

The Administration believes that our nation must build a new, clean-energy economy, reduce our dependence on fossil fuels, and limit emissions of greenhouse gases. We must take dramatic steps towards becoming a clean-energy economy. These include encouraging the use of, and investment in, clean energy infrastructure and energy efficient technologies.

- 7) **The President's FY11 budget ("Green Book") proposes to eliminate certain tax provisions for the oil and gas industry in the neighborhood of \$36B – stating several times that "To the extent the credit(s) encourages overproduction of oil and gas it is detrimental to long-term energy security and is also inconsistent with the Administration's policy of reducing carbon emissions and encouraging the use of renewable energy sources."**
- a. **Does this Administration believe our energy and economic security lies in importing the fuels needed by Americans who use gasoline to get to work, or who get their electricity from natural gas?**
 - b. **If the Administration believes fossil fuel production and use is detrimental, is it suggesting that we should restrict fossil fuel imports?**
 - c. **If domestic fossil fuels production is to be discouraged, what did the President mean in the State of the Union address when he said: "...It means making tough decisions about opening new offshore areas for oil and gas development."?**

Tax subsidies that are not designed to correct an existing distortion or market failure lead to an over allocation of resources to the tax-favored industries and an under allocation of resources to other industries. These distortions in resource allocation result in inefficiency and generally reduced economic growth. The tax subsidies that are currently provided to the oil and gas industry lead to inefficiency by encouraging an over-investment of domestic resources in this industry, to the detriment of other industries. Removing this distortion would improve overall economic efficiency.

The current set of tax subsidies for oil and gas production also work against the goal of reducing the negative externalities associated with oil and gas production. Oil and natural gas prices, for example, do not reflect the environmental harm caused by the release of greenhouse gases in the atmosphere associated with oil and gas production and consumption. In addition, the price of oil does not reflect the risks associated with U.S. oil dependency. Removing these subsidies and pursuing policies that

efficiently address these negative externalities, such as a comprehensive market-based climate change policy, will bolster our environmental and energy security.

The domestic price of oil will be determined by the world price of oil, and the size of our domestic production has little or no influence on the world price of oil. As such, current tax subsidies that encourage domestic production are very unlikely to affect the domestic price of oil and do not significantly promote our energy security. Policies that reduce our dependence on oil, such as a cap-and-trade system or investing in clean technologies, are a more effective way to reduce our vulnerability to an oil price shock and promote energy security.

Policies that increase the efficiency of the American economy and increase our environmental and energy security—policies such as removing subsidies for fossil fuels—are not inconsistent with careful consideration of options for new, properly-priced offshore energy resources.

- 8) The Administration has recently highlighted the need to help small businesses, yet the tax provisions the Administration proposes to eliminate will dramatically impact the small, independent producer, who drilled more than 90% of the wells in the U.S. in 2008.**

Has the Administration considered the impact of its tax proposals on small producers? In proposing the repeal of IDC, has the Administration considered the negative impact this will have on jobs and revenue to the Treasury as drilling operations are cut back?

The Administration understands that small businesses make a vital contribution to our nation's economy. Consistent with this belief, the President's FY 2011 Budget proposes a number of tax relief measures for small business, including elimination of the capital gains tax on small business stock and increased expensing for small businesses.

The tax code currently provides a significant subsidy to non-integrated oil and gas producers relative to other industries—including other small businesses. Removal of the subsidy will lead to a more equal treatment of investment across different industries and would improve overall economic efficiency.

The Administration has taken strong action to encourage job creation, and will continue to do so. Regarding the elimination of oil and gas subsidies generally, in a competitive market, reducing tax subsidies will promote investment decisions that reflect an investment's economic returns rather than its tax benefits. Over the long term, reducing tax subsidies will result in a more efficient allocation of capital, which will tend to increase national output. In other words, eliminating these tax subsidies will make our economy stronger over time. The President is committed to making our tax code more efficient and strengthening our economy.

9) We allow taxpayers to claim a foreign tax credit for taxes they pay on income earned abroad so that there is no double taxation when that same income is included in their U.S. tax base. Statutes and regulations covering the treatment of dual capacity taxpayers have been in place for decades and prevent payments for resources from being claimed as taxes.

a. What evidence do you have that these rules are not working and companies have been claiming royalties or other expenses as income taxes?

Current U.S. tax rules attempt to identify the portion of a foreign levy paid by a dual-capacity taxpayer that constitutes an income tax eligible for a foreign tax credit versus a payment for a specific economic benefit. In making this determination, current rules place significant weight on the formal characteristics and terms of the foreign levy. In many cases, the terms and the structure of the foreign levy as it applies to U.S. taxpayers have been structured or negotiated to meet, in form, the U.S. requirements of an income tax. The fact that recently certain foreign countries (in particular, Qatar and the United Kingdom) have reduced their statutory corporate income tax rates except with respect to oil and gas companies further indicates that at least a portion of the foreign levies paid by such companies are in fact in exchange for the right to exploit natural resources (that is, a specific economic benefit) and not an income tax.

b. Could this proposal lead to double taxation of income and restrict U.S. based oil and gas companies from competing with foreign entities like national oil companies that don't have to operate under the same rules?

Under the proposal, dual capacity taxpayers will be permitted to claim a credit for the portion of the foreign levy that is determined to constitute a creditable foreign income tax. For this purpose, the proposal adopts a rule that would allow a dual capacity taxpayer to treat as a creditable tax the portion of the foreign levy that the taxpayer would pay if it were not a dual capacity taxpayer. As a result, the proposal would not lead to double taxation.

10) The President's budget observes that, "Bank lending continues to contract overall, although the pace of contraction has moderated and some categories of lending are growing again." At the same time, the President has proposed a new, \$90 billion tax on certain financial institutions.

Is it the view of the Administration that the financial institutions targeted by this tax are providing satisfactory access to capital, and otherwise facilitating access to credit, such that they can sustain a new tax without an adverse effect on credit markets?

a. Will all TARP recipients be required to pay this tax?

No. Covered financial firms would include U.S.-based bank holding companies, thrift holding companies, other insured depository institution holding companies, and securities broker-dealers with total consolidated assets of at least \$50 billion (regardless of whether such U.S.-based firms are controlled by a foreign firm). As designed, the fee applies to the largest, most highly leveraged institutions that finance themselves in the wholesale markets (as opposed to through insured deposits or insurance policy reserves). All firms in this category, directly or indirectly, benefited from the extraordinary actions taken by the government to respond to the crisis. There were over 700 TARP recipients, and only a small number of those firms will be subject to this fee.

b. Why is the Administration picking winners-and-losers with this new tax?

The fee applies to the largest, most highly leveraged institutions that finance themselves in the wholesale markets (as opposed to through insured deposits or insurance policy reserves). As such, the fee will place its heaviest burden on the largest firms that have taken on the most debt.

c. Will the new tax be imposed on financial institutions who did not receive TARP funds?

Yes. It is important to understand that every large financial firm benefitted from the extraordinary actions taken by the government to stabilize the financial system, be it direct assistance through the Troubled Asset Relief Program (TARP), access to Federal Reserve loans, special guaranties, and/or other assistance, or indirect beneficiaries.

d. Is it the view of the Administration that the financial institutions targeted by this tax are providing satisfactory access to capital, and otherwise facilitating access to credit, such that they can sustain a new tax without an adverse effect on credit markets?

It is our view that the firms subject to the fee—just the very largest financial institutions—are in a position to pay a modest assessment on qualified liabilities. Given that the fee will not apply to over 99 percent of U.S. banks, if certain institutions did pull back on lending in response to the fee, we believe that smaller lenders would likely step up and gain share in the lending market, counteracting the potential decline in credit availability.

Further, the deposits and capital that banks traditionally use to make loans to consumers and small businesses are exempt from the fee. In a March 4, 2010 letter on the subject, CBO Director Douglas Elmendorf described the potential impact on credit availability as “slight” and that the fee could “improve the competitive position of small- and medium-size banks, probably leading to some increase in their share of the loan market.”

e. How will this proposal increase job creation, and increase lending to small businesses and working families?

The Administration has put into place a significant number of measures to address the concerns noted above. The purpose of the FCRF is to ensure that taxpayers do not have to foot the bill for stabilizing the financial system through TARP.

f. The President signed into law the Fraud Enforcement and Recovery Act of 2009, which among other things created the Financial Crisis Inquiry Commission (FCIC). Among its tasks are to “examine the causes of the current financial and economic crisis in the United States.” Yet the Administration’s proposed tax on financial institutions is asserted to be a “Financial Crisis Responsibility Fee.” This new tax is therefore levied on those parties deemed to be responsible for the crisis and irrespective on their TARP participation, before the FCIC has even rendered an opinion on what caused the crisis to begin with. How do you reconcile that apparent contradiction?

The EESA statute that created the TARP requires that by 2013 the President put forward a plan “that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt”. The President has no intention of waiting that long. Instead, the President is fulfilling three years early his commitment to put forward a proposal that would – at a minimum – ensure that taxpayers are fully repaid for the support they provided.

11) The budget states that Treasury is working with the Small Business Administration on legislation that would encourage small banks to increase their lending to small businesses in their communities perhaps through the TARP.

a. Do you have more details about how TARP will be used to encourage lending to small businesses?

Since the Budget was released, the Administration has announced a proposal to create a new \$30 billion Small Business Lending Fund through legislation that would be separate from TARP. The Administration has proposed using this fund to provide capital to community and smaller banks that would allow them to expand lending to small businesses. Under the President’s proposal, if these institutions increase their lending relative to a 2009 baseline, the dividend on the capital that is paid to Treasury would decline – providing an incentive for lenders to use this capital to extend additional credit to small businesses.

b. Is there a legislative proposal that can be shared with the Committee?

We are currently engaged in the process of discussing our proposal with Congress to determine how best to design a Small Business Lending Fund that can make

additional credit available. In doing so, we are working with the relevant committees to develop legislation that reflects the proposal the President has put forward. At the same time, beyond the core proposal we have described above, we are working with Congress to identify additional ideas that could be included in the Small Business Lending Fund.

c. How would such a proposal fit within the power to purchase troubled assets under Section 101 of the Emergency Economic Stabilization Act of 2008 (EESA; PL 110-343), which created the TARP?

As noted, this proposal would create a Small Business Lending Fund separate from TARP. As a result, it would be established under authority separate from EESA.

12) Press reports prior to the budget's release indicated that the President's budget would include the Administration's plan for the future of Fannie Mae and Freddie Mac. It appears that the budget does not contain a plan for either to emerge from conservatorship or for those entities to be treated as government agencies in the budget. Instead the budget merely indicates that the Administration is studying the problem, and will "provide updates on consideration for longer term reform of Fannie Mae and Freddie Mac as appropriate (page 3523, Analytical Perspectives)

a. Since the Administration appears to have no plan for Fannie and Freddie to emerge from conservatorship, why hasn't the administration added these to the budget as if their operations were conducted by a federal agency?

The Administration carefully considered whether Fannie Mae and Freddie Mac should be consolidated in the Government's financial statements and classified as budgetary entities. However, because conservatorship is only temporary, we determined that Fannie Mae and Freddie Mac should not be consolidated. We believe this determination is consistent with Statement of Federal Financial Accounting Concept No. 2.

Financial statement consolidation and budgetary classification of an entity depends on whether the Government owns and controls the entity in question. The relevant Federal financial accounting standards do not require consolidation where the Government's ownership and/or control are temporary—as is the case with the GSEs. Moreover, the Government is not involved in any day to day decision making or management of the GSEs. The conservatorships of the GSEs are being operated by FHFA, an independent regulator.

While FHFA as conservator has the powers of the management, boards, and shareholders of the GSEs, the GSEs continue to operate as business corporations. At the inception of the conservatorships, FHFA made clear that the GSEs would continue to be responsible for normal business activities and day-to-day operations. FHFA continues to exercise oversight as a safety and soundness regulator and has a

more active role as conservator. While FHFA has very broad authority, the focus of the conservatorships is not to manage every aspect of the Enterprises' operations.

The Government's auditor, the Government Accountability Office, has agreed with the Administration's determination, which is reviewed and assessed on an ongoing basis.

b. When will the Administration finish studying this problem and send a proposal to Congress?

Given the importance of the long term stability of the housing market and the critical role Fannie Mae and Freddie Mac continue to play in the current financial circumstances, we believe a careful approach to reform, built upon significant input from various stakeholders, holds the best potential for a solution that can be introduced, enacted and carried out at a time of greater market stability.

The Administration has made clear its commitment to the long term stability of the housing market and the need to reform Fannie Mae and Freddie Mac from their current state. We will continue to provide updates on this issue as we go forward.

c. How much taxpayers' money has been provided to Fannie Mae and Freddie Mac?

Through March 31, 2010, total funding provided to Freddie Mac under its agreement is \$51.7 billion, and total funding provided to Fannie Mae under its agreement is \$75.2 billion. Fannie Mae and Freddie Mac have paid \$9.6 billion in preferred stock dividends to Treasury.

d. Do you think Fannie Mae and Freddie Mac have benefited from the actions taken by the federal government?

Fannie Mae and Freddie Mac currently serve a vital role in the housing market in supporting broad mortgage affordability across the market. Treasury's clear and continued commitment to these institutions, together with the Federal Reserve's purchase of mortgage-backed securities, has been crucial to restoring stability in the housing market and to maintaining the availability of mortgage credit.

Fannie Mae and Freddie Mac are currently operating under conservatorship administered by the Federal Housing Finance Agency (FHFA) and without the continued activity of Fannie Mae and Freddie Mac today, mortgage rates would be higher and families would find it harder to get a mortgage or to refinance their existing mortgage.

The structure of the Preferred Share Purchase Agreements (PSPAs) provides that any draws paid to Fannie Mae and Freddie Mac increase the liquidation preference of Senior Preferred Stock that is held by Treasury. As a result, if Fannie Mae or Freddie

Mac were liquidated, losses would be borne first by common equity holders and then by previous preferred shareholders. Treasury would not take any losses until those other equity holders have lost the full value of their investments.

e. Is the Administration proposing Fannie Mae and Freddie pay a portion of the new \$90 billion tax imposed on certain financial institutions included in the budget?

The Administration continues to work with Congress to design a financial fee that accomplishes the statutory mandate under EESA to recoup the cost of TARP. Currently, the proposed fee does not cover Fannie Mae and Freddie Mac. The goal of this fee is to ensure a taxpayer return so that losses do not add to further debt. Given the current status of the GSEs under conservatorship and the ongoing process of reform, charging these institutions that fee would not likely accomplish the goal of reducing the debt created by the crisis or reducing excess size and leverage of these institutions. Further, the investment in Freddie and Fannie were authorized under the Housing and Economic Recovery Act (HERA) legislation, not TARP, which includes its own provisions for recouping taxpayer losses as practicable, including higher dividend payments on the preferred investments made and periodic fees.

Questions from Senator Nelson

- 1) Do you have an estimate of how many new jobs will be created – jobs that would not otherwise be created – if Congress passes the President's proposed Small Business Jobs and Wages Tax Cut?**

A recent study by the Congressional Budget Office ("Policies for Increasing Economic Growth and Employment in 2010 and 2011," January 2010) identified an employment tax credit as the most effective way to increase job growth among the tax provisions it examined. However, the study notes that the actual number of jobs created depends on the design of the particular employment tax credit. The Administration's proposal was carefully designed to minimize gaming and to maximize job creation. Treasury Department economists have estimated that a proposal like the President's would benefit over one million employers.

- 2) What is the estimated budgetary cost of the President's proposal to transfer \$30 billion from the Troubled Asset Relief Program to a Small Business Lending Fund? What is the projected federal subsidy rate for amounts committed, obligated, and/or expended by the Small Business Lending Fund?**

As we are still in the process of consulting with Congress on the exact specifications for the Small Business Lending Fund, the estimated budgetary cost or federal subsidy rate for the program, which will reflect the final terms and program specifics, has not yet been determined.

- 3) Our federal government is heavily dependent on foreign creditors, and particularly China, for continued financing. With the deficits projected over the next 10 years, what is your view regarding the willingness of foreign creditors to continue buying up U.S. debt well into the future? What effect will these deficits have on the long-term value of the U.S. dollar? Will our borrowing costs rise as foreign creditors take an increasingly critical look at our long-term solvency?**

The U.S. Treasury market is the deepest and most liquid market in the world. It attracts a broad array of investors—both domestically and internationally—because of its superior liquidity and its position as one of the most important assets in international finance.

Despite the sharp rise in our borrowing needs, we continue to see strong demand for Treasury securities in our auctions. In FY 2009, we raised nearly \$1.8 trillion in new cash at historically low interest rates. This coming year, our marketable borrowing needs are expected to decline modestly, and they will continue to fall in the coming years as the fiscal outlook improves.

Going forward, I am confident that as long as we have competitive and open financial markets, capital will continue to flow into the United States. As for the value of the dollar in foreign exchange markets, our policies are targeted at strengthening the

American financial system and economy. We have moved aggressively and we are making steady progress.

- 4) **The President's budget states: "New TARP agreements will be directed toward assisting homeowners threatened with foreclosure" Can you expand on this? Is the Administration developing a new initiative to reduce home foreclosures, and when will we see the details?**

On March 26, 2010, Treasury announced a number of enhancements to HAMP, which reflect the Administration's commitment to broaden the program's reach and impact, to strengthen the program's implementation, and to continue to provide relief to American homeowners and the mortgage industry as a whole. These changes will provide temporary mortgage assistance to some unemployed homeowners, encourage servicers to write-down mortgage debt as part of a HAMP modification, improve incentives for modifications of loans insured by the Federal Housing Administration (FHA), and help borrowers move to more affordable housing when modification is not possible.

The Administration also announced new FHA refinance options to provide more opportunities for lenders to restructure loans for some families who owe more than their home is worth. Funds from TARP will be made available for incentives to encourage write-downs of any existing second liens and to encourage participation by servicers. TARP funds will also be used to provide coverage to lenders for a share of potential losses on these loans. No TARP funds will go to the FHA itself for any loans. Total TARP support provided through incentives and coverage will not exceed \$14 billion.

Lastly, the Administration announced that it would expand the Housing Finance Agency Innovation Fund for the Hardest-Hit Housing Markets (the "HFA Hardest-Hit Fund") for state HFAs to design innovative, locally targeted foreclosure prevention programs. The expansion allocates \$600 million to states with high concentrations of people living in economically distressed areas, defined as counties in which the unemployment rate exceeded 12 percent, on average, over the months of 2009. Combined with the first sequence of funding, which provides limited additional resources to states that experienced home price declines of 20 percent or more, this program will draw on \$2.1 billion from TARP.

Treasury currently has allocated up to \$50 billion of Emergency Economic Stabilization Act (EESA) funds to the Home Affordable Modification Program (HAMP), the Home Affordable Foreclosure Alternatives Program (HAFA), the Second Lien Modification Program (2MP), the HFA Hardest-Hit Fund, and for FHA program adjustments to expand refinance options. Funding from TARP for the announced enhancements to HAMP will not exceed the \$50 billion originally allocated for housing programs.

- 5) **Roughly one out of every four homeowners is underwater on their mortgage. The numbers are closer to 40 percent in Florida. Increasingly, I am hearing from constituents that the Administration's loan modification program is being abused by lenders. Banks are using the trial modifications as a way to delay the recognition of loan losses and they are not making the permanent changes in the loans that are necessary to make the sustainable for homeowners over the long-term. Do you agree? What are you doing to prevent mortgage servicers and lenders from abusing the loan modification program?**

The Administration has made strong progress in ramping up the Making Home Affordable programs. Under HAMP, more than one million homeowners have seen their monthly mortgage payments reduced by about \$500. For the program to succeed in the longer run, however, we recognize that we face several key challenges: reaching more borrowers who are eligible for the program, but who often don't know how to get help or are not starting trial modifications even when approved; helping more borrowers in trial modifications convert to permanent modifications so sustainable help can be offered; and continuing to improve transparency and enhance the borrower experience, so the public and homeowners can be confident the program is assisting eligible homeowners as intended. We can all do better in ensuring that the Making Home Affordable programs are a success.

The most recent data demonstrates that there has been a significant acceleration in the rate at which borrowers are being approved for permanent modifications. As of March, more than 230,000 permanent modifications have been finalized plus an additional 108,000 approved awaiting only the borrower's signature. Treasury is committed to working with servicers and borrowers to sustain this improved pace.

The Administration has taken a number of steps to assist servicers in ramping up to give eligible homeowners the opportunity to participate in HAMP. Administration representatives were on-site in servicer offices to ensure that servicers increased efforts to deliver decisions to borrowers in trial modifications who have submitted all of their documents and to obtain any missing documents from borrowers. The Administration also implemented a temporary review period to ensure that all borrowers are being fairly evaluated for the program.

Further, the HAMP Compliance Program is designed to ensure that servicers are meeting their obligations under the HAMP Servicer Participation Agreements (SPAs). Freddie Mac is the Compliance Agent for HAMP and has established a separate and independent division to conduct its compliance activities, named MHA-C. As part of its responsibilities, MHA-C conducts reviews of servicers' quality control servicer governance / readiness assessments, onsite reviews, loan file reviews (including a "second look" process, NVP analysis / assessments, and evaluations of incentive payment calculations and borrower allocation. Where anomalies occur, Treasury assesses the severity based on information provided by MHA-C as well as other sources and determines further courses of action which may include additional compliance activities and withholding or repayment of servicer incentive payments.

We have recently issued guidance requiring upfront documentation and income verification for trial modifications and requiring servicers to establish strict borrower response timeframes to help in accelerating the HAMP evaluation process. One of the key findings from our Mortgage Modification Conversion Campaign was that a large number of trial modifications were delayed as a result of insufficient documentation or because borrowers' stated income at the beginning of the trial period differed significantly from their verified income, often complicating servicers' efforts to promptly convert trial modifications to permanent status. The move to upfront documentation and income verification will help ensure that a higher percentage of borrowers who enter trial periods will receive permanent modifications. Also, effective June 2010, servicers are required to reply to a borrower with a decision to offer a HAMP Trial Period Plan within 30 days of receipt of the borrower's completed application package. This should ensure that servicers are held to specific time constraints when considering borrowers.

We also recognize that severity of price declines, together with the effects of high unemployment, means that many working and middle-class families in especially hard-hit areas are facing serious challenges. On February 19, 2010, the Administration announced \$1.5 billion in funding for innovative measures to help families in the states that have been hit the hardest by the aftermath of the burst of the housing bubble. States where house prices have fallen more than 20% from their peak are eligible for this funding. Those states are Nevada, California, Arizona, Michigan, and your home state of Florida, which has been allocated \$418 million under the program. The HFA Hardest-Hit Fund will help housing finance agencies in these states further respond to the most pressing problems in their communities. HFAs have an understanding of the most urgent local challenges and an ability to address them expeditiously. To help address the issue of negative equity, HFAs may experiment with programs that would assist borrowers to negotiate with lenders to write down mortgages. Additionally, on March 29, 2010, the Administration announced an expansion to the program that allocates an additional \$600 million to states with high concentrations of people living in economically distressed areas, defined as counties in which the unemployment rate exceeded 12 percent, on average, over the months of 2009. Those states are North Carolina, Ohio, Oregon, Rhode Island and South Carolina.

Further, on March 26, 2010, the Administration announced several enhancements to Making Home Affordable that offer assistance to underwater borrowers. We announced FHA refinance options that will provide more opportunities for lenders to restructure loans for some families who owe more than their home is worth. These FHA options will provide more opportunities for qualifying mortgage loans to be responsibly restructured and refinanced into FHA loans as long as the borrower is current on the mortgage and the lender reduces the amount owed on the original loan by at least 10 percent. Additionally, to expand the use of principal write-downs in HAMP, servicers will be required to consider an alternative modification approach that emphasizes principal relief. This alternative modification approach will include

incentive payments for each dollar of principal write-down by servicers and investors. The principal reduction and the incentives will be earned by the borrower and lender based on a pay-for-success structure.

- 6) **There is an inherent conflict in our international tax rules. On one hand, we want to discourage American businesses from shipping jobs offshore. On the other hand, we want American businesses operating globally to be able to compete with their foreign counterparts on a level playing field. American businesses that are globally competitive often create jobs here at home at the same time that they expand abroad. The President has focused heavily on the first principle without much emphasis on the second. Do current U.S. international tax rules fail to strike the appropriate balance between these two principles?**

The Administration is focused on finding ways to encourage job growth through economic expansion and making America competitive in the global economy. Our Budget seeks to level the playing field by reducing the incentives in our current system to invest abroad and by closing loopholes that encourage income shifting to low-tax countries. The proposed international tax changes address specific problems in our existing tax laws. For example, deferring the deduction of interest expense allocated to deferred foreign income would reduce a tax incentive for U.S. companies to make investments offshore as opposed to here in the United States. Other proposals address misuse of the foreign tax credit and aggressive transfer pricing. In addition, our Budget encourages investment here in the United States, by proposing to permanently extend the research and experimentation credit.

- 7) **Your budget proposes to impose tax currently on the excessive returns associated with transfers of intangible assets offshore. Administratively, how do you propose to identify “circumstances that evidence excessive income shifting”? How would you determine whether a taxpayer has received an excessive return, and how do you propose to measure and quantify the amount of the excessive return?**

The Administration’s proposal outlines an approach to addressing inappropriate shifting of profits through transfers of intangibles. Specifically, the proposal provides that if a U.S. person transfers intangible property from the United States to a related foreign affiliate that is subject to a low foreign effective tax rate in circumstances that evidence excess income shifting, then the U.S. person must include in income the amount equal to the excessive return.

The proposal thus contemplates two factors that together evidence excessive income shifting: (1) a transfer of intangibles to a foreign affiliate that is subject to a low effective tax rate, and (2) the presence of an excessive return in the affiliate after the transfer. For purposes of estimating the revenue raised by the proposal we determined that an excessive return existed when a U.S. company transfers intangibles to its foreign affiliate and (1) the foreign affiliate is subject to an effective

tax rate of 10 percent or less, and (2) the foreign affiliate earns profits exceeding a 30 percent return. As we develop the details of this proposal, we welcome input regarding how best to target inappropriate shifting of income resulting from the transfer of high value intangibles offshore.

- 8) **Last June, I introduced with several of my colleagues the Algae-based Renewable Fuel Promotion Act. Algae-based fuels have the potential to make a significant contribution to our energy future. Current federal tax policy inhibits the production of algae-based fuels by failing to provide a level playing field relative to other alternative and renewable fuels. Tax incentives apply to the production of liquefied petroleum gas, compressed or liquefied natural gas, ethanol, liquefied hydrogen, biodiesel, liquid fuels derived from coal, and other alternative fuels. My bill would expand the \$1.01 per gallon tax credit for cellulosic biofuels to cover algae-based biofuels. The bill would also modify the 50 percent bonus depreciation provision for property used to produce cellulosic biofuel by extending the provision to qualified algae-based biofuel plant property. Do you support my proposal to modify current energy tax incentives to incentivize the production of algae-based fuels?**

The President's Budget proposes to extend the credit for alternative fuels through the end of 2011. This extension would provide a \$0.50-per-gallon tax incentive for liquid fuel derived from biomass, including algae. This is the same incentive that applies to the production of liquefied petroleum gas, compressed or liquefied natural gas, liquefied hydrogen, liquid fuels derived from coal and other alternative fuels and is generally greater than the tax incentive applicable to ethanol. The Budget also provides for the development of USDA biofuel feedstock research and demonstration centers to develop superior biofuel (including algae) feedstocks.

- 9) **The President has advocated eliminating capital gains taxes on small businesses. The President's budget proposal, however, would only apply to investments in the stock of qualifying C corporations.**

What percentages of small businesses are organized as C corporations? Have you estimated how many small businesses would likely benefit from this proposal?

The exact percentage of small businesses organized as C corporations is difficult to pinpoint and depends on the definition of "small business" being used. Based on data from Tax Year 2007, we estimate that as many as 1.1 million existing small C corporations would be eligible to expand their businesses through new investment that would be eligible for the proposed capital gains exemption, provided that the five-year holding period and other requirements are met. In addition, we anticipate that the number could be higher as many new start-up businesses could be eligible for the zero capital gains rate treatment in the proposal.

Questions from Senator Menendez

- 1) **Clearly, this administration believes that investing today in our nation's intellectual infrastructure – our researchers, our scientists, our technicians and our entrepreneurial small business talent - is the best way to guarantee the creation of thousands of high-paying jobs in my state and across the country.**

Is the administration aware of the difficulties facing small businesses with large capital needs in fields such as life sciences, such as the hundreds and hundreds of small bioscience companies in my state and the thousands across the country that rely on well-functioning capital markets to fund innovative research into groundbreaking new therapies for afflictions such as Alzheimer's, Multiple Sclerosis, AIDS, and various cancers but are too small and pre-revenue and cannot yet benefit from incentives such as the R&D credit? And if so, would the administration support efforts such as my proposal in the Senate's health reform legislation which would sustain much-needed research by incentivizing therapeutic development activities for companies with 250 employees or fewer as the capital markets recover so that our life sciences industry can remain competitive as our economy pulls out of this recession?

Research in the life sciences plays a vital role in advancing medicine and in making our citizens healthier. We recognize and value the contributions of small businesses to this research. Section 9023 of the Affordable Care Act (P.L. 111-148) provides a new therapeutic discovery project tax credit (or grant) for up to 50% of qualified 2009 or 2010 investment by businesses with no more than 250 employees. Treasury staff is currently working with their colleagues at the Department of Health and Human Services to establish this new program.

- 2) **Our nations' caregivers provide loving care to family members across the country, and I know this story well as my sister looked after my mother with Alzheimer's; so that is why I was proud to first introduce the CARE Act in 2005 and very pleased to see the increased funding for the Administration on Aging's Caregiver Initiative and the doubling of the Child and Dependent Care Tax Credit.**

How does this budget's proposal compare to the CARE Act of 2010 (S.2958) that I introduced which provides a refundable tax credit to those caring for ailing family members and loved ones and a tax deduction for long-term care insurance to encourage individuals to plan and invest in their own long-term care? Knowing first hand from my own family's experience the strain that care puts on families how would families in similar situation benefit from what the President has proposed?

The Budget would nearly double the Dependent Care Tax Credit for middle class families making under \$85,000 a year, with families earning up to \$113,000 a year seeing at least some increase in their credit. The Dependent Care Tax Credit helps

working families facing costs for the care of children or other dependents, but its value has eroded over the years because it is not indexed for inflation and has only been increased once in 28 years.

The CARE Act of 2010 (S. 2958) addresses another important but separate issue: long-term care. If enacted, it would provide for: (1) increased spending on a National Caregiver Support Program; (2) a refundable tax credit for people who provide long-term (more than 6 months) care to individuals who cannot care for themselves with a maximum credit of \$2500; and (3) a deduction for the costs of long-term care insurance.

We welcome your ideas in this area and would be pleased to work with you and your staff in developing them.

United States Senate
Committee on Finance



Sen. Chuck Grassley · Iowa
Ranking Member

Statement of Senator Chuck Grassley
Finance Committee Hearing on Administration's Budget: Revenue Proposals
February 2, 2010

Today, we focus on the revenue side of the budget. It is almost entirely in this committee's jurisdiction. It cannot be denied that the budget illustrates the fiscal peril the country faces. The President and Congress face a very tough set of tasks to start us on the path to fiscal discipline. Ignoring that path only makes the ultimate reckoning more difficult.

Mr. Secretary, this hearing provides us with the opportunity to take a look at the current fiscal policy path. We need to ask three questions. Where are we? How did we get here? And, finally, where we are going? The President is right that he did inherit large deficits and debt. I have one chart that shows the inherited deficit. And here's a chart that shows the inherited debt.

Republicans recognize that fact. To have an intellectually honest discussion, members on both sides need to own up to the fact that the deficits and debt were bequeathed on a bipartisan basis. The Congressional Democratic leadership wrote the budgets and passed the spending bills for two years prior to President Obama's inauguration. An outgoing Republican President signed those bills. Let's get the facts straight. A Democratic Congress and Republican President left the deficits and debt.

Over the past year, with the levers of power all concentrated in the hands of those on the other side, we've seen the fiscal path worsen. Deficits are up. Debt is up.

That, Mr. Secretary, is where we are. How did we get there? How did the bipartisan fiscal problems arise?

Both sides disagree. Many on the other side look at the last two decades of fiscal history and reduce it to two points:

1. All of the "good" fiscal history of the 1990s is attributable to the 1993 tax increase bill; and
2. All of the "bad" fiscal history of this decade is attributable to the bipartisan tax relief plans of 2001 and 2003.

Last year, during the budget debate, I showed this revisionist fiscal history doesn't stand up to scrutiny. The data was drawn from the Clinton Administration's Office of Management and Budget ("OMB") and the Congressional Budget Office ("CBO"). What we do know is that a growing U.S. economy is the best tonic to fiscal ailments.

Fiscal history in the past two decades shows that revenues grow strongly when the economy recovers. That history shows that, with bipartisan tax relief in effect, revenues grew faster than after partisan tax increases.

The two sides disagree on this relationship. It's like the saying about the tail wagging the dog. From our view, the healthy economy is the dog and revenue is the tail.

Too often, the other side views tax increases as a necessary imperative to a healthy economy. Fiscal history shows it to be precisely the opposite.

The division between the two sides in their views of how we got here informs the two sides' views of where we go from here. The President, in his State of the Union address the other night, at one point, indicated that we need to look forward. I couldn't agree more.

In this town, too often the tendency is to grow spending and raise taxes. Seldom do folks look at restraining the growth in spending and the resulting pressure to raise taxes.

Unfortunately, looking at the path ahead, the President's budget proves that point. Appropriations are up 25% over the last two years.

How many families have had the luxury of growing their budgets by 25% over the last two years? How many businesses, large and small, have had that luxury? The answer is American families and businesses have done just the opposite over the last couple of years.

The President talked about a freeze in that spending. And look at the pushback he received from his own Congressional Leadership.

Look at the budget and you find a big fiscal hole. Democrats and Republicans know the hole is there. The President knows the hole is there. Everyone agrees the hole needs to be filled.

Those on the other side, consistent with their view of fiscal history, view the tax side of the ledger, as under-subscribed. The President's budget is consistent with that view. Let's take a look at a few examples of the tax increase bias.

Both sides agree small business is the key to a goal both sides agree on: job creation. Yet, the President's budget raises the marginal rate on small businesses by over 15%.

The Congressional Democratic Leadership would go further. The House health care reform bill would've gone further -- raising the marginal rate about 33%. The Senate health care reform bill would've raised the marginal rate by 20%.

Once enacted, either of those bills would take the marginal rates well above the highest rates during the Clinton era.

More dramatic marginal rate increases would fall on investment. For instance, if the House health care reform bill were enacted, it would push the marginal rate on capital income up by almost 70%.

The response from some on the other side is that, because these heavy tax increases are aimed at taxpayers over certain income levels, they would cause no economic harm.

That position, though politically popular, ignores the fact that taxes affect behavior. Economic growth occurs from positive behavior of families, businesses and investors. It is often said that tax cuts aren't free. But, on the other side of the coin, from the viewpoint of those paying the higher taxes, tax increases certainly aren't free either. Some of the group targeted for the tax increase may absorb it, but others will react by changing behavior. Small businesses will be affected. Which means workers, suppliers, and others will be affected. Likewise, if investors shift their money into tax-favored activities, the supply and cost of capital for garden-variety business activities is adversely affected.

What's more, contrary to the rhetoric of many on the other side, it isn't just the top 5% of earners who are singled out for tax increases in the budget. The revenues from the cap and trade program will adversely affect many families below \$250,000 of income. And, the Democratic Congressional Leadership's health care bills both contain tax increases that adversely millions of these middle-class families.

Let's take another look at the fiscal hole in the fiscal path ahead. What I'd ask my friends to do is look not just at the tax side of the Federal ledger. Look at the spending side. Think about that every time a new politically-popular entitlement program is proposed. Every new entitlement, every expanded entitlement, every double-digit increase in new appropriations spending is popular with the group targeted for the benefit.

Those who oppose these initiatives are always on the defensive. Somebody has to pay for this spending. That somebody is usually the portion of Americans not targeted for the benefit. In a budget with rising deficits, it means those Americans not targeted for the benefits can expect a future tax increase.

Looking forward, we need to examine the tax policy initiatives in this budget in three phases. They are the short-term, mid-term, and long-term horizons.

In the short term, the President, Democrats and Republicans agree on the basic objective. That objective: jobs, jobs, jobs. Everyone agrees those jobs will come from expansion in the small business sector. What are small business folks saying? They're worried about the business environment. There are higher taxes in that environment.

There may be new mandates in that environment. There are new regulations in that environment. There is a tight credit market in that environment. Since this hearing is about tax

initiatives in the budget, let's focus on the tax environment. Some higher taxes are known, such as the marginal rate increases in the budget before us. Some are possible and to some degree not known. Will the taxes directed at small business in the House and Senate health care bills materialize in that legislation or some other legislation?

My advice to my friends on the other side, from the President on down, is this. Listen to what small business is telling you. Back off the marginal rate hikes. Don't bury recovering small businesses with new taxes and penalties. Be cognizant of the tax burden you are raising on capital. Remember, cash is the life blood of small business. Be sensitive to the credit markets that small businesses are still struggling with.

In the mid term, the first five years of the budget, take a look at how all the fiscal policy, especially the new spending, affects the current and future hidden tax burden.

In the long term, years six through ten of the budget, realize that spending on its current path is unsustainable. It is the explosion of spending, not taxes at or above historical averages, driving those frightening deficit numbers.



CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

February 11, 2009

Honorable Paul Ryan
Ranking Member
Committee on the Budget
U.S. House of Representatives
Washington, DC 20515

Dear Congressman,

As you requested, the Congressional Budget Office and the Joint Committee on Taxation have estimated the impact of permanently extending more than 20 of the provisions contained in H.R. 1, the American Recovery and Reinvestment Act of 2009, as passed by the House of Representatives. As specified in H.R. 1 as passed, those provisions would either explicitly expire or would specify appropriations only for a limited number of years (usually 2009 and 2010).

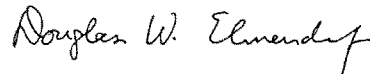
CBO estimates that H.R. 1, as passed by the House of Representatives, would increase budget deficits by about \$820 billion over the 2009-2019 period; we estimate that permanently extending the programs you identified would increase the cumulative deficit over that period by another \$1.7 trillion (see attached table).

As you requested, the Congressional Budget Office has also estimated the costs of debt service that would result from enacting the bill with these extensions. Such costs are not included in CBO's cost estimates for individual pieces of legislation and are not counted for Congressional scorekeeping purposes for such legislation. If the specified provisions of H.R. 1 are continued, under CBO's current economic assumptions and assuming that none of the direct budgetary effects of the legislation are offset by future legislation, CBO estimates that enacting the bill would increase the government's interest costs by a total of about \$745 billion over the 2009-2019 period.

Honorable Paul Ryan
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I hope this information is helpful to you. If you would like further details about this estimate, the CBO staff contacts are Christi Hawley Anthony and Barry Blom.

Sincerely,

A handwritten signature in cursive script that reads "Douglas W. Elmendorf".

Douglas W. Elmendorf
Director

Enclosure

cc: Honorable John M. Spratt Jr.
Chairman
Committee on the Budget

Identical letter sent to the Honorable Dave Camp.

Estimated Cost of Extending Certain Provisions of H.R. 1, as passed by the House of Representatives on January 28, 2009, as Specified by Congressmen Ryan and Camp

(By fiscal year, in billions of dollars)

		2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total, 2009- 2019
Revenues													
Making Work Pay Tax Credit		0	0	-39	-56	-57	-58	-58	-58	-58	-58	-58	-498
Expansion of EITC		0	0	0	-1	-1	-1	-1	-1	-1	-1	-1	-9
American Opportunity Education Tax Credit		0	0	-1	-6	-6	-6	-6	-6	-6	-6	-6	-51
Renewable Energy Production Credit		0	0	0	0	0	-1	-1	-2	-3	-4	-5	-15
UC Interaction with Health Care Coverage for the Unemployed		0	0	*	*	*	*	*	*	*	*	*	3
Total Revenues		0	0	-40	-64	-64	-65	-66	-67	-68	-69	-69	-571
Direct Spending													
Child Support Enforcement	BA	0	0	1	1	1	1	1	1	1	1	1	6
	OT	0	0	1	1	1	1	1	1	1	1	1	6
Medicaid for the Unemployed	BA	0	3	7	7	7	8	8	8	9	10	11	78
	OT	0	3	7	7	7	8	8	8	9	10	11	78
Health Care Coverage for the Unemployed under COBRA	BA	0	7	13	14	13	12	12	12	12	12	12	121
	OT	0	7	13	14	13	12	12	12	12	12	12	121
Medicaid FMAP Increase	BA	0	0	34	43	32	29	31	33	35	38	42	316
	OT	0	0	34	43	32	29	31	33	35	38	42	316
Increase in Funding for SNAP ^a	BA	0	5	8	9	10	12	11	11	11	11	11	99
	OT	0	5	8	9	10	12	11	11	11	11	11	99
Foster Care (part of FMAP increase)	BA	0	0	0	0	0	0	0	0	1	1	1	5
	OT	0	0	0	0	0	0	0	0	1	1	1	5
Increase in Funding for SSI Payments	BA	0	4	5	5	5	5	5	5	5	6	6	51
	OT	0	4	5	5	5	5	5	5	5	6	6	51
UC Interaction with Health Care Coverage for the Unemployed	BA	0	*	*	*	*	*	*	*	*	1	1	4
	OT	0	*	*	*	*	*	*	*	*	1	1	4
Making Work Pay Tax Credit	BA	0	0	1	18	18	18	18	18	18	18	18	144
	OT	0	0	1	18	18	18	18	18	18	18	18	144
Earned Income Tax Credit	BA	0	0	0	3	3	3	3	3	3	3	3	26
	OT	0	0	0	3	3	3	3	3	3	3	3	26
American Opportunity Education Tax Credit	BA	0	0	*	2	1	1	1	1	1	1	1	11
	OT	0	0	*	2	1	1	1	1	1	1	1	11
Subtotal Direct Spending	BA	0	20	69	102	92	80	81	84	87	101	105	861
	OT	0	20	69	102	92	90	91	94	97	101	105	861

Continued
(By fiscal year, in billions of dollars)

		2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total, 2009 - 2019
Discretionary Spending													
Pell Grants and College Work Study ^a	BA	0	0	4	4	4	4	4	4	5	5	3	37
	OT	0	0	1	4	4	4	4	4	4	5	5	35
Head Start	BA	0	0	1	1	1	1	1	1	1	1	1	5
	OT	0	0	*	0	0	0	1	1	1	1	1	4
Early Head Start	BA	0	0	1	1	1	1	1	1	1	1	1	5
	OT	0	0	*	*	*	*	1	1	1	1	1	4
Title I Help for Disadvantaged Kids	BA	0	0	7	7	7	7	7	7	7	7	8	63
	OT	0	0	*	4	6	7	7	7	7	7	7	53
Education for Homeless Children & Youth	BA	0	0	*	*	*	*	*	*	*	*	*	*
	OT	0	0	*	*	*	*	*	*	*	*	*	*
IDEA Special Education ^c	BA	0	0	7	7	8	8	8	8	8	8	9	71
	OT	0	0	*	4	7	8	8	8	8	8	8	59
CCDBG	BA	0	0	1	1	1	1	1	1	1	1	1	10
	OT	0	0	*	1	1	1	1	1	1	1	1	9
NSF Employment in Science and Engineering	BA	0	3	3	3	3	3	3	3	3	3	3	28
	OT	0	*	2	2	2	3	3	3	3	3	3	24
NIH Funding for Biomedical Research	BA	0	3	3	3	4	4	4	4	4	4	4	36
	OT	0	*	2	3	3	3	4	4	4	4	4	30
Increased Funding for Prevention and Wellness ^d	BA	0	0	2	2	2	2	2	2	2	2	3	21
	OT	0	0	1	2	2	2	2	2	2	2	2	19
Increased Funding for Senior Nutrition	BA	0	0	*	*	*	*	*	*	*	*	*	1
	OT	0	0	*	*	*	*	*	*	*	*	*	1
Increased funding for LIHEAP	BA	0	0	1	1	1	1	1	1	1	1	1	10
	OT	0	0	1	1	1	1	1	1	1	1	1	9
Expansion of AmeriCorps	BA	0	*	*	*	*	*	*	*	*	*	*	2
	OT	0	*	*	*	*	*	*	*	*	*	*	2
Increase in Funding for State & Local Law Enforcement	BA	0	3	3	3	3	3	3	3	3	3	4	33
	OT	0	1	2	2	3	3	3	3	3	3	3	27
Subtotal, Discretionary Spending	BA	0	8	33	33	34	34	35	35	35	37	36	323
	OT	0	1	9	24	31	33	34	35	35	36	37	278
Total Increase in the Deficit from Extensions		0	21	118	190	187	188	192	195	200	205	212	1,708
Increase in the Deficit from H.R. 1 as Passed		170	356	175	49	26	24	11	*	1	3	4	820
Total Impact of H.R. 1 with Extension of Certain Provisions		170	377	293	239	213	212	203	196	201	208	215	2,527
Memorandum:													
Debt Service on H.R. 1 as Passed with Extensions		1	4	13	30	51	68	84	99	115	131	149	744

Sources: Congressional Budget Office and Joint Committee on Taxation.

Notes: EITC = Earned Income Tax Credit; COBRA = Consolidated Omnibus Budget Reconciliation Act; FMAP = Federal Medical Assistance Percentage; SSI = Supplemental Security Income; IDEA = Individuals with Disabilities Education Act; CCDBG = Child Care Development Block Grant; NSF = National Science Foundation; NIH = National Institutes of Health; LIHEAP = Low Income Home Energy Assistance Program; SNAP=Supplemental Nutrition Assistance Program; UC=Unemployment Compensation; BA = Budget Authority; OT = Outlays.

*=less than \$500 million

- a. H.R. 1 would increase the maximum SNAP benefit by 13.6% in 2009 and hold it steady until the impact of annual indexing has exceeded that increase. For this estimate, CBO assumed that the maximum benefit would increase by 13.6% in 2009 and that benefits would be indexed annually from this new, higher base.
- b. Includes CBO's estimate of the cost of raising the maximum award for the Pell Grant Program from \$4,241 under current law to \$4,860 under H.R. 1. In addition, this estimate inflates the level of budget authority appropriated for the College Work Study Program in 2011.
- c. Includes higher funding for infants and special education.
- d. Assumes the level of funding provided in 2009 will be provided in each year, adjusted for inflation, beyond 2010.

