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NOMINATION OF TIMOTHY F. GEITHNER

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

ON THE

NOMINATION OF

TIMOTHY F. GEITHNER, TO BE SECRETARY OF THE TREASURY

JANUARY 21, 2009

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COMMUNICATIONS

NOMINATION OF TIMOTHY F. GEITHNER, TO BE SECRETARY OF THE TREASURY

WEDNESDAY, JANUARY 21, 2009

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

The hearing was convened, pursuant to notice, at 10:08 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Rockefeller, Bingaman, Kerry, Lincoln, Wyden, Schumer, Stabenow, Cantwell, Nelson, Grassley, Hatch, Snowe, Kyl, Bunning, Roberts, and Ensign.

Also present: Democratic Staff: Bill Dauster, Deputy Staff Director and General Counsel; Alan Cohen, Senior Budget Analyst; Cathy Koch, Senior Advisor, Tax and Economics; Ayesha Khanna, International Trade Counsel; Joseph Adams, Economic Development Advisor; and Mary Baker, Detailee. Republican Staff: Kolan Davis, Staff Director and Chief Counsel; Mark Prater, Deputy Chief of Staff and Chief Tax Counsel; Theresa Pattara, Tax Counsel; Jim Lyons, Tax Counsel; and Nick Wyatt, Tax Research Assistant.

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

The CHAIRMAN. The committee will come to order.

Franklin Delano Roosevelt once said, “Confidence thrives on honesty, on honor, on the sacredness of obligations, on faithful protection, and on unselfish performance. Without them, it cannot live.”

The nominee before us today has pretty much been nominated to restore confidence in the U.S. economy. It will not be easy. To restore this confidence we must restore faith in the honesty and transparency of financial institutions, we must honor the obligations to which we have committed ourselves, and we must protect the principles on which our economic system is based.

In these troubled times it is also essential that the American people, and the Congress, have confidence in a nominee and his leadership. As a key member of President Obama’s economic team, we must believe that he can help put our economy back on track.

This trust must be earned, and once earned, this trust must be maintained. Close scrutiny of Mr. Geithner’s tax returns uncovered several errors, and questions have arisen regarding his employment of household help. I expect him to answer questions regarding these issues honestly and completely.

These are disappointing mistakes, but after discussing them with Mr. Geithner I believe them to be innocent mistakes. I believe that Mr. Geithner has sufficiently corrected the errors, and I know a man of Mr. Geithner's talent and dedication will be meticulous on these points in the future. More broadly, I also expect Mr. Geithner to give the American people, and Congress, the respect that they deserve.

The Secretary of Treasury cannot ask Congress to make middle-of-the-night decisions that cost taxpayers hundreds of billions of dollars. The Secretary cannot refuse to explain why immediate massive action must be taken without time for consultation or discussion. The Secretary cannot ask Congress to commit massive funds on the basis of a 3-page proposal. If ever there was a time for those kinds of actions, that time has passed.

Rather, we must have faith that the Secretary's actions, and those of the Treasury Department, will be open and they will be transparent. We must know that the Secretary will help enforce the laws passed by Congress. The Secretary must protect the fundamentals of our economy, and the Secretary must unselfishly give of himself to successfully complete the task at hand.

The global economic crisis required unprecedented action. The Troubled Asset Relief Program—the TARP—authorized $700 billion to stem the financial crisis. When Congress authorized this money, we promised the American people that the U.S. Government would be good stewards of their hard-earned tax dollars. The Secretary must ensure that these dollars were not spent in vain.

We also promised that we would keep the TARP program honest. I fought for a Special Inspector General to oversee the program that was enacted. The Secretary must ensure that the Special IG has access to all the information and resources that he needs to get the job done.

And, in the midst of this financial crisis, there is no room for selfishness. I worked to include limits on executive compensation in TARP, and I expect Mr. Geithner to vigorously enforce these limits. We cannot allow taxpayer money to fund golden parachutes to some of the very people responsible for this crisis.

We must also work together to protect hard-working Americans from being forced out of their homes. The Emergency Economic Stabilization Act requires the Treasury Department to work with banks to stem mortgage foreclosures, and I expect Mr. Geithner to carry out this mandate.

I urge Mr. Geithner to find ways to help small businesses. In Montana, all businesses are small businesses. They are struggling. They are feeling the brunt of both the credit freeze and the economic slump. Small businesses are the engine of local economies; collectively, they are too big to fail. We must ensure that TARP does not ignore them.

In addition to administering TARP, Mr. Geithner will be responsible for overseeing the Internal Revenue Service. The IRS employs nearly 100,000 people. He is responsible for collecting the tax revenues that fund our government. We owe it to all Americans to ensure that all taxpayers file their returns honestly and in a timely fashion, especially now. The IRS must collect all revenues it is owed. We must pursue those who evade their taxes by improperly moving their assets offshore.

These are all important priorities, but the health and prosperity of the American economy cannot be solved with domestic policies alone. We must engage with the world's economic powers, engage with them. We must urge them to reform their policies, as well as our bilateral and multilateral relationships.

I think foremost of China. Secretary Paulson established the U.S.-China Strategic Economic Dialogue, otherwise known as the SED. Continuing a good, strong, vigorous, constructive dialogue similar to the SED, I think, is critical, and we can waste no time doing it. Pursuing such a dialogue is not just talk, it is about reforming our relationships to unwind unsustainable balances. It is about getting our relationship on firm footing. It is about finding a balance that is sustainable and mutually prosperous.

We also need to reform our relationship with Cuba. The Secretary oversees the Office of Foreign Asset Control, otherwise known as OFAC. OFAC has allocated way too much precious time, money, and effort to enforcing our trade embargo with Cuba. This makes it difficult for Montana farmers, farmers in other States, to sell their products in a market 90 miles from the United States. This also squanders resources that OFAC could use to fight terrorism financing around the globe.

The Secretary's responsibilities are formidable. I have confidence that Mr. Geithner is up to the job. I have confidence that he will address the important obligations that he will inherit with honesty and honor, and I have confidence that, with the help of his unselfish performance, America will overcome these troubled times and emerge with renewed strength.

Senator Grassley?

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

Senator GRASSLEY. Congratulations to the nominee. Not so much congratulations to the office he has been selected to go to, because I know it has a great deal of personal sacrifice and financial sacrifice.

Thank you, Mr. Chairman, for the hearing.

Today we perform one of the most important functions of this committee: we examine the qualifications of the man nominated to be the next Treasury Secretary. I come into this hearing with a profound sense of concern and worry about the future of our financial system. Yesterday, I was heartened to hear President Obama say, "What is required of us now is a new era of responsibility." For President Obama, that era of responsibility will begin with his Cabinet, and I look forward to helping facilitate that.

Of course, today, most people are worried about a financial crisis, but my worry has been deepened by my dissatisfaction with the decisions made to alleviate that crisis and by what I have learned about certain people entrusted to make those decisions.

On October 1 of last year, I voted for the Emergency Economic Stabilization Act, which created the Troubled Asset Relief Program, or TARP, by acronym. It was not an easy decision to support that legislation, but the financial panic at the time led me to believe that something needed to be done. Plus, legislation that was important to many taxpayers, and to Iowans specifically, was added to the TARP bill.

However, last Thursday I voted against allowing the Secretary of the Treasury to access the second half of the $700 billion in bail-out funding. Instead of using the first payment of $350 billion to purchase troubled assets, as the name Troubled Asset Relief Program suggested and how it was sold to us, the money has been erratically and arbitrarily distributed in a monstrous act of government intervention and ownership over our financial markets.

In addition to the TARP program, taxpayers' dollars are on the line in bail-outs of Bear Stearns and AIG. The Federal Reserve has loaned money to three special-purpose vehicles which are all limited liability companies that use Fed funds to purchase troubled assets. Maiden Lane I accepted residential and commercial loans, as well as derivatives, including credit default swaps from Bear Stearns in connection with its purchase of JP Morgan. In similar deals related to the AIG rescue, Maiden Lane II holds residential mortgage-backed securities, while Maiden Lane III holds the collateral debt obligations purchased from the credit default swap counter-parties.

It would seem that the Feds' investment in these SPVs is based on a valuation of assets, which was conducted in all three cases by BlackRock Financial, who also, I understand, now manages these assets. I championed the need for a Special Inspector General for the TARP and supported the various congressional oversight duties, including the mandate for GAO reports on the program, which at least shed some light on the activities and transactions under the TARP. Similar transparency and oversight of the bail-out conducted outside of the TARP is also needed.

In addition to these concerns about how the TARP and other bail-outs have been managed to date, we have to consider what we have learned about the nominee's tax history. The nominee's troubled tax history was made public last week in a bipartisan Finance Committee document. I think I am accurate in saying we have operated in the same way we always have since Senator Baucus and I have been leaders of this committee, to make that information public if the nominee decided to go forward.

I ask unanimous consent that the committee's staff memorandum released to the members on Tuesday, January 13, along with supporting documentation, be printed in the hearing record.

The CHAIRMAN. Without objection.

[The memorandum and supporting documents appear in the appendix starting on p. 207.]

Senator GRASSLEY. Since the report was issued, additional questions have arisen, specifically about the nominee's failure to pay self-employment taxes on his IMF income reported on his tax returns for the years 2001 through 2004, and the press has documented many of those questions.

So, Mr. Chairman, I would also ask unanimous consent to enter five articles and editorials in the hearing record.

The CHAIRMAN. Without objection.

[The articles and editorials appear in the appendix starting on p. 238.]

Senator GRASSLEY. Over the past few years, this committee has spent a lot of time examining the tax gap. The tax gap is the difference between what taxpayers legally owe and what they actually pay. The nominee has been found to be a tax gap participant. In addition to failing to pay self-employment taxes while working for the International Monetary Fund, the nominee's returns contained other irregularities that added up to his owing $48,268 in taxes and interest to the IRS.

When asked by staff and members of this committee to explain these irregularities, the nominee has offered many excuses that range from statements that he should have known to explanations that if only his accountant had warned him he would have done the right thing.

A troubling fact has emerged. The IRS audit in 2006 yielded a demand by the IRS that the nominee pay self-employment taxes for the years 2003 and 2004. The nominee paid the taxes due for those years. During the audit, it became clear that the same liability existed for the nominee's 2001 and 2002 returns. The IRS, however, was barred by statute of limitation from collecting for those years.

Shortly after President-elect Obama expressed an intent to nominate him, on the advice of the transition team, the nominee amended his 2001 and 2002 returns and paid the amount owed. Furthermore, the nominee received tax allowances from the IMF to pay the difference between the "self-employed" and the "employed" obligations of the Social Security tax.

In considering the nomination, this committee has a difficult road to travel. There are some who believe that the nominee's actions can be explained as simple and common mistakes. To some, he is possibly the only man for the job of healing the recession that we have before us, and a very fractured economy.

His involvement in building and implementing the TARP gives him unique insight into how we have gotten to where we are today. To some he is not merely the best choice, to some he is the only choice.

On the other hand, we need to consider how much the nominee's tax history could reflect on a Secretary of the Treasury. As Secretary, the nominee would be in charge of the IRS. If confirmed, would the nominee be able to effectively lead his department? How much does this troubled tax history reflect on his judgment as a decision-maker? These are some of the issues that this committee must consider.

So I ask the nominee, are you the general drawing on your financial expertise who will marshal the financial troops and assets of the Treasury Department to lead our Nation to prosperity, or are you the general, with this troubled tax episode of the past, who will lead the Nation's tax policy and administration system? These are two key questions that we face today. I look forward to the testimony.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator.

Now, as our witness is from the Empire State, I notice that one of the invaluable members of our committee, also from the Empire State, is here, and I recognize him to say a few words to introduce you to the committee.

OPENING STATEMENT OF HON. CHARLES E. SCHUMER, A U.S. SENATOR FROM NEW YORK

Senator SCHUMER. Thank you, Mr. Chairman. First, thank you for your outstanding leadership of this committee and your fine statement. I want to thank Senator Grassley. I know he is very sincere about the difficulties he is weighing.

It is my privilege to be here today to introduce Timothy Geithner as President Obama's nominee to be Treasury Secretary.

Mr. Chairman, in these times, as our financial system is sailing into uncharted and turbulent waters, there is no navigator more suited for this job by way of intelligence, experience, inclination, and temperament than Tim Geithner. Tim has made some mistakes, which he has freely admitted and corrected. But these errors pale before the myriad mistakes made by the operators of financial institutions and government regulators overseeing them. We need the very best, not the second-best person in Treasury to correct those mistakes.

Tim's career in government began 20 years ago as a staffer at Treasury. His abilities quickly launched him up the career ladder, and by the mid-1990s he was Senior Crisis Manager with then-Secretary Rubin, and then-Deputy Secretary Summers, and helped guide the U.S.—and indeed the global financial system—through a series of international financial crises, including the Asian financial crisis in 1997 and 1998.

For the past 6 years, Tim has served as president to the Federal Reserve Bank of New York. From that position he has tried to raise awareness of the risks posed to the economy by the current crisis and to call Congress's attention to the inadequate powers and authorities of the Treasury Department and the Federal Reserve to deal with this economic maelstrom and brave new economic world.

Far before many other regulators, Tim had recognized the extent of the danger that our economy faced and was trying to raise awareness. In the aftermath of the Bear Stearns failure, Tim noted the current crisis was so severe that it was "not something that the market can solve on its own." In July, he called on Congress to establish a legal framework for dealing with the failures of non-bank financial institutions. Had we heeded his advice then, the Treasury Department and the Federal Reserve might not have faced the failure of Lehman Brothers with an empty regulatory toolbox.

Tim has also been a leader on financial regulatory reform. In September of 2006, he led other regulators in calling for enhanced regulation of hedge funds. In April of 2008, Tim called for a major overhaul of the system, not just in structure, but also in the way regulators do their jobs and the policies that we implement to ensure stability. He noted that "our objective should be a system that preserves the unique strengths of our financial markets in providing individuals and entrepreneurs access to capital and credit, but with a greater capacity to withstand stress."

However, as he takes on this monumental position, there are a few things he must keep in mind. First, he must lead the Treasury Department in a full reexamination of the TARP program, as you stated, Mr. Chairman, and the other governmental responses to the crisis to ensure that they are achieving their goals of stability, promoting lending, and protecting taxpayers. The previous TARP program gave the banks too much dessert before it made them eat any of their vegetables. Secretary Geithner must be the responsible parent and restore some balance to this situation; I have confidence he will.

Second—and we know he will do this since he has already started—Tim must lead a national—in fact, an international—conversation about the structure of financial regulation. Without major reforms to the way that we and others oversee financial institutions, the history of the last 18 months is doomed to repeat itself.

Finally, and perhaps most difficult of all, Tim must help guide the U.S. economy back on to stable, long-term footing. The satirical newspaper, *The Onion,* recently ran a headline that struck a nerve, because I think it is all too true. It read: "Recession-Plagued Nation Demands New Bubble to Invest In."

The fact of the matter is that, for far too long this country has relied on easy credit to support its growth. We need to redevelop stable, long-term industries that can survive the ups and downs of the business cycle. We need to reinvigorate American manufacturing, stimulate American savings, and end our national addiction to debt. We cannot be a country that imports more than we export, borrows more than we save, consumes more than we produce. It will not be easy, but I am confident that, if we commit ourselves to this task, under Tim's hand on the tiller, America will emerge as the strongest Nation on the planet for the next 50 to 100 years.

In closing, Mr. Chairman, Tim faces a daunting set of challenges and tasks, but he is uniquely qualified for this position. I am proud to say that I will strongly support his nomination.

I would like to close by thanking him for his willingness to continue serving his country in troubled times. God knows that he has paid his dues, and then some, over the past 18 months, not to mention the past 20 years. And while he could easily go to the private sector and work less hours for more money than he will make as a government employee, he has chosen to accept the challenge that President Obama presented to all of us and to continue to devote himself to serving his country and striving to make the world economy a better and safer place. For that, I commend him.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. Thank you for that introduction.

I would now like to call on Hon. Paul Volker, former Chairman of the Federal Reserve Board, for introduction.

STATEMENT OF HON. PAUL VOLKER, FORMER CHAIRMAN, FEDERAL RESERVE BOARD, WASHINGTON, DC

Mr. VOLKER. Mr. Schumer, Mr. Chairman, members of the committee, it is a real privilege for me to be——

The CHAIRMAN. Mr. Chairman, you might want to pull your microphone a little closer to you. Perhaps turn it on, first.

Mr. VOLKER. That might help.

The CHAIRMAN. That might help. Thank you.

Mr. VOLKER. It is even more of a privilege, when you can hear me, to appear before the committee. [Laughter.]

The CHAIRMAN. Yes, indeed.

Mr. VOLKER. And to support Tim Geithner's appointment as Secretary of Treasury.

You know, a good many years have passed since I last appeared before this committee, but during all of that time there has never been a more critical time for the American economy, and particularly for financial stability. That is true not just in the United States, but globally.

To put it starkly, we are in a serious recession with no end clearly in sight. The financial system is broken. It is a serious obstacle to recovery. There is no escape from the imperative need for the Federal Government to come to the rescue, to right the economic and financial ship of state.

Over time, the hard fact is that several trillions of dollars will be necessary to be committed in a combination of budgetary expenditures and various guarantee and insurance programs, and extensions of credit by the Federal Reserve.

Obviously, commitments made of that magnitude raise very large questions. They are not only questions of avoiding waste of the taxpayers' money, important as that is. There are also risks of undermining confidence in the dollar and raising fears of future inflation. They need to be recognized.

All that underscores the importance of this committee's responsibilities, and even more it underscores particularly the role of a new Secretary of the Treasury. It is that person who necessarily will carry the principal responsibility within the administration for developing, explaining, and implementing a program to restore financial stability and restructure the financial system.

Now today, the nomination of Timothy Geithner as Secretary of the Treasury awaits your advice and consent. After many years in the Treasury and the Federal Reserve, I have some appreciation of the nature of the position of Secretary of the Treasury and the qualities it demands. I also believe I have good grounds for judging the qualifications of Mr. Geithner.

He occasionally reminds me that our paths briefly crossed some 25 years ago when I addressed his graduating class at Dartmouth. Now, I cannot claim that I provided any impetus or inspiration for his career. In fact, my memory is that the public address system closed down shortly after I began my address. But what has become amply clear in the ensuing 25 years is Tim Geithner's commitment to public service. His career path up through the ranks of the Treasury is a model. It is a model I would like to see inspire, and be emulated by, others attracted to public service.

I think it is also true that he is exceptionally well placed to enhance the professional strength of the Treasury, which should be a matter of some concern to this committee.

More immediately relevant has been the years Mr. Geithner has spent as president of the Federal Reserve Bank of New York, a position that I once held. The New York Fed, by its nature, by its location, stands at the hub of the world of finance. It is the agent of both the Federal Reserve system and the U.S. Treasury, interacting with the markets, with major financial institutions, and with foreign official counterparts, a point you made, Mr. Chairman, in emphasizing that this is a global problem, not simply a national problem.

The role of the bank is vital in time of crisis, and as you know we are in the midst of the mother of all financial crises. As point man, Mr. Geithner had a key role, and it has been recognized, within the Fed, within the Treasury, and by market participants and by officials of other countries. He is not only articulate in public, but well respected in the more restrictive world of scholars and economists concerned with finance.

Now, I cannot reasonably claim that any one person is absolutely indispensable but, as you address his nomination, consider that Mr. Geithner brings unique qualifications in terms of hands-on experience, recognition in financial markets, and the confidence in which he is held by the new President of the United States. You have the constitutional duty to confirm his nomination and to exercise that duty with great care. I do hope that that process can be completed with some dispatch so that President Obama can have his full team in place to deal with the pressing financial crisis that simply will not wait.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Chairman.

I now turn to the witness, Mr. Geithner. Mr. Geithner, your prepared statement will be automatically included in the record. I am going to ask you to proceed for about 5 minutes or so.

Before you proceed, is there anyone here in your family that you would like to introduce?

Mr. GEITHNER. Thank you, Mr. Chairman. I would like to introduce my wife, Carol, sitting behind me, and my father, Peter Geithner, on my left.

The CHAIRMAN. Could you both stand, please? We want to thank you very much for your participation in being part of this team, too. Thank you very much for your participation.

Mr. Geithner, you can proceed.

STATEMENT OF TIMOTHY F. GEITHNER, NOMINATED TO BE SECRETARY OF THE TREASURY, WASHINGTON, DC

Mr. GEITHNER. Chairman Baucus, Ranking Member Grassley, and members of the committee, it is a great honor for me to stand before—to sit before—you today. I want to thank you for meeting with me over the last few weeks and for giving me a chance to hear your interests and your concerns.

I am deeply grateful to the President for asking me to lead the Treasury Department of the United States at this critical moment in our Nation's history. I am particularly grateful to my wife, to my family, for all their support and for their sacrifice.

I want to thank Senator Schumer and Paul Volker for their kind words this morning. I am very grateful to you both for sitting with me here today.

Throughout my career, I have had the great privilege of serving our country in institutions responsible for U.S. economic policy. In these roles, I have learned some very important lessons about government and about economic policy. I believe that confidence in the strength and integrity of our financial system, confidence in our commitment to fiscal prudence, confidence in the value of our currency, are absolutely critical to the fortunes of all Americans.

I believe that markets are central to innovation and to growth, but that markets alone cannot solve all problems. Well-designed, strongly enforced financial regulations are absolutely essential to protecting the integrity of our economy.

I also believe that, as America's economic fortunes become ever more closely tied to those of the rest of the world, that we need to invest more at home in helping Americans deal with the challenges of trade and technological change.

Finally, I believe that our national security depends critically on our economic strength. We can have a great and positive impact on the global economy, but only if the quality of our ideas and our actions win the support of other nations.

We now confront extraordinary challenges: a severe recession here and around the world, a catastrophic loss of trust and confidence in our financial system, unprecedented foreclosure rates, small businesses struggling to stay afloat, millions of Americans worried about losing their jobs and their savings, and a deep uncertainty about what tomorrow holds.

At the food bank where my wife and son volunteer, the lines are long and getting longer, and these things are happening across America. Our test is to act with the strength, speed, and care necessary to get our economy back on track and to restore America's faith in our economic future.

This will require action on four fronts. First, we must act quickly to provide substantial support for economic recovery and to get credit flowing again. The history of financial crises is a history of failures by governments to act with the speed and force commensurate with the severity of the crisis. If our policy response is tentative and incrementalist, if we do not demonstrate by our actions a clear and consistent commitment to do what is necessary to solve the problem, then we risk greater damage to living standards, to the economy's productive potential, and to the fabric of our financial system.

Senators, the ultimate cost of this crisis will be greater if we do not act with sufficient strength now. In a crisis of this magnitude, the most prudent course is the most forceful course.

Now, the American Recovery and Reinvestment Plan that is now before the Congress will meet that test. It provides powerful and direct support to help get people back to work, to encourage private investment, to break the cycle currently crippling our economy, a cycle in which concern about growth hurts investment in spending, causes further job losses, and makes it harder for families and businesses to get access to credit.

This plan, the American Recovery and Reinvestment Plan, is a critical part of the solution, but it has to be accompanied by aggressive action to address the housing crisis and to get credit flowing again. Last fall, Congress passed the Emergency Economic Stabilization Act. Your action—and I know this was a difficult decision for many of you at the time—helped prevent financial catastrophe. The actions of the Senate last week to authorize additional resources will enable us to take additional steps to reinforce recovery.

President Obama and I believe that this program needs reform. I know there are serious concerns about transparency and accountability, confusion about the goals of the program, and a deep skepticism about whether we are using the taxpayers' money wisely. We have to reshape and redesign this program to ensure there is credit available to support recovery. We will do this with conditions to protect the taxpayer and the necessary transparency to allow the American people to see how and where their money is being spent. This program, this financial program, is absolutely essential to recovery, and we need to make it work.

Second, as we move quickly to get our economy back on track and to repair the financial system, we must make investments that lay the foundation for a stronger economic future. The strength of the recovery will depend critically on the investments and reforms we initiate now to make our economy more productive in the future, the reforms to expand access to health care and reduce its cost, to move towards energy independence, to sharpen and deepen the skills of American workers, and to modernize our infrastructure. These investments will make our economy more productive and more competitive in the future.

Third, our program to restore economic growth has to be accompanied—and I want to emphasize this, has to be accompanied—by a clear strategy to get us back as quickly as possible to a sustainable fiscal position and to unwind the extraordinary interventions taken to stabilize the financial system. We need to demonstrate, with clear and compelling commitments now, that when we have effectively resolved this crisis and when recovery is firmly established, that we as a Nation will return to living within our means.

Finally, we must move ahead with comprehensive financial reforms so that the U.S. economy and the global economy never again face a crisis of this severity. Senators, in this crisis our financial system failed to meet its most basic obligations. The system was too fragile and unstable, and because of this the system was unfair and unjust. Individuals, families, and businesses who were careful and responsible were damaged by the actions of those who were not.

So we need to move quickly to build a stronger, more resilient system with much greater protections for consumers and for investors, with much stronger tools to prevent and respond to future crises. We have experienced a great loss of faith in our economy, but we have not lost the most fundamental of American abilities: the ability to adapt to change and to reform. This will take time. It will require action on a scale we have not seen in generations. We will have to keep at it until we restore the confidence of Americans, and of the world, in America's economic leadership.

This is my commitment to you, and this is President Obama's promise to the American people. We are a strong Nation with great resources. We can meet these challenges. Our shared goal is a healthy, more stable, and more competitive free market economic system that can once again do what it does best: encourage people to invest and invent, to innovate and create jobs, and to build stronger communities and better lives.

I want to say how grateful I am to my colleagues at the New York Fed and at the Federal Reserve system. Like the career staff at the Treasury, they are an exceptionally talented and dedicated group of public servants. They are brave, creative, and pragmatic, and it has been my great privilege to work with them.

Senators, before I finish, I want to address directly the concerns many of you have raised about the mistakes I made in preparing my tax returns. These were careless mistakes, they were avoidable mistakes, but they were unintentional. I should have been more careful. I take full responsibility for them. I have gone back and corrected these errors and paid what I owed.

I want to apologize to the committee for putting you in the position of having to spend so much time on these issues, when there is so much pressing business before the country. If you and your colleagues give me the opportunity to serve as Secretary of Treasury, then I will do everything I can to justify your trust and your confidence.

Thank you.

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

The CHAIRMAN. Thank you, Mr. Geithner.

Before I ask my questions, our committee has a tradition of asking three standard questions of all nominees. Here they are:

First, is there anything that you are aware of in your background that might present a conflict of interest with the duties of the office to which you have been nominated?

Mr. GEITHNER. No.

The CHAIRMAN. Do you know of any reason, personal or otherwise, that would in any way prevent you from fully and honorably discharging the responsibilities of the office to which you have been nominated?

Mr. GEITHNER. I do not.

The CHAIRMAN. Do you agree, without reservation, to respond to any reasonable summons to appear and testify before any duly constituted committee of Congress, if you are confirmed?

Mr. GEITHNER. Absolutely.

The CHAIRMAN. Thank you.

The basic question I think that most Americans have today—I mentioned it earlier—is the lack of confidence in today's financial system. It has been quite a while, unfortunately. You have alluded to some actions that might be taken to restore that confidence in your prepared statement. Could you just today, now, directly tell the American people what you are going to do to help restore that confidence as quickly as it possibly can be achieved? What are you going to do?

Mr. GEITHNER. Senator, you are absolutely right. We have seen just a catastrophic loss of trust and confidence. When you lose trust and confidence, it is very hard to restore it, and it takes a lot of care and attention to bring it back.

What the President is going to do is, he is going to come before the Congress—we hope in the next few weeks—and lay out to the American people a comprehensive plan to help stabilize the core of our financial system so that the banks that are so critical to our economy are able to provide the credit necessary to get recovery going; he is going to lay out a comprehensive plan for addressing the housing crisis in this country, which has been so central to the recession and its basic causes; and he is going to lay out a broad set of programs for trying to directly address the constraints that are now making it harder for small businesses, for students, for people who want to buy a car, for municipalities across the country, to get access to credit, to make those things. Those three things are going to be the central part of the President's program.

As he does that, he is going to make sure—we will make sure—that we have in place strong, carefully designed conditions to protect the taxpayer, conditions that improve the possibility that private capital will come in and replace the government's role as quickly as possible, and with a set of measures to provide much greater transparency about how the money is being spent, and the results the investments of the taxpayer are producing.

We are going to have to work much more closely together, Senator, with the Treasury, the Fed, and the FDIC, working together rather than separately. We are going to, as you said in your opening, have to work much more closely with other countries and with the international financial institutions, because this is a global crisis. It is going to require a global response.

Our actions here will be more effective if they are taken in close coordination with the actions of the other major financial centers. We are going to have to work much more closely with the Congress. I think the world needs to see Congress and the executive branch working together to solve this problem.

We will not be effective in restoring confidence unless we see a clear commitment by the country as a whole to work to take the actions necessary to solve these problems, and we will consult carefully with you and work as hard as we can to address the concerns raised by you and your colleagues.

The CHAIRMAN. And those changes, those conditions, clearly include very significant limits on executive compensation, on reports, and transparency, that track how the dollars are being spent, and also address conflict of interest potential.

Mr. GEITHNER. Absolutely, Senator. Larry Summers, who is the president of the National Economic Council, provided the Senate, the Congress, with two letters last week that laid out a set of detailed conditions and reforms to the program. We are going to look very carefully at the recommendations by the congressional oversight body, by the GAO, and everybody else who has looked at this basic program. We will adopt those conditions that we believe will help make the program more effective.

The CHAIRMAN. You alluded to the tax issues. I would like to give you a chance to, in a little more detail, explain what happened.

Mr. GEITHNER. Thank you, Senator, for giving me a chance to do that. Let me just try to explain a little bit why I believe, looking back now, I got myself in this position.

In 2001, I left the Treasury Department. I went to work for the Council on Foreign Relations temporarily, and then ultimately went to the IMF that year. That year, I had several sources of income. Three employers reported income to me and to the IRS on a Form W–2 as an employee. I also received self-employment income that year, reported to me on several 1099 forms. I paid self-employment taxes on the income reported to me as self-employment income. I paid income taxes, taxes on my W–2 income, as I always had done so. I believed, mistakenly, that I was supposed to file as an IMF employee, as I would normally file tax as an employee generally.

Now, that was a mistake. As I look back at all the documents that I provided to the committee in response to your careful questions, it was very clear, both in the initial documents the IMF staff gave me to explain the way the IMF system worked, in the quarterly statements I received from the IMF, in the annual tax forms I received, in all those documents, looking back, it was very clear.

But when I made that initial mistake and I failed to correct it initially, I repeated it over the times I had income from the IMF, even in those years where a tax preparer prepared my returns. In 2006 when the IRS conducted its audit, I went back and hired an accountant to help me work through that problem, and I paid what the IRS auditor at that point said I owed.

Now, if I had thought about it more carefully at the time and I had asked more questions, I would have gone back and asked a bunch more questions about that, and I would have approached it differently. But as I said in my opening statement, these were careless mistakes, they were avoidable mistakes, but they were completely unintentional. I take full responsibility for them. Again, I apologize for putting you in the position where you have to spend so much time looking through these questions, particularly now.

The CHAIRMAN. Thank you.

Senator Grassley?

Senator GRASSLEY. Yes. Mr. Chairman, if I could, I would like to give Senator Kyl 10 seconds for something he wanted to say.

The CHAIRMAN. Absolutely.

Senator KYL. Mr. Chairman, I simply want to note—and I know we all have conflicts—I have some really unavoidable conflicts over the next hour and a half or so. I will not ask for any special consideration, but I do want whatever rounds of time we have available for questioning, and to submit written questions at the conclusion of that that I might still have.

The CHAIRMAN. Yes. There will be time.

Senator KYL. Thank you very much. I appreciate it.

The CHAIRMAN. There will be time.

Senator GRASSLEY. Yes.

The Treasury Secretary is responsible for overseeing the IRS, which is tasked with enforcing the tax laws. In a 2007 report, the GAO indicated that as of 2007, the total unpaid tax debt was $290 billion. This is just the amount that the IRS knows taxpayers owe. This does not include the amount due from taxpayers who do not properly report income. Social Security and Medicare taxes are a key component of the tax gap. The person ultimately responsible for tax policy must be credible on the issues of tax reform and compliance.

I was a champion of the IRS Restructuring Act of 1998. This legislation imposes significant penalties on IRS employees who do not pay their taxes, including the possibility of being fired. Not discussing your tax returns, Mr. Geithner, would be like sweeping them under the rug, an option that the IRS employees and the average taxpayer do not have available to them.

Given that the staff and media reports raised significant questions about your late payment of self-employment taxes, I think it is important to set the record straight before we proceed. As a result, I would appreciate responses to the following questions. These questions, I hope, elicit short answers, since you have been very clear in your opening statement and in answer to Senator Baucus.

Were you liable for self-employment taxes on your IMF income from 2001 through 2004?

Mr. GEITHNER. Yes.

Senator GRASSLEY. Did you submit an application for tax allowances for your income and self-employment taxes for the years 2001 through 2004?

Mr. GEITHNER. I did.

Senator GRASSLEY. Did you sign these applications that included a certification that you would pay the taxes that you received allowances for?

Mr. GEITHNER. I did, yes.

Senator GRASSLEY. All right.

Did you receive checks for the tax allowances you applied for?

Mr. GEITHNER. Yes.

Senator GRASSLEY. Did you receive statements with these checks that indicated the amount of the allowance that should be used for income and self-employment taxes? If yes, why did you remit your income taxes but not your self-employment taxes? Only if you want to add to what you said to Senator Baucus.

Mr. GEITHNER. I did not, and I should have. I mistakenly believed that I was meeting my obligations fully, including self-employment taxes, but I did not prepare my returns in a way that caught that mistake initially.

Senator GRASSLEY. Did you use software to prepare your 2001 and 2002 tax returns?

Mr. GEITHNER. I did.

Senator GRASSLEY. You did not?

Mr. GEITHNER. I did.

Senator GRASSLEY. Oh, you did?

Mr. GEITHNER. Yes.

Senator GRASSLEY. All right.

Which brand did you use? [Laughter.]

Mr. GEITHNER. I will answer that question, Senator, but I want to say, these are my responsibility, not the tax software's responsibility.

Senator GRASSLEY. All right.

Mr. GEITHNER. But I used Turbo Tax to prepare my returns. [Laughter.]

Senator GRASSLEY. Did the software prompt you to report income and pay self-employment taxes on your IMF income?

Mr. GEITHNER. Not to my recollection, Senator.

Senator GRASSLEY. If yes—well, not to your recollection.

Well, I thank you for answering those questions. While I understand that the tax code is complex and sometimes even tax preparers get it wrong, it would seem that minor due diligence on your part may have prevented the oversight in failing to pay your self-employment taxes. I appreciate that you prepared your own returns in 2001 and 2002. I believe that the tax code should be simple enough so that individuals can meet their responsibilities under the tax code without having to pay expensive lawyers and accountants; however, I believe that the average American is aware of their obligations to pay Social Security taxes, despite the fact that in many cases it may be their employer who remits their taxes on their behalf.

It is deeply problematic if a U.S. citizen with your financial knowledge and expertise does not consider whether he should be making a contribution to the Social Security trust fund when his employer makes clear that it is the employee's responsibility. You cannot blame the tax code for such tax return errors, and you also cannot point a finger at tax return preparers—or, in this case, the IMF, which appears to do a lot to ensure that people know the law. Individuals have a responsibility to understand their taxes and ultimately account for them.

Mr. Geithner, over the last 5 years Chairman Baucus and Senator Conrad have been aggressive on efforts to close the tax gap. I have tried to help them in that effort. We have made some progress over that time, but the problem is still huge. Commissioners Everson and Shulman have put a dent in the tax gap. Treasury brought forward tax gap proposals, and we have enacted a couple of significant ones. One dealt with credit reporting, the other with stock basis reporting. Congress passed a pilot project on private debt collections and a 3-percent withholding proposal for government contracts.

So, Mr. Geithner, my two final questions: do you take the tax gap seriously? Do you plan to continue to implement the Bush administration tax gap strategy, some of which I laid out here? Is there any reason that we should reverse tax gap legislative proposals?

Mr. GEITHNER. Senator, the President is committed to working with the Congress on an effective program to close the tax gap. I share that commitment and, if confirmed by the Senate, I will work very hard to try to bring forward to the Congress and continue the progress that you helped lead and initiate to try to close that gap. There are a bunch of ideas I have heard from you and your colleagues on how best to do that and, if confirmed, I will listen very carefully to any sensible idea, working very closely with the Commissioner of the IRS in trying to achieve that basic objective. But the President is committed to that, and of course I share that commitment.

Senator GRASSLEY. Are any of the proposals that we have already put forth lacking in support from the new administration? The two that I mentioned, for instance. There may be more. But private debt collections and a 3-percent withholding proposal on government contracts. Those are a couple of enacted proposals that are out there, our attempts to close the tax gap.

Mr. GEITHNER. Senator, my sense is that better reporting by third parties and more comprehensive withholding are going to be absolutely critical. The two proposals you raised, I would like to spend a little more time thinking through and talking to you about them. I have heard concerns on both sides of those issues but, if confirmed, I will come listen carefully to your concerns and figure out how best to meet those concerns.

Senator GRASSLEY. If you could give me an answer in writing on those two issues, I would appreciate it, before your confirmation.

Mr. GEITHNER. Absolutely. Absolutely.

The CHAIRMAN. All right. Thank you, Senator.

Senator Bingaman is next.

Senator BINGAMAN. Thank you very much, Mr. Geithner, for being here. Let me just say, I thank you for your public service over many years. I accept your statements that these problems with tax returns were honest mistakes, so I intend to support your nomination.

Let me go on to two issues I wanted to ask you about. As Chairman Volker just said here in testimony to us, the financial system is broken. The question is: how do we restore the flow of credit in our economy? It seems that there are sort of two ways that this has been attempted. One is the backstopping of financial institutions one way or another, what was done with Citibank, what was done with Bank of America recently.

There has been talk of having a bad bank, and I know that the idea there is to acquire these so-called "troubled assets" and thereby get them off the books of these companies. I guess the Brits have come up with their proposal, as the *Financial Times* characterized it, to write a huge insurance contract for the banking sector. Could you just give us a brief comment as to the validity of some of these proposals or the different ways that we might approach this? It seems like the whole thing has been pretty ad hoc up until now.

Mr. GEITHNER. Senator, I agree with that concern. I should emphasize, we are at the beginning of this process over repairing the system, not close to the end of that process, and it is going to require much more substantial action on a very dramatic scale. I completely agree with what Paul Volker just said to you a few minutes ago about the basic scale of the challenges.

I think, again, the basic lesson of the financial crisis, if you look at it, is the failure to appreciate early enough the magnitude of the problem and the failure to move quickly enough, to have the government do what only governments can do in financial crises, which is to take the risks that the private sector will not take.

My personal view is, for us to get through this and for us to make sure that recovery is supported by the flow of credit that is just vital, that we are going to have to do more to make sure institutions at the core of our system are strong enough that they can lend, but we are also going to have to provide much more substantial direct support to credit markets so that the complicated mechanism that small businesses depend on, that student loan markets depend on, that the automobile finance market depends on, that the commercial and residential real estate markets depend on, that those markets start to come back.

If we are effective on that front, we should be able to get risk premia down, interest rates down, and get that basic mechanism of credit markets flowing again. But you have to go at it on all fronts. We have been carefully reviewing a broad range of proposals, consulting very, very widely among experts both in this country and around the world about how best to do that. Our expectation is, our hope is, we will be able to come forward relatively quickly with a comprehensive plan.

I do not want to provide any specific details today. I think one of the things we have learned about the last 18 months or so is that we have seen the costs in terms of uncertainty created by tentative signals not followed up by clear actions, with not a lot of clarity and goals. I do not want to be, today, in the position of magnifying that basic problem.

Senator BINGAMAN. Let me ask about one other problem you are going to be faced with as the Treasury Secretary, and that is salvaging the automobile industry in this country. I strongly support doing that. I think it is very important that we have a domestic automobile industry. There is an article in this morning's *Wall Street Journal* about the Chrysler-Fiat deal requiring U.S. loans.

In very rough frame, as I understand it, basically they are saying that Chrysler has to get another $3 billion from the government in order for Fiat to go forward with this. Fiat will acquire a 35-percent interest without putting any cash in, and then at some time in the future, assuming that the company is making profits, Fiat will get another 20 percent for $25 million.

It is hard, frankly, to explain to the American taxpayer why the taxpayer should not own Chrysler if we are going to put in $3 billion, or have some major up-side opportunity for the U.S. taxpayer if we are successful in allowing Chrysler to succeed and prosper. So, I do not expect you to comment on the specific deal, but do you have any thoughts as to how we can assure taxpayers that their interests are taken care of if we do put these large infusions of cash into that sector?

Mr. GEITHNER. Senator, you are absolutely right that we are going to have to, as we move forward, try to make sure that any assistance the government provides is assistance in support of a comprehensive restructuring that will leave the American automobile industry in a stronger financial position where they can be profitable and healthy without government support going forward.

Our judgment is that that is going to require very, very substantial changes by all stakeholders in these companies, and we are in the process now of putting together a team of people with expertise in manufacturing, in restructurings, who understand how these labor contracts work so that we can give the President the best advice and come to you and give you the best plan that meets this test. But you are absolutely right to emphasize the point that assistance should come with conditions that give us confidence that we are going to leave the industry stronger, more viable in the future without having to rely on government support.

Senator BINGAMAN. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bingaman.

Senator Hatch, you are next.

Senator HATCH. Well, thank you, Mr. Chairman.

Welcome to the committee, Mr. Geithner. I appreciate the time that I have spent with you, and I appreciate your explanations here, both then and today as well.

Let me just say, I am sure you are as concerned about the prospects of trillion-dollar deficits as I am—trillion-dollar-plus deficits. It seems to me that as soon as we get the economy turned around we need to address spending in a very serious way. To me—and to anybody with any brains, it seems to me—we have to engage in entitlement reform: Social Security, Medicaid, Medicare. And energy. That is not necessarily an entitlement, but that is where the dollars are, and that is where we are going to need to find changes if we are going to stop our country from going down the drain.

What are your thoughts on entitlement reform and on budget reform as well?

Mr. GEITHNER. Senator, I think you have framed it exactly right. We start this process today with a deficit that the CBO estimates in the range of $1.2 trillion. It is absolutely critical to the efforts to get the economy back on track that we give the American people, and investors around the world, confidence that we are going to have the ability and the will, working with the Congress, to get our fiscal position back down over the next 5 years to a sustainable position, but also that we are willing to start to take on and find a consensus on a bipartisan basis for putting Social Security and Medicare on a more sustainable financial position longer-term.

I think we have to do both those things together. Harder to do given the magnitude of the deficit we start with, but the recovery will not be strong enough unless we can make more credible than we have been able to do as a country over the last several decades our willingness to put our fiscal position back to a sustainable position, and that requires not just a credible set of commitments over the next 5 years or so, but that we begin the process now of taking on entitlement reform. The President is consulting with the Congress on how best to do that. We are looking for a mechanism that offers the best prospect of getting bipartisan support early, and we would very much like to work with you and your colleagues on how best to do that.

Senator HATCH. Well, thank you. Many on both sides of the political aisle believe that our corporate income tax rate—and I am one of them—which is among the highest in the industrial world, is a major hindrance to our national and international competitiveness.

Now, I have two questions about this. First, do you agree or disagree that our corporate tax rates should be significantly reduced? Second, some policymakers—including my friend, the chairman of the Ways and Means Committee in the House, Charlie Rangel—believe that the corporate tax rate should be reduced, but only by eliminating other so-called "corporate tax benefits" such as the Research Tax Credit.

Now, do you agree with Chairman Rangel's approach or would you prefer an approach that would not offset revenue loss from a corporate tax rate by raising other corporate taxes?

Mr. GEITHNER. Senator, the tax policy of the United States plays a very important role in creating incentives for investment, for work, and for savings. We have to look at the entire framework of the tax code, and we look at every new policy through the prism of, what is it going to do to incentives for work and investment in this country?

The President believes, and I share this belief, that we have substantial opportunities for reform of the entire corporate tax system. We are not going to be able to do that immediately in the context of the recovery investment plan, of course, but we hope to be able to work with you and other members of this committee and the Congress on a package of reforms that are going to try to give us confidence that American business will be productive and competitive going forward, and we will be open to all ideas on how best to do that.

The President, as you know, is committed to making the Research and Development Tax Credit, the R&D tax credit, permanent. There is a lot of merit in doing that. But again, I think, very important, as we look at how to address a broad set of changes in the tax front that we are going to be forced to address in the next 2 years, is that we give adequate attention to improving the overall corporate tax system so that it makes sure that American businesses are as productive as possible going forward.

Senator HATCH. I get many complaints from my folks out in Utah, especially our business people, that our corporate tax rules place American firms at a disadvantage when it comes to competing abroad.

As you know, we are one of a handful of developed nations that taxes home-based entities on their income, regardless of where it was earned, while most other developed countries employ a territorial system of taxes—only that income earned within their borders. Now, do you think that moving towards territorial taxation would make it easier for our companies to compete globally and also simplify the corporate tax system in the process?

Mr. GEITHNER. Senator, that is an issue I am going to have to think more carefully about, and would welcome a chance to listen to you and your colleagues about exactly how we navigate through that set of questions. But I think you are right. You have to look at the entire package of incentives that it actually creates in the context of what other nations do before you can make a judgment about what set of reforms are going to try to meet this basic test, which I think we are all committed to, of how to make sure that American businesses are as productive as possible.

Senator HATCH. Well, thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Hatch.

Senator Kerry?

Senator KERRY. Thank you, Mr. Chairman.

Mr. Geithner, welcome. Glad to have you here before the committee. Let me just say that I look forward to voting for you, supporting your nomination. I think you are superbly qualified. I know, not just through the testimony of Paul Volker, for whom we have great respect, but others, that you come to this committee with a great reputation for integrity, and I accept completely the explanation you have given us with respect to the mistakes on your tax returns.

The levels of negligence and the sins of commission of those responsible for the management and regulatory oversight of our financial system are absolutely staggering, so much so that the former chairman of the Fed, for whom the committee and the country have great respect, Paul Volker, just said to us and to the country that "the financial system is broken." He said that "this is the mother of all financial crises." You cannot really put it more starkly than that. It is in that context that I want to sort of put something to you.

I think that events have already overtaken what the House of Representatives has passed and what is currently on the table in the context of a recovery package. I do not want this committee or the Congress to be put in the position of repeating any of the mistakes that have been made.

In that light, when you say that we need accountability and transparency and we need this investment package, I could not agree with you more: yes, we do. But the problem I have is that, as it is currently proposed, the House package and the investment package, I fear it stands a good chance of simply being wasted and of not having the impact that we want our overall economic recovery package to have, because the system underneath it is broken.

People are fond of saying that we have a crisis of confidence. I do not believe we have a crisis of confidence; I think we have a reality crisis. We have a real crisis of the fiscal reality of our lending institutions. Since they all know it exists, they are all frozen and they hold back. Until you fix that, we are not going to be in a position to make the investment package, and the other things we need to do, take hold the way they need to.

I am convinced, as I think the President is, and you are, that we are on the brink of an entirely sort of new economy if we invest correctly and if we move towards the technology, education, research, and investment side with the full level that it is going to take to open up those opportunities.

But none of those opportunities is going to properly open up if a whole bunch of the money that we are putting in continues to buy what I will call polluted assets, fundamentally. We are propping up shareholders, we are propping up, fundamentally, insolvent institutions. Unless those institutions clear their books of those toxic assets, we are simply going to compound this crisis.

First of all, I do not think the package is large enough. We just heard Mr. Volker talk in terms of $1 and $2 trillion. I think you are not going to restore this process unless you come with a package that is comprehensive, ultimate in a sense, where the marketplace says, sort of with a breath of relief, this is going to do the job, now I dare to lend, now I have books clean enough to lend.

In fact, I think you can advantage the American banking system very significantly by moving aggressively in the global marketplace to be the first to do this and finance it through the Treasuries, et cetera, and ultimately winding up, I think, being less expensive to the American taxpayer as a result.

So I would ask you to speak to that. I think that we need a package that we will have confidence is going to clean the books, put those banks—I mean, Paul Krugman wrote an article just the other day, you may have seen it, about the Gotham Bank, $2 billion of assets, $1.9 billion of liabilities, but 400 of those assets are actually mortgage and other kinds of relatively insecure assets, so really it is $200 billion. So they are sitting there as what he calls a "zombie bank."

There are too many zombie banks out there. I would like to know if you and the President are prepared to put before us this comprehensive plan so we can vote with confidence that we are delivering to the American people, and delivering the message to the marketplace that we need.

The CHAIRMAN. Mr. Geithner, very briefly. If you could answer that question in negative 20 seconds, which is a short way of saying we have gone 20 seconds beyond the allotted time. But please answer very briefly.

Mr. GEITHNER. Senator, I share——

Senator KERRY. Well, with all due respect, Mr. Chairman, there are lots of questions that ended at zero and the answers were provided afterwards.

The CHAIRMAN. Yes. Well, there are a lot of Senators who have a lot of questions to ask, and I am trying to just be fair to all Senators.

Thank you, Mr. Geithner.

Mr. GEITHNER. Senator, I share the concerns you expressed and agree with the objectives you set out. We are going to try to meet that objective with the plan we put out to the Congress and the American people. The challenge is how to do it in a way, as you said, that is going to work and give people confidence that these institutions have the strength and the ability to lend going forward. But we are going to have to do more than just try to make sure that banks are strong enough that they can lend, but we are going to have to make sure—you know, we have a very complicated financial system and the capital markets are central to how our economy works.

It is a very delicate, complicated balance, but we need to make sure, as we stabilize the banks, make sure they are strong enough to lend, that we are doing things that are going to be effective in getting risk premia down, interest rates down, and credit flowing again through those capital markets, and we are going to try to do both of those things at once. But I agree with your concerns and your objectives.

The CHAIRMAN. Thank you. Thank you, Senator.

Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman.

Welcome, Mr. Geithner. Obviously the role of the Treasury Department is to be a steward for both the U.S. financial and economic systems, both of which are in simultaneous crisis. Obviously, your role as Secretary would be to chart a course out of this morass, and certainly the breadth and depth of your experience would suggest that you certainly have the credibility and the experience to move forward, given the fact that you have worked for three different administrations and five Treasury Secretaries.

Notably, leadership also requires translating vision into action and into executing solutions. I want to just explore with you for a moment your role in the credit derivatives market. It has been mentioned, and impressively so, that you identified the magnitude of that crisis and warned of the systemic problems that could occur because there was no way to identify not only the size of that market, but also, in the event that there was a serious crisis, whether or not our system could sustain that.

You gave a series of major speeches since 2004 regarding credit derivatives, and ultimately, in June of 2008, you called for comprehensive regulation and financial overhaul. But what I would like to know is, because you obviously had a major bully pulpit—Wall Street is within your jurisdiction—what actions did you specifically take and whom did you go to? Did you go to the Board of Governors, the Chairman of the Federal Reserve, to the Treasury

Secretary? What would you have done differently, given 20/20 hindsight? Why did you not aggressively pursue regulation earlier—I do not know, maybe you did—with the Treasury Secretaries, or with the Congress?

Also, when we look at what happened with Lehman Brothers, there were different explanations from the Treasury Secretary, the Chairman of the Federal Reserve, and a spokesman on your behalf. It is unclear whether Lehman Brothers was allowed to collapse because it was judged that investors had time to take precautionary measures or whether the Federal Reserve and Treasury lacked the authority to do anything about it. Finally, I would like to explore why there have been no purchases of toxic assets, which was the original intent and purpose of the $350 billion that we provided last fall.

So when I look at the entire picture, I am concerned about a lack of confidence in where we stand today and our ability to get it right. Actually, I think we did work with speed and force last September, much to the objection of the American public, frankly.

So I would like to know from you exactly what you did with respect to credit derivatives, Lehman Brothers, and why toxic assets were not purchased. Thank you.

Mr. GEITHNER. Thank you, Senator.

Let me start on credit derivatives. When I became president of the New York Fed, this critically important market, with tens of trillions of notional exposure, was a market where trades were confirmed, if they were confirmed, by fax, by pencil and paper, by phone. A very rudimentary, private execution framework existed. Firms did not know what their positions were and their exposures were.

What I did was to get the major institutions who are responsible for about 95 percent of this market in the room at the New York Fed with their primary supervisors from around the world—the first effort done on this scale, I believe, ever. We got those institutions to commit to clear, concrete commitments to substantially strengthen that infrastructure and put it on a stronger foundation going forward.

The changes made over that period of time, starting in 2004–2005, were very, very effective in trying to make sure that the infrastructure in this critical market was strong enough, stronger than it was before, so that we could withstand a shock of this magnitude.

Now, as important as that was, I worked with the SEC, and again with the lead supervisors of the major global firms around the world from Switzerland, from Germany, from France, from the United Kingdom, and from Japan to make sure that we were trying to encourage very substantial improvements in risk management so that these firms had a better sense of the risks they were exposed to in credit derivatives and a broad range of other complex financial products.

Those efforts, I believe, had a lot of traction. They made the system stronger. They could have had more traction, of course. If more had been done earlier and there had been more responsiveness to those efforts, then this crisis would have been less severe. But those things were very important, and I believe they are very effective. I think that market today is on a path to the point where it is going to have the basic strength and resilience you would expect from a market that important.

Now, you raised—Mr. Chairman, could I continue on the two other questions she raised?

The CHAIRMAN. Briefly. Yes, briefly.

Mr. GEITHNER. All right. Complicated questions to address this quickly. But let me speak to the question you raised about Lehman, Mr. Chairman, and then perhaps I could respond in writing to the other questions.

Lehman's failure was an enormously complicated, enormously consequential event. It did not cause this financial crisis, but it absolutely made things worse. Lehman failed fundamentally because it faced a need for capital on a scale that the market was unwilling to provide. The market was unwilling to provide it, in part, because of the severity of the crisis at that point. Over the course of the summer, things were getting dramatically worse, and everybody was pulling back from risk on a dramatic scale.

Neither the Department of the Treasury, the executive branch, nor the Federal Reserve had been given the authority by the Congress that would have made it possible for the government to put in capital on a scale necessary to avoid default. We could not force any institution to come in and buy Lehman Brothers or guarantee their obligations, and no one was willing, without the government taking a very, very substantial capital position, and we did not have the authority at that point to do that.

That was a critical and tragic set of constraints. This country should have never been in the position where we entered a crisis of this severity without an adequate set of tools to address failure by an institution that large, that consequential, and that systemic.

We did work very hard to try to limit the damage, but anything that complicated and systemic was going to cause very, very substantial damage. It was clear at the time, it is absolutely clear in retrospect, and one reason why it is so important.

The CHAIRMAN. You need to shorten it up a little more, please. Thank you very much. Thank you.

Senator SNOWE. Thank you.

The CHAIRMAN. Thank you, Senator.

Senator Wyden, you are next.

Senator WYDEN. Thank you, Mr. Chairman.

Mr. Geithner, you cannot fix a problem if you do not know what the problem is. It seems to me we are not getting our arms around the enormity of this, because no one has required America's financial institutions to fully report the true measure of their liabilities. Will you do that, and when?

Mr. GEITHNER. Senator, if confirmed for this office, I will work very hard with the responsible regulators in the United States and around the world so that we have a set of accounting requirements and disclosure requirements that do a better job than we have done to date in trying to make sure that investors in these institutions have a better sense of the risks they face.

But I just want to point out—and this is critically important—it is very hard to do in an environment with this much uncertainty, and the scale of the recession ahead and the losses that will come with that.

Senator WYDEN. I understand it is a challenge. But it is clear—we saw that yesterday in the markets, the way they were responding—that the American people believe that there may be more tough times ahead. People might default, not just on mortgages, but on consumer loans and auto loans. I think that is priority business. You are going to have to get tough with those institutions. It is a hard task, but that is something that I am counting on you to do, if confirmed.

A second area I want to ask you about, we talked about in my office. That is your role with respect to Citicorp when you were at the Fed. Citicorp has been one of the primary recipients of funds under the Troubled Asset Relief Program. It has had to be rescued like no bank holding company to date. We looked at the statutes. The Federal Reserve Bank has a significant supervisory role over bank holding companies.

My view is that the alarm bells should have been going off in 2007. There, you had a situation where they had huge losses. The CEO was leaving. Do you think you should have handled that situation differently in 2007?

Mr. GEITHNER. Senator, in that case—and I would say across the financial system—nobody who has been part of this system, as a member of the board of an institution, as a chief executive, as a supervisor, as a regulator, as a central banker, as a treasurer, as a finance minister, nobody who has been part of this system can look at this crisis and not be deeply, deeply uncomfortable by the failure of the basic checks and balances in our system. To fix this going forward, I believe it is going to require—I am going to come to your question just quickly—very, very substantial reform.

Senator WYDEN. What would you have done, personally, differently, if anything? Because it seems to me the Fed had significant supervisory authority there. The alarm bells were going off. I want to know what you, looking back, would have done differently.

Mr. GEITHNER. Senator, I believe across our system there has been too much skepticism about the effectiveness of supervision and the necessary rule it plays in making our system strong in the future. Market discipline is not sufficient in containing risk and injecting the level of prudence necessary.

Supervision plays a critical role and supervision could have been more effective. Our system created a very complicated set of accountability and responsibility among the myriad of supervisors and regulators responsible for overseeing bank holding companies. Part of the failure in the checks and balances was——

Senator WYDEN. Should your supervision have been more effective?

Mr. GEITHNER. Absolutely.

Senator WYDEN. Thank you.

Let me ask you about one other area. Yesterday, the unemployment rate in Oregon went to 9 percent, the highest in 25 years. We have small businesses that cannot get credit, zero. They get no bail-outs, and they are very angry because they feel there is a double standard with respect to how funds are distributed under the financial bail-out legislation, that big institutions can walk off with millions and they cannot get changes in these rules so they can get a loan.

What specifically will you do to support a fairer distribution of these bail-out funds, particularly so that small businesses that have been hit like a wrecking ball can start getting credit again?

Mr. GEITHNER. Senator, a very important question. I absolutely share your concern. I think across the country you are seeing exactly the same thing. I think the critical test of everything we do, among other things, is, does it result in more access to credit on appropriate terms for small businesses across the country?

The President believes, and I share this belief completely, that you have to do very, very substantial support for overall growth and demand, and the President's program not just does that, it has some very important targeted tax benefits for businesses across the country, which will help meet those concerns.

But it is going to be absolutely important to try to make sure that this program of support for the financial system is made available to small banks across the country that play such a critical role in our communities, and that we do enough quickly enough to try to get the basic markets that are central to small business lending going again. I think that there is a lot we can do in that area. I am open to ideas, look forward to suggestions, am happy to work with you on it, but I think you are right to emphasize its importance, and it will be the critical test, fundamentally, of whether our program is working.

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Wyden.

Senator Kyl is next, but he is not here. Next after Senator Kyl is Senator Schumer, but Senator Kyl can certainly have his time when he returns.

Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman. Thank you, Mr. Geithner.

First question. Senator Kerry was talking to you a little bit about good bank/bad bank. It is appealing because the alternative seems to be almost a death of a thousand cuts, keep marking down the assets further and further. The thing I worry about with it is cost. I did a little calling this weekend to people who would know and they said it could be $3 trillion, $4 trillion if you did the whole good bank/bad bank across the board, which creates great worries for the dollar and for inflation down the road. I mean, it just shakes our financial system, something that large.

Do those estimates seem out of the ballpark to you? Even if it is a little less than that, do we have worries in doing this in terms of the cost effect on the dollar, et cetera?

Mr. GEITHNER. Senator, the good bank/bad bank type solutions have been present at the solution to most financial crises around the world. It is very important that we look carefully at whether they are going to be as effective in this context as they have been in some past cases. But you are right to say they are enormously complicated to get right.

We want to be very careful that we are not just using the taxpayers' money most effectively with the most potential impact and leverage on the financial system, but also that we do these in ways where the taxpayer and the government understand the risk we are taking, that the system is going to be managed with the best possible return going forward.

It is an enormously complicated set of questions. Those are among the questions and options that a team of people—very smart people, experienced people—are looking at today. It is possible that something there will be part of the solution going forward. But I do not want to, today, provide any more details on how best we can navigate this.

Senator SCHUMER. But cost is a serious consideration, I would presume?

Mr. GEITHNER. Right. We want to have the best impact on the financial system with the least potential cost to the taxpayer, with the least potential risk. Finding that balance is going to be hard.

Senator SCHUMER. All right.

Next question. We do have to get to the bottom of the real estate dilemma, probably more than anything else here. I have always felt you need both a carrot and a stick. Lots of carrots have been proposed without any sticks and not much has happened, whether by Secretary Paulson, Senator Dodd, Congressman Frank. The stick that I think works best is bankruptcy, that talk about bankruptcy reform. We have now had a few banks become supportive of this.

(A) What is your view? I know President Obama has been for this. (B) What about putting it in the stimulus?

Mr. GEITHNER. Senator, the President is supportive of changes to the bankruptcy code in the mortgage area. He recognizes, as I know do you and many others, that doing that requires enormous care. It is very important that we make it more likely, not less likely. We get private capital to come in to the financial system. That is going to be absolutely essential. We need to make sure we reduce uncertainty about the basic rules of the game that govern property rights and contracts going forward. So we are going to be supportive of trying to do that in the most careful way possible, and we are open to suggestions. If confirmed, of course, I will work with you and your colleagues about what the best device for doing that is.

There is a great benefit in moving quickly to resolve uncertainty about what the rules will be going forward, but it is also true that we want to have a comprehensive housing package, and this is likely to be an important part of that. So, we are open to suggestions on how best to move forward.

Senator SCHUMER. Great.

Third question. We just went through the second round of the TARP. The greatest criticism, I think, from both sides of the aisle is, you put the money in—Senator Wyden mentioned this in terms of small business. It is across the board—and you do not see much lending going out. That is probably because the banks are in such a weakened condition that they are holding on to their capital for dear life, because even if the dollar now is, they think, valued at 40 cents, it could go down to 20 cents. If they lend based on the 40 cents, they may be high and dry.

How do we make sure that the next round of the TARP pushes more money out into the economy, small business, construction lending, credit cards, college loans, autos, et cetera?

Mr. GEITHNER. A very important question, and it is the center of the President's considerations as we think about the plan we want to present to the American people. I want to start just by pointing out something you said, which is that without the actions that the Congress made possible in the fall we would have seen a much more dramatic contraction in lending across the entire financial system.

Senator SCHUMER. Right.

Mr. GEITHNER. Avoiding that was absolutely central. But moving forward, we are going to have to try to make sure that the banks that are at the core of the system are strong enough that they can provide the credit necessary to get recovery going again, but we are also going to have to provide much more substantial support to the capital markets, credit markets more generally, because that basic infrastructure is central to the basic mechanics of the markets that support corporate lending, small and large business lending, to the commercial/residential real estate markets, to student loan markets, to auto finance markets. Our view is, you are going to have to do both. Again, the key lesson is, we have to do it with enough force and clarity that people see impact quickly. Frankly, we have to make it clear that we are going to keep at it until we fix it.

Senator SCHUMER. Thank you.

The CHAIRMAN. Thank you, Senator.

Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

Welcome, Mr. Geithner, a friend to the committee.

Of the many positions in the Federal Government about to be filled, the Treasury Secretary is among the most critical today, obviously. We are confronting a severe financial panic, and one false move by the Secretary of the Treasury could result in years of stagnation and high unemployment.

Even before the disclosure of the nominee's tax problems, I had serious reservations about this nomination. Mr. Geithner has been involved in just about every flawed bail-out action of the previous administration: he was the front-line regulator in New York when all the innovations that recently have brought our markets to their knees became widespread; he went along with the flawed monetary policy decisions of Alan Greenspan and Ben Bernanke; he failed to cite China for manipulation of its currency; and he stretched the law beyond recognition to bail out Bear Stearns.

All those actions or failures to act raised questions about the nominee's judgment, but the failure to pay taxes specifically provided to him by the IMF is the most troubling because it reflects a degree of negligence towards the law he will be charged with enforcing.

Mr. Geithner does not provide a satisfactory explanation for the problem, certainly not one significant for a high-ranking public official whom the American people demand, and deserve, to hold to a higher standard.

The committee has known about these matters since December 5th, but it was not until about 1 week ago that the information was shared with the members of the committee. Soon afterward, the chairman sought to hold a rushed confirmation to which I and others objected. This hearing is still rushed, and my staff had only limited time to access the relevant information. Now the chairman wants to mark up the nomination tomorrow.

As far as I know, the committee has never interviewed the IRS personnel involved in the tax case, and none of the witnesses has been made available to the staff or committee members. That is unacceptable in light of evidence that the IMF clearly explained his payroll tax obligations, as acknowledged by the nominee himself.

Mr. Geithner's failure to pay all the Social Security and Medicare taxes he owed until he was to be nominated is hard to explain to my constituents, who pay these taxes on a regular basis. I could spend a lot more time explaining my concerns about this nomination, but I would like to get to them later in questions that I will ask the nominee. Thank you.

The CHAIRMAN. Thank you, Senator. I might say that I make no apology in my efforts to try to help this administration get its economic team up and running in these very difficult and troubling times, and that is why I think it is important that the committee move expeditiously.

I would also say that all the relevant materials have been made available, certainly at the staff level, to all Senators for a good number of weeks. Given those two competing factors, it is the chair's judgment that this is the proper speed within which to take up the hearing.

Senator BUNNING. Would the chair answer me one question?

The CHAIRMAN. Certainly. And also, hopefully, the nomination.

Senator BUNNING. Was the meeting noticed properly?

The CHAIRMAN. The meeting was noticed properly.

Senator BUNNING. Noticed in a timely fashion?

The CHAIRMAN. The meeting was noticed properly.

Senator BUNNING. That is not what I was told.

The CHAIRMAN. I regret that, then.

Senator BUNNING. Thank you.

The CHAIRMAN. Senator Roberts, you are next.

Senator GRASSLEY. It does not matter whether you are Republican or Democrat, it is how you arrived.

Senator ROBERTS. I have not switched parties yet. [Laughter.]

Senator GRASSLEY. I am telling him, it is not a partisan thing.

The CHAIRMAN. No, no, no. It is all arrival. It has nothing to do with back and forth and party. It is all arrival, and you are the next one entitled to speak.

Senator ROBERTS. Well, I appreciate that, Mr. Chairman. I am sure not going to back off of it. Thank you very much.

Mr. Geithner, thank you very much for your willingness to serve in this very, very difficult situation. We had a good talk in my office, and I found you very engaging, and I certainly thought that you knew what you were talking about, and I thought our meeting was very educational. I thank you for your phone call later after the tax issue came up, in which you were very contrite.

I am not going to split the shingle on the tax matter, but I do want you to know that, after that was reported, my phone lines lit up, and they are now also lighting up in my offices in Kansas and here, asking why we are considering a nominee for Treasury Secretary who had not paid the taxes that he owed. I will leave it there. Except to say that, if you did not pay these taxes simply because it was a matter of oversight and confusion, Mr. Chairman, we have a wonderful example, I think, and the best case yet for undertaking reform to make the tax code simpler for all taxpayers.

I was intrigued by the suggestion in the *Wall Street Journal* that we use this as an impetus for a tax holiday for all Americans who have made a mistake and do not want to engage the IRS in the briar patch and end up with some kind of a penalty. So, maybe you can call for that, once you are confirmed. You are going to be confirmed, and you can work with the President and we can have a tax holiday for all Americans who have these kind of problems.

Now, basically I know, as somebody has said—I think Senator Wyden—over the past year you have been the architect or played a role, along with Secretary Paulson and Mr. Bernanke, in the structuring of several financial industry rescues, including the AIG. Last week, Congress approved the release of the remaining $350 billion of the TARP funds.

I opposed the creation of the TARP program and the release of the second round because I have very serious concerns about how the first $350 billion was spent. I am not sure today, yet, how that was spent. If confirmed, I would like to know what steps you will take that will assure Americans that their hard-earned dollars are being used wisely and appropriately under the TARP.

Here is really what I am getting at. It is a lot like what Senator Wyden was pointing out, Senator Kerry was pointing out. I know what the government can do. The government can do a lot of things. The government can furnish our national security, and we all know how that is done. The government can really do a lot in terms of infrastructure, and we build a lot of things.

And goodness knows, in this committee and in the Congress, we know we are a giant income transfer machine, and we figure out whom we take from and whom we give to, wrapped with a lot of strings and a lot of cost. That is the entitlement programs that you and the President have indicated you would like to reform, and I certainly join you in that.

But I never found out from Mr. Paulson and Mr. Bernanke, in talking personally with them about the TARP funds, how they were going to take a category of assets, toxic as they are, and put them out there on the playing field and the government would set a market price. How does the government set a market price? I think that is a most unique and most unprecedented thing, and I never could figure it out.

I said, who is going to do this? Privately, in conversation with both gentlemen, they said, well, we will contract it out, we have so many good people. Well, who are you going to contract it out with? Well, maybe folks in academia. Well, that gave me a lot of good feelings about that. I said, how are you going to do it? Well, we are going to take a sliver of a category of assets. What sliver? Well, we do not know yet.

We are going to put that on the playing field. I said, well, how are you going to set a market price? Well, we will set a market price and, if five people come on the playing field and say we are going to buy that, obviously it is too high, we will have to lower it. Then if we have a market price, we say, out there at maybe 20 cents on the dollar and nobody comes, we will have to raise it up.

I said, do we have the wherewithal to do that? There were just questions, and I never got to the bottom of it. I do not think the American people know who is doing this, how they are going to do it, and what they are going to do. I think that is what you have to do in the transparency here, because of your experience in what we are doing with the TARP and what I would call the great omnibus bill, as opposed to the stimulus bill which is going to happen, and I know that it needs to happen.

Now, there are a few banks in America that are so large they are considered too big to fail. I have 350 mostly rural banks in Kansas. I just talked to the Kansas Bankers Association this morning. They do not like the conditions and they do not like the stringent regulations. They certainly do not like Barney Frank's bill, where you are going to sit down with the regulators and piecemeal this stuff out. So they do not want to be tossed in the briar patch, and they have contributed zero to the economic crisis we now find ourselves in.

I am just asking you, should these large banks that pose a systemic risk be broken into separate pieces in order to avoid such large losses? Should they have a different, more stringent set of regulations than the banks that I have in Kansas that have not contributed to this problem, but yet find themselves with, to be perfectly frank, FDIC SWAT teams running in, trying to say their performing loans should be not-performing loans, and everything else. So there has to be at least some forbearance in this, and I know that, but there also have to be stringent regulations. I am 56 seconds over time. That puts me in, what, about fifth place? [Laughter.]

The CHAIRMAN. It puts you on pretty much equal par with most members of this committee.

Senator ROBERTS. Yes. And I am not going to ask you to respond, because he will not let me, number one. Number two, I think you know my concerns. We talked about it. Thank you for your willingness to serve, sir.

Mr. GEITHNER. Thank you, Senator. I have heard your concerns, and I think they are the right kind of concerns.

Senator ROBERTS. Thank you.

The CHAIRMAN. Thank you.

Next, Senator Ensign is not here. Senator Cantwell, you are next. The committee rule is, whoever is in the Executive Session room first is the first to be recognized. You were in there first.

Senator CANTWELL. Well, thank you, Mr. Chairman. I appreciate that.

Mr. Geithner, thank you for being here. I think, of your responsibilities for the position, you take an overall system of responsibility and accountability, even though we have various financial entities within the government that are independent.

So my questions to you, and I have questions that I hope you can just answer "yes" or "no" to because I have four or five, and I will try to be brief in describing them too. I am interested in your overall philosophy about how you are going to approach this from the issues and experiences that we have just had.

So my constituents are not as concerned—or I should say I am not as concerned—about your individual taxes. My constituents and I are concerned about the potential for a continued cozy relationship between the Federal Government and the financial institutions that they are supposed to oversee and regulate.

So my first question. You talked in your statement about comprehensive financial reform. Do you mean regulatory reform?

Mr. GEITHNER. Yes.

Senator CANTWELL. Thank you. I am glad to hear you say that you did not have any concerns about using that term.

Earlier this week, or a few days ago, there was an article in the *New York Times*—two different articles. Ms. Shapiro, who is the head of the Financial Industry Regulatory Authority, talked about the Madoff situation and the ponzi scheme, basically saying that there were some issues, but there were no inquiries. But in another article—this is January 15th, so I believe they were both the same day, the statements—FINRA also, every 2 years, reviewed the Madoff books, but apparently they missed the fact that maybe Mr. Madoff was not actually making trades. Do you think, yes or no, that that is a failure of FINRA?

Mr. GEITHNER. I do not think I can give you a "yes" or "no" answer about that, Senator, just to be fair, just because I do not know the details of their responsibilities in that case. But I completely agree that that case——

Senator CANTWELL. So "there was no evidence that the Madoff dealer executing trades for Madoff, that they"—this is coming from FINRA. They are now saying, we do not have any proof that they made any trades. But they basically said they had been reviewing their books every 2 years since they started. So, if FINRA, this self-regulatory agency, had been reviewing their books every 2 years and now are just coming to the conclusion that they never made trades, is that a failure?

Mr. GEITHNER. Well, I understand what you are saying. I think it is absolutely true that the enforcement mechanism failed to prevent this and to deter it, and to catch it soon enough. That is absolutely true.

What I do not know exactly is what their specific responsibilities were and how well they discharged those responsibilities. But it is absolutely true that the system of deterrence and enforcement failed to detect this and prevent it.

Senator CANTWELL. So was that FINRA?

Mr. GEITHNER. Again, I am just trying to be fair. I do not know enough about the details.

Senator CANTWELL. If you are a self-regulatory agency whose main purpose is to clean up the industry and make sure there are no problems, and you reviewed the books every 2 years, you do not think that was a failure?

Mr. GEITHNER. Well, I am sure the system failed. What I just do not know is the precise details of what they did and why they missed what they missed, and what the responsibilities were.

Senator CANTWELL. But from an overall point, would you not say that that was a failure?

Mr. GEITHNER. I would say, absolutely, that the system failed in the Madoff case, like in many other cases we have seen.

Senator CANTWELL. All right.

Well, I think that this goes to the philosophy of how aggressive someone is going to be. Given Senator Snowe's question about the derivatives market and your answer—and I appreciate what you did at the New York Fed in setting up a system to deal with credit derivatives, I appreciate that—but do you think you missed the growing threat of the credit default swap market, because that was at the same time and it turned into a pretty big industry.

Mr. GEITHNER. I absolutely did not miss that. It was my life's work at the New York Fed from the beginning to try to make sure that we were getting the infrastructure in those markets more mature and stronger, and to make sure the institutions at the center of those markets were managing their risks more effectively. Everything I have referred to in response to Senator Snowe's question was about the credit default swap market, creditors in markets more generally—derivatives markets more generally, not just in credit.

Senator CANTWELL. So you think the system that you set up established the oversight for credit default swaps in an efficient way?

Mr. GEITHNER. Senator, what I said is that we did a range of things that were necessary and effective in making the system stronger. But we are going to have to take a broad, comprehensive look at the entire framework that surrounds derivatives and the incentives created for institutions within them. I was not implying or suggesting that it is done.

Senator CANTWELL. All right. Can I ask you one more question, because my time is up: do you support aggregate position limits for commodities and credit derivatives across all platforms so that we have effective management of this market?

Mr. GEITHNER. Senator, position limits have played an important role in the design of our exchanges and they have played an important role in preventing manipulation and in sort of containing risk in the system as a whole, and I believe they should be effective. I would be happy to work with you and listen to your concerns on how best to make them effective.

Senator CANTWELL. So do you support aggregate position limits across all commodities and across credit derivatives?

Mr. GEITHNER. I would support examining carefully how best to make sure that those limits to prevent manipulation and to ensure the basic stability and financial soundness of exchange and central clearing are adequate to support those objectives.

Senator CANTWELL. I know my time is up, Mr. Chairman. Thank you.

The CHAIRMAN. Thank you, Senator.

Senator Stabenow?

Senator STABENOW. Thank you, Mr. Chairman.

Welcome, Mr. Geithner. You and I have had an opportunity, which I appreciate, to talk about what is high on my list in terms of American jobs and manufacturing. I am not going to get into specifics in terms of the auto industry today, but we have had, for 8 years, an administration that did not understand or support what needed to be done to keep manufacturing jobs in the United States. I would like to know, just in general, what role you see for manufacturing in the economy and, if confirmed, how you will utilize multiple authorities that you have in order to be able to support this vital industry.

Mr. GEITHNER. Senator, I believe what the President deeply believes, that manufacturing plays a critical role in our economy. We have the most productive manufacturing center in the world, by many measures. That is a great tribute to our strength and resources as a Nation.

But the manufacturing industry in the United States is going through an extraordinarily challenging period, and I think an effective response, as the President believes, is going to require that we address rising health care costs, that we try to make sure that our workers in the United States come out of our education system with better skills to be able to compete better going forward, and that we have trade agreements to do a better job of protecting the interests of American workers and businesses.

I say this just because it is going to require a very comprehensive approach. You cannot look at it simply through the prism of individual provisions of the tax code. You need to look at it comprehensively, at the overall environment in which American businesses, not just in manufacturing but generally, operate.

I know the President is deeply committed to trying to make sure that we come with a comprehensive strategy, looking across all the provisions of policy instruments we have to try to address the objectives we share.

Senator STABENOW. Thank you. I know specifically that, as you talk about more direct support in the credit markets, we both know how critical that is as it relates to auto loans, as well as small business and manufacturers and so on, and being able to get, as many colleagues have talked about, more credit available for small businesses and for community banks. We have only had two banks in Michigan, as you and I have talked about, that have received any of the TARP funding, and none in southeastern Michigan where half the population is in Michigan. So, I appreciate your other comments on that.

One other question. We have not really talked about trade much, but that directly relates to manufacturing. The massive interventions by the Japanese government back in 2003 and 2004 to weaken the value of the yen helped to fuel one of the largest bilateral trade deficits in the United States in 25 years. In 2006, the deficit hit $88 billion, two-thirds of which was autos and auto parts. The misaligned yen subsidized auto exports in the United States for years, and frankly contributed to the loss of over 4 million good-paying American jobs in the last 8 years.

The yen has strengthened significantly over the last couple of months, reflecting market conditions. For the past 2 weeks, it has hovered at about 90 yen to the dollar. Last week, the Bank of Japan Governor told the press: “With the recession deepening, Japan could intervene in currency markets for the first time since 2004.” Many of us consider that move by Japan towards intervention at this time to be effectively trying to steal our stimulus. What action would you take, as Secretary, in the event that Japan moves to intervene in foreign exchange markets?

Mr. GEITHNER. Senator, that is, as you know, not just an important question, but an enormously delicate question. Let me just tell you what I believe, and I spent a large part of my professional life in positions at the Treasury responsible for exchange rate policy and these issues. I believe that it is very important for the United States and for the global economy that our major trading partners operate with a flexible exchange rate system in which market forces determine the value of exchange rates. I think that is good economic policy for us, and I think it is good economic policy for the vast majority of the other major economies. I look forward to working with you and your colleagues in how we address the many concerns that this very sensitive issue touches.

Senator STABENOW. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Rockefeller, you are next.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Thank you, Mr. Geithner. I look forward to supporting your nomination.

I am going to ask you something which is off the beaten path, but which has not been asked and therefore needs to be asked, because we are talking about spending money, and recovery, and stimulus, and the rest of it.

If you look at the American electricity situation, you make, obviously, the first conclusion: if you do not have electricity running, nothing works, including any of your computers. So you look at where we are now. We have about 7 percent coming from so-called "green" production, all of which I favor. You have wind, you have solar, biofuels, all of that. All of that. Add that all up, 7, 8 percent. You add on nuclear, which has its own particular problems. Nuclear, per se, does not bother me, but the concept of a Tomahawk right down a cooling tower bothers me greatly, in spite of how many steel rims you put around to protect it. That is about 20 percent. That is considered clean.

I spent some time talking with some people who have been appointed by our new President, and he pointed out, this one particular person at Office of Science and Technology Policy, that there are already at work in this country at least two power plants producing electricity from coal that come in at a carbon reduction rate which is right in the middle of where nuclear power is now. The nuclear power does not produce carbon dioxide. In other words, the emission rate, global warming rate, is the same.

I then go on to the fact that—I apologize to the ranking member, but I have always considered ethanol a waste of time, for 15, 20 years, and a waste of money and on its way out. Then I am looking for the great new discoveries that will take the place of this 51 percent that is now done by what is obviously dirty, and that is coal.

Coal is dirty. Clean coal is dirty. There can be no discussion on the use of coal on a long-term basis unless we bring in engineers from around the world and spend a lot of money to get them to be able to reduce it to wherever these two plants already are. Maybe we can just use their technology and then have to pay because of the spike in the price for those who have to pay that electricity bill and cannot afford to do so until competition begins to level things out.

There is no way to talk about a stimulus package, a healthy America, a functioning American economy when you have a 51-percent gap in the pie because we decide as I think Congress may try to do. The President has not been friendly towards clean coal.

He mentions it. Whenever he does, I put it in my mind, so much that I forget that he has not said it very often. It is not a very friendly administration that way. One person who likes this idea, incidentally, is Larry Summers, but do not try it on Carol Browner.

So we have this situation where you cannot run a country unless you find a substitute for what is now currently not clean coal. Nobody has found it. We have a 400-year supply in this country of coal. It does not make much sense to me not to try to use American ingenuity, international ingenuity, to reduce the carbon emissions to approximately where nuclear power is, whatever that is. It is considered clean, so therefore it has to be pretty good, 5, 6 percent, whatever. Four.

So my question to you, sir, is, why is it that we are not talking about putting this in the package, spending the money to answer what to me is overwhelmingly the largest—you can solve all the bank problems you want, pay executives fairly, regulate properly. It will not make any difference if you do not have electricity.

Mr. GEITHNER. Senator, I found you compelling on this in private and as compelling in public on this basic question. If I am confirmed to this job, I expect to be part of the team of people the President has brought in to help figure out a way to put in place an energy policy for the country that will meet not just the objectives that you laid out, but the broader imperative of using energy more efficiently and in a way that is less damaging to the environment. I think you are right that it is going to be very hard to do, complicated to do. The stimulus package now moving through the Congress has changed as it has moved through. We are open to suggestions on how to make that package most effective.

Senator ROCKEFELLER. You just got one.

Mr. GEITHNER. And I hear your suggestion, and I know you have made it to others. I will try to make sure it gets a fair and considered hearing.

Senator ROCKEFELLER. Thank you, sir.

The CHAIRMAN. Thank you, Senator.

I note for the record that Senator Bill Nelson is present at the committee today, and I welcome him here today. The organizing resolution to provide for new Senators to new committees has not yet passed. Maybe it will pass later today. There are three new Democratic Senators who will be on this committee once that organizing resolution is passed. There will be two new Republican members on the committee when that happens. I look forward to all members—all new members—joining this committee in full capacity as quickly as possible, and that will hopefully be later today, and future days.

But we welcome you here today and look forward to the time when you are a full participating member, Senator.

A question kind of on my mind, and on the mind of several others—I think Senator Schumer alluded to it—is, in this dance between taxpayers and investors, as you try to get the credit markets moving freely, how you are going to value these toxic assets and what procedures you are going to use. If you buy them up and put them into a so-called "bad" bank, I guess the basic question is, most people think you will have to pay a premium if you go that route as opposed to, for want of a better expression, nationalization. So my question is, how are you going to value those assets as you set up a so-called "bad" bank? What procedures are you going to use? It is a big question on the minds of many, many people, and certainly the minds of, I can say, members of this committee.

Mr. GEITHNER. Senator, I agree with you. It is an incredibly difficult thing to do and to get right, and getting it right will be central to the basic credibility of the program. But what we do will depend a little bit on the precise nature of the program we design and lay out. I cannot give you an adequate response to how we do it well without doing it in the context of the framework of the program we are going to lay out.

Obviously you can look at how the market is pricing similar securities. You can use model-based estimates by independent third-party evaluators to try to make a judgment about what the ultimate value of these things are. You can listen to supervisors give their own expectation and these kind of things. There is a range of approaches you can do, and all of them have risks, all of them are imperfect, they all have limitations. Most people believe, I think, you need to look at a mix of those type of measures, but it is very hard to do, but critically important to get right. But when we come up here and lay out for you the program we think is going to be most effective, we will explain how we think we can best solve this valuation problem so that we are protecting the interests of the taxpayers.

The CHAIRMAN. That was going to be my next point. Clearly, there is the impression here in the Congress that taxpayers have not been sufficiently protected in the initial rounds of TARP. There is, I think, a very deep concern that American taxpayers may not be sufficiently protected this next time around.

So, I would urge you to err a little more on the side of protecting taxpayers, because I think that will engender much more confidence in the country. A lot of investors who invested in these institutions did so at their own risk. American taxpayers are just trying to help us, help the government, help the country function economically, in a prosperous way, but in a fair way, fair to them. So I would urge you, actually quite significantly, to err on the side of taxpayers as you set up those valuation schemes.

Actually, I would like to submit for the record, Mr. Geithner, today's *New York Times.* I am sure you saw it. These are questions for you, questions by various people, for example, Charles Rossotti, and a question about the complexity of the tax code. Anna Jacobson Schwartz asked, again, what criteria you are going to use. Let me see. I think Mitt Romney asked about how we can effectively regulate the financial services industry. Robert Shiller of Yale asked what you mean by "resiliency when times are normal."

Greg Mankiw asked a question, too. Basically, if President Obama supports the estate tax, why should a person who leaves his money to his children pay more in taxes than a person with the same lifetime income who spends all of his money on himself?

Of course, there is a question of Roger Myerson, who basically asked, should a large financial institution incur higher reserve requirements or other regulatory penalties when they become too big to fail? Really, I think it addresses the basic question of "too big to fail," which I think is a huge question our country is facing.

I urge you very strongly to figure out ways where we do not allow institutions to reach the point where they think they are too big to fail, because then I think they take riskier positions and it is unhealthy to the system. Moral hazard questions arise much more significantly. I just urge you to try to find a way, as difficult as it is, to avoid that situation. Thank you.

[The article appears in the appendix on p. 69.]

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Yes. Say, would you do me a favor? The next time Senator Rockefeller talks to you about ethanol, would you remind him that Senator Grassley supports coal gasification and clean coal technology? [Laughter.]

The CHAIRMAN. I will do that.

Senator GRASSLEY. Well, thank you.

The CHAIRMAN. I will remind him.

Senator GRASSLEY. Thank you.

Mr. Geithner, I am done asking about your taxes now. The Treasury Secretary plays an important role in setting tax policy. As Finance Committee members, we would like to get your views on the trends in revenues. CBO reports that, over the past 40 years, taxes as a percentage of GDP averaged 18.3 percent. In the year 2000, Federal taxes took 20.9 percent of GDP, a record post-World War II level. Individual income taxes were at even more dramatic levels. CBO reported individual income taxes to be 10.3 percent of GDP. I have a lot of other statistics, but I think you know what I am talking about.

Now, we hear a lot of criticism from those who opposed the bipartisan tax relief plan of 2001 and 2003—and I want to emphasize "bipartisan." One of the main criticisms is that we cut income taxes too much. That is, the allegation is that the bipartisan tax relief plans gutted the Federal revenue base.

I was pleased to see Drs. Furman and Goolsbee indicate in their *Wall Street Journal* op-ed of August 14th of last year that an Obama administration would seek to keep the revenue base at or close to the historic averages of GDP. So, three questions, and I am going to ask them all at once.

Do you agree with Drs. Furman and Goolsbee? Do you disagree with those who argue that the only path to fiscal discipline is to maintain record levels of Federal taxation as a percentage of the economy? Lastly, do you recognize that there is a down side to future economic growth if we return to record levels of Federal taxation?

Mr. GEITHNER. Senator, I agree that you need to look very carefully at the overall tax burden the tax code imposes on American businesses and workers, and there is a point at which it would cause damage to future growth in a way that would be troubling, I think, to all of us. I think you are right that the current level of tax revenues and GDP are slightly below the historical average, partly because of the tax changes made over the last decade, but significantly because our economy is going through such a deep recession.

I think, as we look at changes to the tax code going forward, we have to be very careful to make sure we give the American people confidence we are going to bring our resources and our expenditures more into balance. As I said in my opening statement, as a country we need to make it clear to people we are going to be able to live within our means in the future, and we are going to have to look at a whole range of difficult things in that judgment.

But the test for changes to the tax code should be: what impact are we going to have on incentives to save, invest, and create jobs; are we being fiscally responsible; and are we producing a system that is going to be simpler, easier to comply with, and provide a level of fairness that the American people expect?

Senator GRASSLEY. Yes.

My next series of questions, I might not be able to get all the way through, but I will stay around and do a third round.

As you and I discussed in my office, I brag a lot about the fact that I conduct what I consider vigorous oversight of various executive branch agencies. I have done this during my entire time in Congress. I consider it a constitutional responsibility of Congress. But I also consider myself an equal opportunity overseer. I believe that sunshine is the best disinfectant, regardless of which party controls the Congress or which party controls the White House. The primary way I conduct oversight activities is to write letters asking detailed questions and requesting documents.

Responses to my letters and document requests are critical to doing this oversight. Many Federal agencies have a stated policy—now, this is where it gets down to the nuts and bolts—that treats information requests from a chairman—and I was chairman, but now we have a different chairman, a person who works very closely with me, thank God—of a congressional committee and subcommittees differently from a request from a ranking member, like now I am a ranking member.

Specifically, the policy treats only requests from chairmen as entitled to documents otherwise covered by law. But that stated policy finds no support in the text of any other law or Senate rule. Furthermore, it is for the Senate and its committees and subcommittees, and not for the executive branch, to determine who may speak for them.

Given my history of oversight, you can be sure to receive letters from me during your tenure, if you are confirmed. I hope that, like your predecessors, you will commit to responding to my inquiries and document requests in a full and timely manner. That is my question to you: would you do that?

Mr. GEITHNER. Yes.

Senator GRASSLEY. Thank you very much.

I think I will quit there, because we go into other things at this point.

The CHAIRMAN. Senator Snowe, you are next.

Senator SNOWE. Yes. Thank you, Mr. Chairman.

I wanted to follow up with you, Mr. Geithner, on the original purpose and objective of the rescue plan that we enacted in late September and early October, which was obviously the purchase of illiquid assets. Treasury's shift away from that objective undermined the confidence of the American people. It looks like TARP is being implemented in an ad hoc fashion.

Now, I would like to explore with you what your thoughts are, because obviously you played an instrumental role in devising this rescue plan. Why did the Treasury fail to move forward with purchasing illiquid assets?

Second, in the examination of the Congressional Oversight Panel's report that was recently issued, there really was a sharp condemnation and rebuke of the Treasury Department in its failure to provide transparency and accountability. In fact, Treasury did not respond to some of the questions and did not have a vision for the program. Treasury did not have a strategy. It could not explain why it did not purchase illiquid assets, other than saying that it was too complicated to do so. Moreover, Treasury failed to explain why providing a massive infusion of capital into banks would be more effective.

So we need some explanations, because now we have approved the additional $350 billion, and I would like to know how you believe the new administration should proceed. But more importantly, why did the Treasury Department—and you were part of that rescue plan design at the outset—move away from purchasing illiquid assets? In retrospect, would it have been more successful and effective to purchase illiquid assets from the banks?

Mr. GEITHNER. Senator, let me start where you ended. I do not believe—well, let me do the affirmative. I believe that the actions taken in October by the Treasury Department and the Chairman of the Federal Reserve and the FDIC were absolutely essential to trying to arrest the risk of a much more damaging, deeper deterioration in our financial system. I think that was the right decision at the time. I think if that had not been done at that time, I think we would be facing really a catastrophic failure in our financial system. So I agree that that was the right set of proposals to make at the time.

But let me just step back for a second. I was not Secretary of Treasury then, I am not Secretary of Treasury now. If you confirm me to be Secretary of Treasury, I will work very hard to meet the concerns you expressed, and the American people have expressed, your colleagues have expressed about how this program has been implemented.

As I said in my opening statement, I think you are right to say there has been confusion about goals, concern about transparency and accountability, and really concern about, again, whether we are protecting the interests of the taxpayers, as we have this great obligation to do. I will be very careful in trying to make sure that our program meets those basic concerns.

I think it was clear in the summer, if not before, that the United States needed to have three types of authorities it did not have coming into this crisis: one was the authority to put capital into financial institutions; one was the authority to provide a better, more effective mix of insurance guarantees, and perhaps asset purchases to help deal with this broad legacy asset problem across the system; but it was also critical for our country to have the capacity to prevent and deal with catastrophic failures by non-bank financial institutions. All those authorities were very critical.

The Emergency Economic Stabilization Act that was passed by the Congress back then provided some important new authorities in that area, and it was absolutely central. But again, I think the actions taken then, although they were not primarily my responsibility then, were absolutely central and they were the most effective use of that authority at that time.

Senator SNOWE. Well, do you understand why the public's confidence has been eroded, and certainly ours, in terms of the Treasury putting forward the primary objective to buy those assets? The Congressional Oversight Panel was abundantly clear in its criticism of the Treasury Department for failing to explain why it did not buy those assets and making the case for why capital injections into banks was a more effective strategy. Moreover, it is unclear if the current approach is even working, and it does not seem to be working at this point.

Do you think that it is working?

Mr. GEITHNER. I absolutely believe that the actions taken have made a very substantial impact in avoiding the risk of a much more damaging de-leveraging of the financial system, and if those actions had not been taken we would be living today with a financial system that was causing much more damage to recovery and growth than we are seeing.

But you are right to say the system is still under substantial stress, and it is going to be very important, as we do a recovery package, to do a more effective job of meeting your concerns and those of the Congress and the American people so that we can demonstrate we are going to use these resources carefully and wisely going forward.

Senator SNOWE. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Snowe.

Senator Ensign, you were unable to do your first round, so you are next.

Senator ENSIGN. Thank you. I appreciate that. I had a leadership meeting I had to attend, so I appreciate you letting me do that.

I have a couple of questions. First of all, I do not know if you have seen the Congressional Budget Office scoring of the stimulus package that the House put out. What I would like you to address, very briefly, if you could, is on the spending side of it, most of the effects are in the out-years, especially the investments in infrastructure. Those, the vast majority of them, are spent—on the energy side, only 7 percent I think is spent in the first 2 years; on the rest of the infrastructure, I think less than half is spent in the first 4 years.

With scoring like that, how does that stimulate our economy? Hopefully, 2 years from now we are not dealing with the financial crisis that we are dealing with today. I think we are all hoping we are out of this thing by then. So how does that square with actually spending $825 billion to stimulate our economy, which everybody said, the economists that I have read said, you need a large stimulus package? Well, if only a tiny amount of the stimulus package is actually going into the economy in the next 2 years, how does that help stimulate our economy?

Mr. GEITHNER. Senator, a very important concern. That has shaped the design of the entire package. You have to look at the entire package, though. The entire package includes a substantial amount of tax incentives that should work very, very quickly in affecting behavior.

Senator ENSIGN. On that, in last year's tax rebates that were sent out, in the analysis that I have seen, only 12 percent of that actually went into the economy, actually got spent. You are trying to drive the consumption end of it.

So part of that is, do you think that what has been proposed here—because the biggest part of this is actually sending checks out—is actually going to work differently this time than it worked last year?

Mr. GEITHNER. Senator, a very important concern. But again, the combination of business tax incentives and the tax reductions for working Americans is designed in a way to have substantial and very quick-acting effect on overall economic growth and behavior.

You are also right, that the spending provisions—you want to make sure that they are going to spend that as quickly as possible. We want to see as much spending, carefully designed, efficient spending, go out quickly so that you have more jobs created right away.

We have tried to be very careful to make sure that the spending provisions and investment provisions of the package will have that quick-acting effect, and to limit the risk that you have, what we call very long tails, on these basic commitments. The President and his economic team are looking at a range of ways to try to make sure that we are spending these resources more quickly, while still being very careful and very open and transparent about them.

We believe we are going to be able to do a substantially better job than the government has done in the past in making sure that the infrastructure and energy-related spending that the CBO report referred to is going to spend out more quickly than was true in the past. But you have to look at the overall package as a whole. The overall package is large and quick in the impact that it will have on the economy.

Senator ENSIGN. How will the checks that are sent out by the government in tax rebates—why is it going to be different now than it was last year?

Mr. GEITHNER. Two reasons. One is this is, although it is a 2-year reduction, it is part of what the President hopes to become a permanent change in taxes for those workers, American workers. That will help, too. It also comes in the form of a visible immediate reduction in withholding that is sustained over that period of time. Because of those two reasons, we think it will have more impact on spending than the package you referred to last year.

Senator ENSIGN. And finally, do you, just philosophically when you have studied—we obviously have examples in the past of severe economic times in our country, and other countries, Japan during the 1980s and 1990s, and our Depression era. Do you think that the New Deal is what brought us out of the Depression?

Mr. GEITHNER. Senator, I believe the consensus of historians and economists is that——

Senator ENSIGN. It does not matter, the consensus. What is your opinion? Because you are the one who has to be confirmed today.

Mr. GEITHNER. I share the belief that it was only when we had in place very, very substantial fiscal stimulus and a much more effective plan to stabilize the banking system, and a broad change in our exchange rate regime at that time, did we have a set of policies that were going to be effective in bringing us out of depression. As you know, that took a very long time. We got there later than we should have as a country, in part because of some conscious judgments made, including by the Federal Reserve, frankly, to pull back from supporting recovery too soon.

Senator ENSIGN. How do you explain the 1937 Depression within the Depression, when a lot of those policies that you just mentioned were already in place?

Mr. GEITHNER. Well, again, I think if you look back in the record, like in Japan, as you referred, part of the problem was a bit of early shift towards restraint before growth was strong enough, and that is one of the reasons why the path to recovery in the United States in the 1930s and the path in the 1990s was so slow and so protracted, and it underscores the importance of doing a lot soon and staying with it.

Senator ENSIGN. Did you think tax policies had anything—tax increases during the 1930s, 1937—had anything to do with the Depression within the Depression?

Mr. GEITHNER. Well, I do think there were a lot of aspects of the government's response in the 1930s that made the recession worse and last longer.

Senator ENSIGN. Did the tax increases in 1937, in your opinion, add to the Depression within the Depression?

Mr. GEITHNER. Senator, to be honest with you, I have more familiarity with the monetary policy and mistakes of the period of time and those in the financial system than I do with the precise dimensions of the tax and spending decisions then. Again, I think the overall consensus, which I share, is that later mistakes were partly of the nature of moving too quickly to pull back support at a time when conditions were very fragile.

Senator ENSIGN. All right.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Lincoln, you are next.

Senator LINCOLN. Thank you, Mr. Chairman. I appreciate you having us all here today to move quickly.

Mr. Geithner, thank you for joining us. We appreciate your willingness to be here. We do all know that our Nation's economy is in dire need of being turned around, and we are looking forward to working hard to make that happen.

I have also wanted to say I appreciate how much time you have given me to visit in the last couple of weeks, the discussions that we have been able to have. I think you certainly know from my previous conversations that I have been very, very frustrated with the way that the Troubled Asset Relief Program has been implemented. We have handed out tremendous amounts of taxpayers' dollars to our Nation's largest financial institutions, yet there has been little or no relief that has trickled down to mainstream America, the businesses, the consumers out there, the homeowners.

That has brought great concern to us in Arkansas. In fact, these institutions have actually tightened their credit, with little or no effort to kind of work with those consumers or small businesses. Small businesses in my State have seen their finances cut off and their loans called under threat of collection. Homeowners have seen little help in terms of refinancing.

As the head of the New York Fed, you have certainly been intricately involved in the creation and implementation of TARP. I know my colleague Senator Wyden asked this question probably in one form or fashion, but really reflecting on, had you been the Treasury Secretary during that process, what would you have done differently?

I guess, more importantly, will the program stay on the same track, so to speak, in the coming weeks and in what we see ahead of us? Are you going to take it in a new direction? Hopefully you will share with me some of those new directions.

Mr. GEITHNER. Senator, the President of the United States is committed to fundamental reform of this program, and he wants to make sure that we effectively and credibly address all the concerns raised, by you and many others, about the way this has been done so far.

As I said earlier, the critical test of this program will be whether we do enough soon enough to make banks strong enough that they can lend and help make sure that credit is flowing to the parts of the economy where it can have the most impact, including to small businesses. We are going to have to do that, again, with carefully designed conditions to protect the taxpayer and with a much more detailed set of provisions for transparency and accountability.

The President's Director of the National Economic Council sent two letters to the Congress last week with some recommendations for how we could do that. We are going to take a careful look at the recommendations of the Congressional Oversight Committee, and all the other people who have looked at this stuff, and we will look carefully at those and we will adopt the ones we think are most effective in that area.

Senator LINCOLN. Good.

Mr. GEITHNER. But we understand and share the concerns about the amount of impact we have seen from this so far, and we will do our best to try to meet those concerns with a set of reforms that will make it more effective.

Senator LINCOLN. Well, I hope so. With all due respect, I do hope that it will not be the same track, so to speak. I hope that there will be a new direction in how this happens. I also hope that—you speak of details—when those details come to us, that you give us an opportunity to really know the details of what your intentions are. It is extremely hard to answer to our constituency if we do not have more details, if it is just mostly rhetoric.

Two last questions, and you can answer them however you would like in the time I have left. We desperately need some answers for our small businesses. I have been very concerned about the lack of detail in terms of how we are going to approach small businesses and what we are going to do for them out of this TARP money.

They need it. They are the engines of our economy, particularly in rural States, and it is absolutely essential, I think. So I hope you can spread some light on the steps that you will take to make sure that small businesses across this Nation will quickly receive some help that they need.

I guess the last one: did you see the storm clouds coming? We got this call in September of this unbelievable urgency, that the sky was falling, and that we immediately had to give this unlimited authority and these huge amounts of taxpayers' dollars. It was amazing, because we had met with the Secretary of Treasury, as well as the Chairman of the Federal Reserve months ago, and all asked the question: what can we do to help?

In your seat as chairman of the New York Fed, did you see those storm clouds coming? I guess, really, what could have been done in the months or years ahead of this crisis that would have helped us out a little?

Mr. GEITHNER. Senator, thoughtful, important questions. Let me do small businesses, first. Four quick things. The recovery and reinvestment plan has a set of very important, powerful provisions that will help directly address the kind of challenges facing small businesses.

We believe that the resources, the authorization Congress gave the administration back in the fall and last week should go to community banks so that community banks can also help work with small businesses to meet their credit needs. We are open to ideas, and are looking at and carefully thinking through changes to existing small business credit programs to see if we can make them more effective in this basic challenge. I am open to suggestions from you and your colleagues about how best to do that.

Finally, we believe we can put in place a more powerful set of financing programs that will help get the credit markets that are critical to small business lending going again, too.

But I think, as I said to your colleague, that will be a critical test of the effect of this program going forward, but it is going to require that we make sure that banks are strong and able to lend as we try to address the direct credit needs of those parts.

Now, on your second question about the storm. This crisis began not in September, but it began back in early 2007. I was at the center of efforts to try to promote a much more aggressive response early, not just on the housing side, but in the financial sector in particular.

I was very involved in trying to make sure that the Central Bank, in particular, was moving aggressively to make sure that monetary policy was getting to a better place where it could support recovery and that we were encouraging banks to raise capital necessary to play a critical role in recovery.

I did work very actively to try to encourage the administration to get the broader authorities that we thought were going to be necessary to address this. But this did not begin last September, it began way before that. Although policy did move, it did not move aggressively enough across the entire board. We are living with the consequences of a deeper recession, in part, because of that.

Senator LINCOLN. Thank you.

The CHAIRMAN. Senator Wyden?

Senator WYDEN. Mr. Geithner, if confirmed, your department will have a very large role in American health care. Suffice it to say, there are scores of breaks and incentives in the code. In fact, the biggest chunk of money in America's health care system goes out the door through the Federal tax code. It comes to at least $247 billion a year, and, as you and I talked about, it rewards inefficiency and also benefits the most well-off in our society.

Now, Chairman Baucus, to his credit, puts the reform of these Federal health tax rules on the table. They are on the table now because of the chairman's very good white paper on health care. I believe that it is possible to reform the Federal health care tax rules and honor the pledges that our new President made on health care. In other words, the new President said, I want to make sure everybody can keep the coverage they have if they want, and he said, I do not want to clobber the middle-class people with new health care taxes.

So my question to you is, when you get your call from Tom Daschle, our health care czar, and he asks you whether you are open to reforming these Federal health care tax rules, as the chairman suggests in the white paper, a lot of us are interested in—if Senator Daschle calls you and says, are you open to reforming these Federal health care tax rules, what will your response be?

Mr. GEITHNER. If I am confirmed by the Senate and he calls me, I will say that I am open to looking at changes to the tax treatment of our health benefits so that we can achieve the President's objective of expanding access and improving care in a way that is fiscally responsible over time.

Senator WYDEN. Well, I appreciate that answer. We are going to be following up with you, and I am going to be working very, very closely with our chairman on that, and our colleagues on both sides of the aisle.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator, very much.

Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

Now I can get to some questions. Mr. Geithner, precisely when did you first learn that you were required to pay to the IRS the allowance for Social Security provided to you by the IMF that you applied for each year? Precisely.

Mr. GEITHNER. Senator, the first time I learned that I had not met my obligations to pay self-employment tax, this was when I received the notice from the IRS auditor that they had conducted an audit of my tax returns. As I said, I took that extraordinarily seriously. That was the first time I was made aware that I had not complied. Until that point, I felt I had complied.

But I want to just emphasize——

Senator BUNNING. I have a lot of questions.

Mr. GEITHNER. Can I say, quickly, one thing, though? I went back and looked at all that material and, as I said in my opening statement, it was very clear. I had many opportunities to catch that initial mistake. Of course, if I had realized earlier I was not complying, I would have moved more quickly to comply.

Senator BUNNING. Well, let me get to that.

I have found that the IMF goes to great lengths to make sure that employees comply with their U.S. tax obligation. One current IMF employee, who describes himself as a "lifelong Democrat," called my office to express his disbelief that you did not know about it. Every year, you had to file a written request for a gross-up payment to the Social Security tax.

I have one of the statements you signed right here. It says, "I hereby certify that I will pay the taxes for which I have received tax allowance payments." You provided this to the committee. But why did you not provide it to your accountant when he was preparing your returns for the 2003 tax year?

Mr. GEITHNER. Senator, as you said, I provided that form to the committee. I absolutely should have read it more carefully. I signed it each year. I signed it in the mistaken belief that I was complying with my obligations. And you are right that this is my responsibility. In those years that my accountant prepared my returns, he also did not catch my error. But those are my responsibilities, not his.

Senator BUNNING. But you did not furnish this to your 2003 tax—you did your own in 2001 and 2002.

Mr. GEITHNER. I did my own in——

Senator BUNNING. Then you got an accountant.

Mr. GEITHNER. I did my own in 2001. I filed an amended return in 2001 that was prepared by a tax preparer. In 2002, I did my own. In 2003 and 2004, an accountant prepared my returns. I believed, Senator, I was giving my accountant all the necessary information so that he could help me prepare my returns. But as I said, it was my responsibility. The critical mistake I made was at the beginning, that first year, and because I did not catch it after that, I kept making it.

Senator BUNNING. This individual called me and explained that you were counseled to pay self-employment tax, but you and your accountant later ignored that advice. Can you explain why this person—why did you ignore her advice at the IMF?

Mr. GEITHNER. Senator, I relied on the judgment of my accountant. I should not have relied on that judgment. That is my responsibility, not theirs.

Senator BUNNING. Would you have paid your 2001 and 2002 tax had you not been nominated to be the Treasury Secretary?

Mr. GEITHNER. Senator, as I said initially, I should have asked more questions when I concluded that audit at the time, and I did not. When I think back on that, I regret not having done that. But I should have done it at that point.

Senator BUNNING. Let me get on to currency in China and the global trade imbalance. Mr. Geithner, in 2004 you gave a speech in Singapore in which you expressed concern that Asian reserves had reached $2.5 trillion. Last year, we had the largest trade deficit in history with China, and Asian reserves had reached nearly $3.2 trillion. China's reserves stand alone above $2 trillion and are counting. Experts say the yuan is still undervalued by 30 percent.

Last year, President Obama co-sponsored legislation that I introduced with Senator Stabenow to create a WTO-consistent trade remedy for manufacturers harmed by currency manipulation. I also introduced legislation with Senator Stabenow to require the Treasury Secretary to cite China for currency manipulation under the 1988 Trade Act.

Do you believe that currency manipulation by China remains a significant issue today, and what would you do to address it as Treasury Secretary?

Mr. GEITHNER. I do believe that it is a significant issue. As I said earlier, I believe it is important for the United States and for the global economy that our major trading partners operate with a flexible exchange rate system and that market forces determine the level of those exchange rates. I think that is very important. I will, when I have some time to think through how best to achieve that objective, look forward to a chance to work with you and your colleagues in the committee on how we do that.

But you are right to emphasize the President's commitment to this. This is an important issue for the country. It is a difficult, complicated question to work through.

Senator BUNNING. My time has expired. I have about eight more questions that I will submit to you, and I would appreciate you responding.

Mr. GEITHNER. Absolutely, Senator.

Senator BUNNING. Thank you.

The CHAIRMAN. Thank you, Senator Bunning.

Senator Kyl, your presence has now been noted.

Senator KYL. Thank you, Mr. Chairman. I apologize.

The CHAIRMAN. You missed the first round, you missed the second round.

Senator KYL. That is all right.

The CHAIRMAN. If you want a full 10 minutes, you can take it.

Senator KYL. Yes. Thank you very much. I have at least that much time.

Mr. Geithner, I am a little astonished that you would, in your opening statement, assert that the American recovery and reinvestment plan will meet the test that you set out for its success. The two key elements you discuss are providing powerful and direct support to help people get back to work and to encourage private investment.

Now, the two biggest components of the package are the component for a rebate for taxes and the infrastructure and energy spending side. Let us take both of those.

As to the first, you and I discussed in my office—and we quibbled a little about the exact percentage—but I quoted you Marty Feldstein's statement that recent government statistics show that only between 10 percent and 20 percent of the previous rebate dollars were spent. You said you thought maybe it was closer to the high side of that than the 12 percent that I had cited. But even if it is, let us say, 20 percent, that at least was in one lump sum.

People could see the $500 or $600 that they received. This is going to be something on the order of 10 bucks a week, or whatever, in withholding. What makes you think that with all of the previous tax rebates, including the most recent one last year not providing stimulus, that somehow or other this most recent one will, and therefore meet the test that you laid out?

Mr. GEITHNER. Thank you, Senator. Our view is that this is designed in a way that will help improve the prospects that a larger portion of the tax benefit is spent. There are two reasons why that is the case. The first is, this is an initial down payment on a reform that the President would like to make permanent and pay for. Our hope is that, with the expectation this is going to be an enduring change in withholding and tax treatment for the Americans that are eligible, it will have a more powerful effect on spending.

The second reason is that, because this is designed in a way, rather than getting a one-time check in the mail initially, a lump sum payment, people will see a change in withholding statements every week and they will have the reasonable expectation that it will be continued. For those reasons, we think it will have more impact on spending behavior and have more effectiveness than the stimulus package that was designed earlier last year.

But I understand the concern people raised about it. None of us will know for sure what the impact on behavior is going to be, but it is designed very much to address the concerns you began with.

Senator KYL. Yes. I appreciate that. It is all a guess. Let me cite the statement that Larry Summers made. We discussed this as well. He wrote the following: "Investments will be chosen strategically based on what yields the highest rate of return for the economy." It seems to me that this fails to meet that test either.

Let me turn, though, with that specifically in mind, to the CBO analysis of the infrastructure. You are familiar with that analysis and report of just a couple of days ago. For those who may not be familiar with it, just a couple of their conclusions: CBO estimates that less than half of the construction funds in the stimulus bill will be released into the economy over the next 4 years. Less than half within the next 4 years. Less than $4 billion would reach the economy by September of 2010. So, most of the infrastructure money would not even hit the economy until, we assume, it is already beginning to recover.

On the energy side, which is also high in terms of spending, CBO estimates that only 7 percent of the energy money will be spent within a year and a half period of time. How is that going to provide stimulus?

Mr. GEITHNER. Senator, I had a chance to respond to some of those concerns while you were out of the room, but I just want to repeat the formulation I said before. I think you have to look at the overall package. The overall package of tax changes and investments and aid to States, in our judgment, based on very substantial consultations with a broad range of economists and people in the Congress, we believe that package will offer very substantial support quickly to the economy as a whole.

Senator KYL. If I can just interrupt you.

Mr. GEITHNER. Yes.

Senator KYL. So there is something in there that will—I mean, you acknowledged CBO's analysis. I guess you have no reason to contradict it.

Mr. GEITHNER. No, no. I want to respond on that.

Senator KYL. Well, would you? That is what I am asking specifically.

Mr. GEITHNER. Yes.

Senator KYL. I am going to get to the other items. What you are saying is, there are other items that might kick in earlier. I am going to ask you what they are specifically, but tell me why you think CBO is wrong, please.

Mr. GEITHNER. I have not read very carefully the CBO concerns, but my colleagues have. Our judgment is that we can do a much better job than the government has done in the past in getting those resources out the door quickly. Of course, we want to be very careful as we do it not to waste resources. But they were making a set of judgments based on how this had been done in the past, and the President said publicly, and his team is looking actively at ways to get those resources out the door more quickly.

I think we all share the objective that we want to do things that are going to have substantial support quickly, add to things that make our economy more productive in the future, without adding substantially to long-term expectations for expenditures that will be harder to meet.

Senator KYL. But here is the point. Maybe it is not an order of magnitude, but it is such a significant difference from what you are trying to accomplish: less than half the money over a 4-year period. Does it not seem implausible to you that marginal changes in how you can improve getting the money out the door could conceivably make up for that kind of a deficit?

Mr. GEITHNER. We think we can do substantially better than the CBO estimates suggest. The President wants his team to do better. He is committed to do it. We are going to do everything we can. We are open to suggestions on how best to do that. But we share your concern that in designing the package—again, we want to have strong force quickly. Again, I think if you look at the overall package——

Senator KYL. All right. Well, let us get to the overall package, because you are kind of falling back on the defensive, well, maybe this is not going to be very immediate, but there are other things, how to transfer payments to States. How does an increase in Medicare or Medicaid spending give you the return on investment that Larry Summers was talking about in terms of jobs and investment?

Mr. GEITHNER. Senator, I understand your concerns about those proposals. But our judgment is, those proposals will help reduce the need for States—without that support, States will have to make very, very, very substantial reductions in critical government services at a time when the economy cannot withstand those effects. So that scenario where we believe you can have very, very substantial support to the economy, both in terms of employment and expectations for businesses quickly——

Senator KYL. Well, the classic Keynesian concept here is that, where there has been a deficiency in spending or a gap in spending, that government, in times of recession, needs to fill that gap with more spending. That is the idea here. But States and localities have been increasing their spending dramatically over the last 4 or 5 years; in 2008, by an average of 7 percent, and in a lot of States it was a lot more than that. So it is kind of hard to argue that more spending capability for the States is going to fill a gap in spending by the States and localities, is it not?

Mr. GEITHNER. Well, Senator, I think in the absence of those provisions, I think it is absolutely clear States will have to cut back very, very dramatically, and that will raise unemployment and reduce demand for goods and services created by American businesses. So I think it really is essential to do and should be a part of—and would be, I think, a part of—any credible fiscal plan to help bring recovery back.

Senator KYL. So rather than encourage States to try to become more efficient and to cut back on things that in tough times you just cannot afford to do, you intend to send them the money so they will not have to make those tough decisions.

Mr. GEITHNER. No, I do not think that is a fair way to characterize it. I think of course we would like these provisions to come with conditions that will improve confidence in their citizens that this money is being used wisely, but the critical priority for the country now, I think, is to make sure that the government is providing enough support to get growth back on track faster. I think these aid to States provisions are an absolutely important part of that program.

Senator KYL. Well, one of the ideas with the bail-out—I mean, this is essentially what that would then be—is that these be loans. At least the American taxpayers get their money back. Would you be supportive of conditioning some of the support to the States or localities on being eventually repaid to the Federal taxpayer?

Mr. GEITHNER. Senator, I think that is an interesting idea. I do not know whether that is practical. But I want to reinforce the President's commitment that, as these provisions are considered by the Congress, that we are open to suggestions on how to design this package in a way that is going to be most effective in achieving this objective of getting the economy back on track. So we will be open to any suggestion. We have tried to consult very widely. If there are ways we can meet this objective more effectively, we would like to try to do that.

Senator KYL. All right. Well, that is a suggestion. Now, what is your response to it?

Mr. GEITHNER. Senator, I do not know if that is practical in this context. We have tried to take advantage of the fact that there is an established set of mechanisms Congress has used in the past to provide aid to States in recessions. We are trying to use those and adapt them to make them more effective. I do not know why that idea has not been adopted in the past by the Congress. I would like to think about it a little more carefully.

Senator KYL. Excuse me. Some of the money is just outright grants. It is not tied to a Medicare or Medicaid formula, and so on. Correct?

Mr. GEITHNER. That is correct. That is correct.

Senator KYL. All right.

Mr. GEITHNER. But again, the overall thrust is to try to make sure that States are not forced to cut back dramatically at a time of national weakness and peril.

Senator KYL. One of the things that the President announced as a goal was that about 40 percent of the so-called "stimulus package" would be tax relief. Now, one can argue about whether—in fact, the way it is scored, the proposal on the tax rebates is scored as "spending." But what percentage of the packages introduced in the House of Representatives do you estimate to be——

The CHAIRMAN. If you could answer that fairly briefly, too, I would appreciate it.

Mr. GEITHNER. Sure.

The CHAIRMAN. Thank you.

Senator KYL. The percentage number.

Mr. GEITHNER. Senator, I am not sure I am going to get the percentage exactly right, but somewhere in the realm of 40 percent is in the provision that we would call tax incentives and tax changes.

Senator KYL. Well, 40 percent?

Mr. GEITHNER. I do not want to get the math wrong. But a substantial part of the package, the framework we proposed, I think what emerged from the House's committee now is consistent with that, has a very substantial part in the form of tax incentives and tax changes.

Senator KYL. All right.

Mr. Chairman, I have had the equivalent of two rounds. I am willing to wait for my third round.

The CHAIRMAN. All right. Thank you.

Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman. And thanks for having a second round.

Mr. Geithner, I wanted to emphasize how important this small business issue is, and look forward to working with you. We will have suggestions. A bank in our State, in Vancouver, WA, was just taken over by the FDIC, by a bank from Oregon that had just received $214 million from TARP, obviously to help stimulate loans. They are taking over the deposits of the Washington bank, but it seems like the lines of credit for small businesses are frozen.

So this is a real issue, where these small businesses during this time period—and you mentioned, obviously, the asset-backed securities and lending program, but some of those things are not in place. They are not in place right now so, while these larger banks are getting the lifeline, these small businesses are not getting the line of credit that had been previously established. So we need to act rapidly to fix that problem, so we will look forward to working with you.

I want to go back to this regulatory reform issue, because it is so important. The former SEC chairman, Mr. Levitt, basically described the CFMA, the Commodity Futures Modernization Act, at least when he was talking about derivatives and credit default swaps, as a failure. Would you agree?

Mr. GEITHNER. Senator, a lot——

Senator CANTWELL. I am sorry. I am sorry. He used the word "mistake." Was a mistake.

Mr. GEITHNER. Was a mistake.

Senator CANTWELL. Yes.

Mr. GEITHNER. I do not think I agree with that. But I do agree that we are going to have to take a very careful look at the whole comprehensive framework of requirements, regulations, constraints, incentives that exist for the institutions that play a central role in those markets.

We want to make sure that the standardized part of those markets moves into a central clearinghouse and on to exchanges as quickly as possible, and that is now happening because of the work we have supported. We will look at a range of other changes too to try to make sure these markets function the way we need, with more benefit in terms of capacity to hedge and less risk to the system as a whole.

Senator CANTWELL. Why was it not a mistake?

Mr. GEITHNER. Senator, I guess I think that it is just a more complicated set of problems that are created here. We have a situation where institutions at the core of the system did not understand and adequately manage the risks they faced and exposures through those products and others. They did not understand the effects these things had on a bunch of other important markets for credit and equity markets as a whole. But again——

Senator CANTWELL. So do you support the full regulation of credit default swaps?

Mr. GEITHNER. I would support taking a careful look at how to put in place a more effective framework of regulation over the participants in those markets and the markets themselves. I am open to suggestions on how best to do that, but we need to get it right. It is going to be a really complicated, difficult thing to do.

Senator CANTWELL. What scares you when I say regulation of those tools on the exchanges? What is bothersome about that?

Mr. GEITHNER. Well, as I said, I am fully supportive of moving the standard part of those markets on to central clearinghouses and exchanges. I think that is really important for the system and will help reduce risks in the system as a whole. I think that is necessary, but not sufficient.

Again, we are going to have to look at the incentives the capital requirements create for how much exposure through these instruments institutions hold. We need to look at how the hedges are treated through regulatory capital and accounting. It is an enormously complicated set of questions. My resistance is not to the objective, it is just that I want to make sure we get it right.

Senator CANTWELL. And my resistance here is that I am tired of these exotic tools. There is nothing exotic about what has happened to our economy. There is nothing exotic about these people who have lost their jobs. This is just the exotic tool of today, credit default swaps. What is going to be the tool of tomorrow that someone else uses? So what I want to know is that this administration, which I am so excited about—I love the fact that you just said "the President of the United States."

I know the President of the United States, in this new capacity, is going to do great things. But I want to know that this larger issue of the financial markets being out of control and the fact that they can create exotic tools faster than we can regulate them is a tremendous problem for our economy. I want to understand how we are going to fix that and not wait for the next tool to come along.

Mr. GEITHNER. I completely agree with you. I think you said it very well, which is that innovation got ahead of risk management and restraint and prudence. It is always the case; it is too slow to catch up. A critical objective, and I know the President believes in this deeply, is to try to make sure that our system is designed with a set of rules to make that less likely in the future.

Senator CANTWELL. So how are you going to do that? I think Professor Stiglitz or somebody said, well, have every new tool come through a clearinghouse before it is implemented. So, I am just suggesting that as one idea that has been thrown out.

Mr. GEITHNER. Again, we will——

Senator CANTWELL. But how do you approve these before they get into action? Because a $62-trillion credit default swap market that blew up this whole thing is definitely not the way to go.

Mr. GEITHNER. Well, Senator, we will be open to any suggestion we think will work. We will consult very carefully and widely. I know the President wants to come to the Congress quite quickly and lay out a framework of recommendations for reforms. If you confirm me for this job, I will play a central role, working with my colleagues in the SEC, the Fed, all the bank supervisors, the accounting profession, et cetera, so we can meet the basic objective you laid out to make sure that innovation in the future does not get so far out in front of the checks and balances in the system, that we are left with this level of risk and fragility in the system.

Senator CANTWELL. Well, I am going to look forward to knowing and understanding some of those measures, and hopefully I will be able to know more in the next few days.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. I think that is a very important question. It is not just in the financial markets, but it is also loopholes in the tax code, that very bright tax attorneys can figure out ways to get around the tax code way too quickly, and it is very hard for the IRS to keep up. In fact, I think in many respects the IRS has not kept up. So, that is another area where you are going to have to think about how we do not get too far behind, but in fact how we not get behind as industries develop fancy, exotic instruments to make a buck for themselves at the expense of the rest of America.

I am a little concerned with your answer. I understand it on the surface. Your answer that, well, these things are incredibly, enormously complicated and you want to do what is right, I understand all that. The slight concern I have is that, again, very bright people in these institutions and their lawyers are going to come to you with all of these fancy ways of doing all these things, and more often than not it creates a lot of stuff that really does not help the American economy.

There are many who think that we spend much too much time in America developing these exotic financial products at the expense of, say, the manufacturing sector, at the expense of the real economy, and the best and the brightest go to Wall Street, they do not go to engineering schools and to develop better products.

So I am concerned, and I am hopeful that you are very, very—maybe tough is the word, in coming up with a new regulatory regime and, I think, send a terrific signal that we are not going to indulge a lot of exotic new stuff which is not really very productive at all in the real sense of the term, but rather move a little more towards the real economy and where we can start making things and doing things to help strengthen our economy overall.

I have another question for you, and that is on China. I think how we manage our relationship, the United States with China, is extremely important and will in some ways determine the living standards of Americans and Chinese, and for that matter, people in other parts of the world. I applaud Secretary Paulson's efforts to set up this Strategic Economic Dialogue. I think that helped. It was not the be-all, end-all. In fact, Secretary Paulson said not too long ago, I read, even though that did help a lot, he is somewhat convinced now that nothing ever happens unless there is a crisis. You can talk to death, but nothing really happens unless there is a crisis.

So our charge, our American charge to the next administration, is to figure out ways to avoid a crisis, do what needs to be done to avoid a crisis. We have been talking about that in the financial sector. You yourself said that you saw this coming, the storm clouds coming in 2007, early 2007. Yet for some strange reason, this country did not respond to those storm clouds. Maybe people did not listen to you enough. Maybe you were not sufficiently forceful, I do not know.

But nevertheless, in these turbulent and volatile globalization times we all face, early-warning systems are going to be even more important than before, and having the intestinal fortitude and the courage to follow up is going to be even more important than it has been in the past.

So with respect to China, I just urge you, and would like your response as to how we get to the point where the RMB, the yuan, is a market currency, it is not set by the Chinese government, as it now is, and how we get off this mutual addiction—American consumers addicted to Chinese products and China addicted to loaning to us. Your thoughts?

Mr. GEITHNER. Senator, I like to start, always, in this case by emphasizing the obligation we have to put in place a set of policies that are going to improve confidence in Americans and in investors around the world in our capacity to run our country more effectively, not just to make our economy more productive in the future, but to try to convince people we will be able to live within our means and put our fiscal position onto more sustainable paths, and to confront the very difficult long-term questions of entitlement that we have had such a hard time coming to grips with in the past. I think that is absolutely essential.

We can be careful, creative, effective in our relationships with other countries, but unless we do that well, those efforts, diplomatic and otherwise, will not be effective in protecting our interests as a country. I completely share and deeply believe your central point about China's importance to the global economy and to our economic and financial future, and I think we have to get that right.

Our interests as a Nation lie in trying to make sure China manages its transition as effectively as possible with the least potential damage or risk to the global economy, and it is going to require a very substantial, sustained engagement of attention and time. In my time at the Treasury in the past, I was part of a lot of efforts, some of which were not very effective, some of which were very effective, in trying to design forums with China and other countries that would help make sure we can work on things together which meet our mutual benefit. If I am confirmed, I will play a very active role in that effort.

I will repeat on the exchange rate front, again, just to say that I believe that it is in the interests of the global economy, not just our interests, that our major trading partners move over time to a more flexible exchange rate system. An important, difficult challenge I will face is to try to figure out how best to advance that objective, not just with China, but with our other major trading partners as well.

The CHAIRMAN. It is going to take a humongous effort. Here again, Secretary Paulson's words, nothing much happens, just a lot of talk, unless there is a crisis. It is just going to take a huge effort, on your parts and on the parts of others, to do what needs to be done to avert that crisis.

I have heard you a couple of times refer to entitlements. I am just a little curious what you mean by that. I am a little concerned it is kind of a throw-away by the administration to various people who are concerned about entitlements. It is an easy thing to say. Some people say, gee, it is entitlements, that is the problem.

I am concerned. I am just curious what your thoughts on that subject are, because as you well know, the Social Security trust fund is not in bad shape. I think the projections I saw, it is not going to go belly-up for another 20 years, maybe. That is not the huge part of the problem. We have a few years between now and 2041. That is not urgent today.

Second, with respect to the Medicare trust fund, which is more urgent, there is the temptation to say, we are going to cut entitlements. I say "temptation" because the main reason that the Medicare trust fund is rising at such an alarming, rapid rate is not because of baby boomers.

The Congressional Budget Office did a study several months ago and showed that that is a very small part of the problem. The main reason is because health care costs in this country are rising at such a rapid rate, not just for Medicare, but for the entire country. We spend $2.3 trillion a year on health care in this country, roughly half public, half private.

So the real answer in entitlement reform is not entitlement cuts. That is not the answer. I think we should stop saying it that way because it raises incorrect expectations. The real answer is really health care reform. It is getting a handle on the rapid rate of increase in health care costs. As you know better than most anybody, we spend about twice as much per capita on health care than does the next most expensive country, and we are ranked, America, about 17th, 18th, or 19th worldwide on health care indicia. So, we are not getting our money's worth here. This is going to be hard.

I wrote a white paper on how to go down this road and address health care reform. I think, frankly, it is the basis for all health care discussions here in the Congress. It is very similar to President Barack Obama's thoughts on this subject. So I urge you to not talk too much about "entitlements," but rather rephrase that and say we have to address health care reform. That is the way we are going to start getting a handle on this $1.1-trillion deficit that you talked about.

Mr. GEITHNER. I agree, and I accept that advice. I think you are right, that you cannot get to the broader solvency problems in

Medicare without getting there through health care reform that effectively addresses the rising costs. I think that is absolutely right.

I do think, though, it is also important, even though the magnitude of the financial challenge in Social Security is much more modest, maybe particularly because of that, it is also important that we look at ways we can start to address that question, too. Because again, as a country, we have an unsustainable fiscal position. I think confidence in America will depend in part on us being willing to convince people that we are providing a framework, on a bipartisan basis, to try to put in place those kind of reforms.

The CHAIRMAN. I appreciate that. But Social Security reform is a quite small part of the long-run problem. Very small.

Mr. GEITHNER. Yes. It is a much smaller challenge.

The CHAIRMAN. This $1.1 trillion that CBO estimated had nothing to do with Social Security, or had very little to do with Social Security.

Mr. GEITHNER. Yes.

The CHAIRMAN. It had nothing to do with Social Security, because we are borrowing from it.

Mr. GEITHNER. Right.

The CHAIRMAN. What it really had to do with is all the other problems, the loaning, TARP, and everything under the sun. That is the reason.

Mr. GEITHNER. I completely agree.

The CHAIRMAN. So one should not say the problem is Social Security.

Mr. GEITHNER. No, no. I did not mean to imply that. I just meant to say that this basic challenge of credibility on the fiscal side is an enormously consequential and important challenge.

The CHAIRMAN. It clearly is.

Mr. GEITHNER. And it requires health care reform. I completely agree. But that is necessary, not sufficient. We need to make sure that, again, as we move forward, we do a better job of earning the confidence of the American people that we are going to be able to confront these things.

The CHAIRMAN. Thank you.

Senator Grassley?

Senator GRASSLEY. I appreciate the briefing and answers to follow-up questions that your staff at the Federal Reserve eventually provided regarding the Bear Stearns deal. The only anxiety I had about that, I was hoping to get those before we voted on the TARP proposal on October 1, because I thought it was important.

But I want to move on beyond that to discuss with you what I consider a lack of transparency with the level of public disclosure about the assets being held by the Federal Reserve through Maiden Lane LLC.

Specifically, it appears that the reported valuation of those assets may be overstated. The reason is that much of the debt in the portfolio is guaranteed by Freddie Mac and Fannie Mae, which are in turn guaranteed by the Federal Government. In other words, a rosy scenario for Maiden Lane LLC is not necessarily a rosy scenario for taxpayers.

Is it not true, if the defaults of those loans are high, then the taxpayer is still left holding the bag, even if the Federal Reserve gets its money back from Maiden Lane LLC?

Mr. GEITHNER. Senator, what I would like to emphasize is that we put in place, after we did that enormously consequential decision last March, a regime where, on a quarterly basis, we disclosed publicly an estimate of valuation that is produced by a very carefully designed process to make sure it is independent and careful so that we are providing, again, the best judgment of what the value is in that context.

That is very important to me, and I think it is very important to the Fed. I respect and appreciate your concern that we achieve that. We believe it is designed in a way that is very careful with a good set of checks and balances there, and I think that regime will stand the test of time.

But on a quarterly basis the American people will see what that estimate is, how it is changing over time, and therefore they will see one measure—not a complete measure necessarily, but one measure—of the risk to the American taxpayer in that judgment. But before I conclude, you need to judge that against the benefits we achieved in preventing default at an enormously fragile moment in our country of a major systemic financial institution.

Senator GRASSLEY. What would be the situation if those assets were not guaranteed by the Federal Government?

Mr. GEITHNER. Well, Senator, you are right to say that there are risks in that portfolio, including the risks that you see a higher level of default rate and losses across the American economy. You are right to say that. But again, this provides what we think is the best measure of the overall risk to the taxpayer.

Senator GRASSLEY. All right.

Given that the Bear Stearns and AIG bail-outs were conducted outside of TARP, do you think that it makes sense to broaden the authority of the Special Inspector General for the TARP to oversee these funds as well? If you do not agree with me, why not?

Mr. GEITHNER. Senator, that sounds like a reasonable suggestion, but I want to think about it more carefully before I respond. I do think it is important to point out that in the Emergency Economic Stabilization Act Congress also passed a set of important new conditions for oversight and transparency in reporting on the entire set of programs financed by the Fed, and, if there are ways we can improve that, I would be happy to work with you and your staff on how best to do that.

Senator GRASSLEY. Well, thank you.

You said in your statement today that you intend to reform the TARP to "ensure that there is enough credit available to support recovery" with "tough conditions to protect the taxpayer" and to ensure transparency.

How do you intend to reform the program, and how do you intend to increase transparency? Do you agree with Secretary Paulson that the focus of the program must return to troubled assets rather than bailing out banks?

Mr. GEITHNER. Senator, I believe, as I said earlier today, that we are going to have to have a comprehensive program using all the authority the Congress provided us to try to make sure banks are in a stronger position so they can lend and so that we get the credit markets functioning again, and get risk premia interest rates down in those basic markets.

At the same time we do that, we are going to try to put in place a more effective, comprehensive housing strategy because that has been at the center of this crisis. There are a lot of ideas up in the Congress and in the regulatory community on how best to do that.

As we do that, we are going to lay out what we think are the best conditions, most effectively designed to protect the taxpayer, and we are going to take the best of the proposals out there from the Inspector Generals, from the GAO, from the congressional oversight body, to try to improve the level of transparency and reporting provided.

Larry Summers laid out a number of specific suggestions in the last two letters in the last 2 weeks about how best to do that. We are open to any other suggestions on how to do that. If I am confirmed, a critical priority of the Secretary of the Treasury will be to try to be responsive to those concerns you and so many others have expressed about how the program has been implemented.

But again, the critical test for us is going to be, how do we make sure that there is more strength and confidence in the core of the financial system, and how do we get these credit markets functioning again so that lending is available on a scale and a condition that will make it more likely we get out of this sooner?

Senator GRASSLEY. Mr. Chairman, you took 9 minutes. Could I have 4 more minutes?

The CHAIRMAN. Clearly.

Senator GRASSLEY. All right.

Regarding the three special-purpose vehicles involved with JP Morgan, which absorbed Bear Stearns and AIG, when will financial statements of these entities be made public? That is one. Does the use of these private vehicles not result in less transparency, since JP Morgan and AIG may otherwise have had to report such investments to the SEC reporting? Do you think that these entities should be subject to the SEC reporting requirement, why or why not? So, three questions.

Mr. GEITHNER. Senator, important questions. I think that the regime put in place around disclosure and the accounting standards applied to those entities are very strong. I believe that the checks and balances in place, again, provide a very effective set of provisions. They were designed in a way to meet Generally Accepted Accounting Principles, again, with a disclosure regime that is consistent with what we would apply generally to financial institutions. But as always, I am a practical person, and if there are ways we can improve on that record I would be open to doing so, working with my colleagues at the Fed.

Senator GRASSLEY. All right. So then I think you are disagreeing with me, and maybe my impression of it is wrong, but I think there is less transparency, but you are saying there is not. Is that what you are saying?

Mr. GEITHNER. I believe——

Senator GRASSLEY. Because we will have to sit down and talk about that then.

Mr. GEITHNER. Right. Right. Again, I think what has to go into this is a range of different things. One is, you want to make sure that there is a carefully designed regime for setting the value on these things.

Senator GRASSLEY. Yes.

Mr. GEITHNER. And that the accounting regime that applies and the disclosure requirements that apply meet the important objectives you laid out. We believe this framework meets those objectives. But as I said, I am a practical person and am happy to listen to suggestions on how to improve that.

Senator GRASSLEY. All right.

Why is it that BlackRock is the only firm qualified to value and manage the assets of special-purpose vehicles? Did you consider any other firms? If yes, why was BlackRock selected? If no, why were others not considered?

Mr. GEITHNER. Let me just address the Bear Stearns case in particular, because that is initially where we asked BlackRock to come provide this very important service.

Senator GRASSLEY. Yes.

Mr. GEITHNER. As I have testified before, we had to move very, very quickly in that time frame, and we believed at that moment we had no alternative. They come with a world-class reputation and set of expertise in doing that, and we thought the interests of the American taxpayer would be best served by having them there on our side as we made those consequential judgments.

Now, if you look at the judgments the Fed has made, and the Treasury going forward, we have been able to take advantage of a broader set of expertise and institutions in helping do this, and we recognize that there are other sources of expertise that would meet our obligations going forward. Of course, we would want to make sure that we are having the best expertise at the table on the side of the taxpayers to make these judgments.

Senator GRASSLEY. This will be my last question. My staff has informed me that they were told, in both the briefings with your staff as well as AIG officials, that the underlying assets on all these SPVs actually have value, that the majority of the assets in these private entities are "performing."

If that is the case, I do not understand why a Federal bail-out was necessary. Is it not true that the only reason that these assets, including mortgage-backed securities and collateralized debt obligations, have value is because of the Federal Government guarantee? If not, do you think the predominance of subprime mortgages was overstated and that the frequency of defaults was overstated?

Mr. GEITHNER. I do not believe so, Senator. Again, what the financial system is facing, and has been true, again, as I said for 18 months, is an acute rise in uncertainty, a substantial withdrawal in financing, and the combination of those two things has made the markets unwilling to take risks markets have to take for economies to work.

To help address that problem, the government of the United States and the Federal Reserve have done extraordinary things, and those things have involved risk to the taxpayer. We had to judge those risks against the benefits we achieved for the economy of avoiding defaults with catastrophic consequences. But you are right to emphasize the fact that there were risks in the judgments we made. We try to carefully control those risks to make sure we understand them carefully, and that there are good checks and balances for how these are managed going forward. But we have to judge that risk against the benefits we created for the economy and the financial system of preventing default with catastrophic consequences.

Senator GRASSLEY. Let me make a statement, instead of asking a question. Assuming you are right and they have value, then should we not be pointing the fingers at the big—well, I had better say it this way. I think we ought to be pointing fingers at the three big credit rating agencies for downgrading credit ratings of the securities. That is the way I see it.

Mr. GEITHNER. Well, I agree with you that the rating judgments by the credit rating agencies have been—how can I say it more starkly than what you did? There were systematic failures in judgment about the level of the risks in the securities they were rating, and that played an important role in contributing to this crisis.

Senator GRASSLEY. All right.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Kyl?

Senator KYL. Thank you, Mr. Chairman.

I am going to submit some questions to you in writing, and I will need the answers before I think it will be appropriate to vote. But a couple of them, we discussed: your agreement with the proposition that Treasury needs to maintain an important role in helping to fight terrorism, with the emphasis on the international banking system.

Mr. GEITHNER. Absolutely.

Senator KYL. Some questions relating to the value of the dollar, some questions relating to corporate finance. In particular, here are the incentives and disincentives regarding debt versus equity financing, which are important to a lot of things we have been talking about.

I also, to follow up on my previous questions, want to have you put in writing for me as to each of the major programs of the so-called "stimulus package," why you think they are going to be job creation and investment friendly. If you can actually relate the kind of job or jobs that you think are going to be created by that, I would prefer that as well.

So I will give you a general question, and then on a program-by-program basis, I would like to have you answer that. I remember that you are going to be judged in a year or two, and this is not—or should not—be a political exercise. It should be what works, as President Obama said in his remarks yesterday. What works? I understand that there are political reasons to support a lot of programs, but your job, and what you said here, is to evaluate whether they actually work to stimulate the economy, to provide jobs and investment. I think you will be judged on how you answer those questions.

I went home last week, and I got an earful from my constituents. They want me to ask you a whole bunch of questions, and I am going to give you an opportunity to expand in a more fulsome way on the matters relating to your income tax.

But another area that there seemed to be great interest in—and I will just formulate a question for the record—relates to your work in supporting Secretary Paulson, or working with him, on the decision relating to Citibank, both with respect to the acquisition of Wachovia and the position you took on that when Wells Fargo came into the picture, as well as the judgments that you and others made regarding what Citibank needed and what it would need. I mean, it turns out that Citibank is in worse shape than I think you all anticipated at the time.

But in order to try to give you a fuller opportunity to respond to some of the things that people are asking, let me state this predicate. One of the arguments for your being nominated is that you have been there, you know the TARP program, you have been working with these things, that you are very intelligent, that you have good judgment, that you take your obligations seriously.

Given all of that, which I will stipulate to, it seems implausible that, in effect, your only answer to the income tax issues that arose is that you have no answer, that you do not know why the mistakes were made, but they were made.

Let me focus on a couple of these things and ask you if there is some better answer than that. On the form that you filled out—and by the way, could you tell us, how many times did you fill out the tax allowance application? Was that once a year for 3 or 4 years?

Mr. GEITHNER. I cannot see that form, but I believe that form is an annual form. But Senator, as I said initially in response to Chairman Baucus's question, I had forms I received on a quarterly basis. You could say every payroll statement I got gave me an opportunity to realize this mistake earlier. The initial documentation the IMF gave me as a new employee laid this out clearly. When I went through that in providing those forms for the committee, it was very clear that this was an avoidable mistake. It should have been avoided.

As I said, if I had caught it earlier and not established that initial pattern in how I was meeting my obligations, I would not have been in the position where, for those 2 years I was working there in the tax years that applied, I had not met those obligations.

Senator KYL. Yes.

Mr. GEITHNER. You are right. I had many opportunities to see it, but having missed it initially, I kept missing it.

Senator KYL. Thank you for that. That was not really the point I was trying to make. What a lot of my constituents have said is, obviously there is no defense that "I just missed it" when you are audited by IRS. In fact, most people, even if they have a relatively small obligation, pay a penalty on that.

That is another issue about why, in effect, somebody in your position received what could be considered preferential treatment without having to be penalized. In fact, at least two or three of my constituents said, would I support a safe harbor of, anything under $35,000, you do not have to pay penalties? I said, well, I will be happy to ask Mr. Geithner if he would support that. I rather doubt it.

Mr. GEITHNER. Senator, could I respond just on the issue of penalties?

Senator KYL. Sure. Yes. Go ahead.

Mr. GEITHNER. When the IRS conducted its audit and told me what I owed, their initial assessment included an assessment of penalties. But at that point they explained to me—and I paid those penalties initially, as you would expect me to do. But at that point they explained to me that they had found this to be a—they used the word, I think, "common" problem and they encouraged me to apply for a waiver of my penalties, and they subsequently granted that waiver. But that was a judgment they made. That just goes to the point, I think, that they felt this was a common enough problem that it was not unusual in my circumstances.

Now, having said that, this was completely my responsibility. As I said at the beginning, if I had not made that initial mistake in how I thought I was complying with my obligations, I would have corrected it far sooner.

Senator KYL. I am sure that when you sign documents you try to be careful about what you sign, and that you at least read some of what you are signing. This is what strikes me as somewhat implausible. When you are given a piece of paper to sign, you would at least look at the title, I would presume. The title says "Tax Allowance Application for U.S. Federal/State Income Taxes and Social Security Tax."

So, I mean, if that is all you read, you know exactly what it is that you are being asked to sign. Then there are about 9 or 10 lines down at the bottom—9, I think—in which, twice, it is asserted "which I will pay." The conclusion is, "and that I will pay the taxes for which I have received tax allowance payments from the fund."

Do you remember ever reading that?

Mr. GEITHNER. Senator, as I said, when I went back and read that when providing it to the committee, it was very clear, and I should have read it more carefully. But again, I thought I was complying at that point, had no indication, no knowledge that I was not. That is why I signed it. Having done it that first time, I systematically signed it going forward. I should have been much more careful. I understand your concern with that. As I said, there was ample opportunity in what the IMF provided me that I could have caught this earlier.

Senator KYL. Now, my understanding is that you—I do not know if you sat right down and wrote the checks, but soon after knowing what the tax allowance was for the Federal and State taxes, you sat down and wrote those checks. Is that correct? I think that is what you told us.

Mr. GEITHNER. Yes. Every quarter, I wrote a check which I believe covered my tax liability as an American citizen. But, of course, I was mistaken in that, and because in that initial year when I did my full returns I did not catch that mistake, I continued it. As I said, although I think maybe you were out of the room when I said this, because in subsequent years, when my returns were prepared by an accountant, they did not catch it, I was left with a mistaken belief that I had fully complied.

Senator KYL. On the reverse side of the application there are three lines right in a row: Federal tax, State tax, SE, meaning self-employment tax. What explanation do you have for writing the check for Federal, writing the check for State, and somehow totally ignoring the next line?

Mr. GEITHNER. Again, you are absolutely right, that every quarter I received a form with those lines on it. In fact, if I go back, I think even every payroll statement lays it out that way. But again, because that first year—remember, I always thought I was an employee of the IMF. I was not self-employed by the IMF, I was an employee of the IMF and my income was reported on a W–2.

So I did my taxes the way I had always done them when I had W–2s and treated that as employee income. And because of that and the way I did my returns, I did not catch it early enough. But you are absolutely right, Senator, that I had ample opportunity on each of the forms—and I provided these forms to the committee—to catch this earlier.

Senator KYL. You knew that you were doing something by signing this, that you were applying for something. What did you think you were doing when you first signed this?

Mr. GEITHNER. I thought I was certifying that I had met my obligations, which I thought I had.

Senator KYL. You did not even appreciate that you were applying for what they euphemistically call a "gross-up" in your salary in order to offset the tax liability?

Mr. GEITHNER. I think that form is designed to make sure that the allowance they are providing is calculated appropriately. I think that is what I was signing, again. But the critical thing, and you are right to say this, is the language is very clear. If I had read it more carefully at the time, I would have caught it, but I signed it in the mistaken belief that I was complying with my obligations.

Senator KYL. Yes. The title is "Tax Allowance Application."

Were there any written communications between your tax preparer and you relative to the audit which concluded that you owed additional taxes for 2003 and 2004?

Mr. GEITHNER. I do not know, Senator. But I believe I gave the committee, and of course the presidential transition team, all the documents relevant to that audit.

Senator KYL. Would you double-check and make sure?

Mr. GEITHNER. I will.

Senator KYL. There is a reason for my request, and I will follow it up with a second question.

In discussing this with your auditor, it had to go something like the following: so I owe some additional taxes? Yes. What for? Well, you are supposed to pay the self-employment tax, which you did not pay.

Now, I know if I got a letter of audit from the IRS, first of all, my knees would be shaking and I would be scared to death, and I would try to figure out what I did wrong if they concluded I did something wrong. It would be a big deal in my life. I assume that you took this seriously and it was a big deal in your life as well, right?

Mr. GEITHNER. Absolutely.

Senator KYL. And when you found out what you had done wrong, it is incomprehensible to me that you did not immediately realize that you had done it wrong for the entire time that you had been at the IMF.

Mr. GEITHNER. Senator, as I said before, I took the audit very seriously. I hired an accountant to go back and help me figure out what I had done wrong and how to correct it. I paid what the IRS said I owed.

Senator KYL. I Understand that. But I am asking about your state of mind. When you first became aware of the fact that you had an additional liability as a result of this audit and you found out why you had that additional liability, it strains credulity to think that it did not immediately occur to you that you had that liability for the whole time that you were at IMF.

Mr. GEITHNER. Senator, as I said, if I had thought about it more at the time I would have asked a lot more questions and I would have handled it differently, and I regret not having done so.

Senator KYL. Yes.

Mr. GEITHNER. This was my mistake, and it is my responsibility.

Senator KYL. I appreciate that. And what I am really asking you is whether you did think about it long enough to realize that you had the liability for the 2 years previous as well.

Here is the question that at least a couple of constituents wanted an answer to, and it is a perfectly legitimate answer if you answer the question yes, but you have said otherwise: is it not a fact that you immediately, or very quickly, realized that the same mistake that was made in 2003 and 2004 was probably made for 2001 and 2002, but that the statute of limitations had run and you did not have to pay the tax for those other 2 years?

The auditor said you did not have to pay anything more than for 2003 and 2004, and you accepted that. I think 99 percent of taxpayers would say, well, I am glad the statute of limitations ran out and I did not have to go back and pay the other 2 years.

So I guess my question is, was your state of mind such that it did not even occur to you that you were taking advantage of the statute of limitations by not going back to 2001 and 2002 obligations, which were identical to the 2003 and 2004 obligations?

Mr. GEITHNER. Senator, as you said, an IRS audit is an extremely serious thing. I took it very seriously. I looked very carefully at what they said I owed. I paid what they said I owed. As I said to you many times, when I think back on it now I should have asked a lot more questions. I should have taken more care in considering it at the time. But when the IRS conducts an audit and they tell you that this settles your obligations, I paid what they said I owed.

Senator KYL. Sure. And any taxpayer would. But my question to you is a little different than that, and that is whether you thought at the time, or at any time thereafter, even I did not do anything different those first 2 years I probably would have owed that too, except that the statute of limitations has run out so I do not have to pay that. Did that thought never cross your mind until you became a candidate for nomination as Secretary of the Treasury?

Mr. GEITHNER. Senator, again, as I said, the IRS told me what my obligations were, I met those obligations, and I did not think about it again until I was going through the vetting process and I disclosed all this material to those committees. They came and asked me a bunch more questions about that, and it was in that context that I decided that it was appropriate for me at that point to go back and correct for that earlier error. And as I said to you before, I regret having not done that sooner. I believe I should have done it sooner, and if I had thought about it more maybe I would have come to that judgment sooner.

Senator KYL. But you are saying that that is the first time that it occurred to you that you also could have a liability for 2001 and 2002?

Mr. GEITHNER. That was the first time I had thought through carefully the question about whether I should go back and cover that. But again, I should have thought more carefully before. If I think about it today, I would have handled that differently.

Senator KYL. If there is anything that you would like to supplement the record with in respect to our exchange just now, I would appreciate it if you would do that as well when you provide these written answers, including if you can determine whether there was anything in writing between you and your accountant, or anything else that would bear on the question of whether, in fact, you relied upon the statute of limitations rather than just having failed to think about it.

Again, I will say: it is legal to rely on the statute of limitations. There is nothing wrong with relying on the statute of limitations. I think what some people find implausible is that that is not what you are saying you did. What you are saying is that you did not think about it until it was brought to your attention in connection with your nomination. Is that correct?

Mr. GEITHNER. I said, Senator, that I did not—looking back on it, did not think about it carefully enough and did not ask enough questions, and I regret not having done that.

Senator KYL. But that is different from the question I just asked you. You are not now then saying that it did not occur to you, prior to your nomination, that you might also have an obligation for 2001 and 2002, which is barred by the statute of limitations. Is that correct?

Mr. GEITHNER. Senator, of course I was aware of the fact that I had began work at the IMF in 2001 and 2002, but again, I did what I thought was the right thing to do at that time, which is, the IRS told me what Iowed——

Senator KYL. Yes. I am sorry to take extra time here, but would you answer my question rather than dancing around it, please? The question is whether it occurred to you before you were nominated or before you were approached to be nominated, that in point of fact you did not have to go beyond 2003 and 2004 because of the statute of limitations.

Mr. GEITHNER. Senator, I did not believe, when I settled that audit and paid what they owed me, that I had obligations to go back. I did not think about that until I was going through the vetting process and had disclosed at that point to the transition members reviewing my tax records the entire circumstances surrounding that episode.

I had not thought about it in the intervening years, had no occasion to think about it, and I might not have thought about it unless I had gone through that process. But having thought about it then, I did what I thought was right, which was to go back and correct for that error.

Senator KYL. All right. That is a relatively clear answer, the answer being: no, you did not think about it until it became important in connection with your nomination.

Mr. GEITHNER. Well, what I said was that I did not think about it until, having gone through that process and disclosed all this to the transition team. I was forced to go back and go through it again and think about it. Having done that, I did what I thought was appropriate then.

Senator KYL. Yes. And that is the first time it occurred to you that it may be that you avoided the liability because of the statute of limitations.

Mr. GEITHNER. I did not believe, Senator, that I was avoiding my liability. Senator, I have worked in public service all my life. My first job in government was as an employee of the Treasury. I grew up in government with a deep appreciation of the obligations that come with that.

I would never put myself in the position where I was intentionally not meeting my obligations as an American taxpayer. In this case I made a series of mistakes, but they were not intentional mistakes. They are my responsibility. I take those things extremely seriously. Again, I regret those mistakes, but they were not intentional. I have corrected them, but they are my responsibility.

Senator KYL. All right. Rather than me asking for any additional testimony, review carefully what you said. If you think it needs to be modified, because you are under oath here, in a way, please provide that for the record.

The CHAIRMAN. All right. Thank you, Senator.

I have a couple of questions from Senator Grassley which I would like you to look at, and you can respond in writing.

[The questions appear in the appendix.]

The CHAIRMAN. As is our usual practice, Senators will have written questions for you and will submit those to you. I ask that all Senators submit those questions by 5 p.m. this evening. I urge you, Mr. Geithner, to respond to those questions before our mark-up of your nomination tomorrow morning at 10 a.m.

Mr. GEITHNER. All right. Thank you, Senator.

The CHAIRMAN. The hearing is adjourned.

[Whereupon, at 1:42 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

SUBMITTED BY SENATOR BAUCUS

The New York Times

January 21, 2009
OP-ED CONTRIBUTOR

Questions for Mr. Geithner

Timothy Geithner, President Obama's nominee for Treasury secretary, appears before the Senate Finance Committee on Wednesday. The Op-Ed page asked seven experts in finance and economics to pose the questions they would like to hear the nominee answer.

1. The American tax code is so complex that even Treasury secretary nominees can easily make mistakes on their returns. Furthermore, while income tax rates are 10 percent to 35 percent for individuals and 35 percent for corporations, because of the proliferation of deductions, credits, exclusions and loopholes, the revenue from income tax amounts to only 10 percent of gross domestic product. Should you give priority to simplifying the code and enforcing compliance before raising rates?

— CHARLES O. ROSSOTTI, the commissioner of internal revenue from 1997 to 2002

1. Ordinary taxpayers would like an answer to this question: Why have they been billed more than $45 billion to rescue Citigroup from failure when, as president of the Federal Reserve Bank of New York, you were its primary supervisor? Three major problems led to Citigroup's downfall: bad investment policy; overexpansion, which overwhelmed Citigroup's management; and an inadequate capital base. Why was Citigroup's supervision inadequate to deal with these problems?

2. The Treasury and Federal Reserve have been selecting which companies in American industry and finance will get taxpayer money. What criteria do you use to decide?

3. During the banking crisis of the late 1980s, assets of failed savings and loans were acquired by the government's Resolution Trust Corporation. The trust corporation then sold off the assets in an orderly fashion. Would you consider requesting Congress to revive the Resolution Trust Corporation, so you would not have to decide which companies to save and which not to save? Would you consider re-establishing the trust corporation now for commercial banks that are likely to fail?

— ANNA JACOBSON SCHWARTZ, an economist at the National Bureau of Economic Research and the author, with Milton Friedman, of "A Monetary History of the United States, 1867 to 1960"

1. Do you believe that money from the Treasury's Troubled Asset Relief Fund should be exclusively used to preserve our financial system, or should it be used to assist distressed non-financial institutions like manufacturers and retailers? If non-financial institutions are eligible, how do you decide which are deserving?

2. Do you believe raising taxes on savings and investment, as would occur if the Bush tax cuts expire in 2010, will help or hurt our economy?

3. How do we more effectively regulate the financial services industry without adding unnecessary regulations that cripple our ability to compete globally?

— MITT ROMNEY, a former governor of Massachusetts

1. In the past, you have praised the "resiliency" of the American financial system. But a resilient financial system would demand that banks maintain stricter capital standards in normal times so that when a crisis hits, they don't all have to tighten lending at the same time. What exactly did you mean by "resiliency"?

— ROBERT SHILLER, professor of economics at Yale

1. The income tax code favors those with employer-provided health insurance over those who buy their own health insurance or pay medical bills out of pocket. It also favors homeowners over renters, through the mortgage interest deduction. Is this tax treatment efficient or fair? Might you favor a more level playing field?

2. President Obama supports the estate tax. Why should a person who leaves his money to his children pay more in taxes than another person with the same lifetime income who spends all his money on himself?

— N. GREGORY MANKIW, a professor of economics at Harvard

1. The American financial regulatory system is highly fragmented, with authority divided among federal and state governments, the Federal Reserve, the comptroller of the currency, the Securities and Exchange Commission, etc. Do you favor an overhaul of the system and, if so, what should the new system look like?

— JOHN STEELE GORDON, the author of "An Empire of Wealth: The Epic History of American Economic Power"

1. This country has long benefited from the world's confidence in our financial markets. Are financial regulatory reforms necessary now to restore investors' confidence and revive our economy?

2. Should debt securities that are held by regulated banks and pension funds be rated by multiple independent credit reports that have been commissioned by a federal agency, or should we continue to let the issuers of debts decide who will rate their risks?

3. Should large financial institutions incur higher reserve requirements or other regulatory penalties when they become "too big to fail"?

— ROGER B. MYERSON, a professor of economics at the University of Chicago and a winner of the 2007 Nobel Memorial Prize in Economic Sciences

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TIMOTHY F. GEITHNER
PRESIDENT AND CEO

October 8, 2008

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Charles Grassley
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Grassley:

Below are responses to the questions posed in your letter to Secretary Paulson, Chairman Bernanke, and me dated July 10, 2008. I sincerely apologize for the delay in responding to you. My staff will follow up immediately with Committee staff to make the arrangements referenced in my response to question #1 below.

1) Your initial response provided a list of the general categories of the assets contained in the collateral portfolio. Please identify and provide more specific and complete details regarding each asset within these general categories, including a list of hedges associated with those assets.

In order to maximize value in the sale or liquidation of the collateral portfolio, the Federal Reserve must manage the pool of collateral over a long-term horizon and liquidate it in an orderly fashion that is not affected by the unusual market pressures on liquidity that currently affect the market. Public disclosure of individual assets in the collateral pool and of the hedging strategies that are employed to reduce the risk in the portfolio would undermine our ability to best protect the taxpayer against loss on the liquidation of the portfolio. Nonetheless, in order to allow Congress to conduct appropriate oversight, the Federal Reserve Bank of New York ("FRBNY") will provide at FRBNY and on a confidential basis to the staff of the Committee greater details regarding the assets in the portfolio.

2) Please describe in detail how BlackRock was selected to be the manager of the assets.

BlackRock was selected under FRBNY's Acquisition Guidelines ("Guidelines"). The Guidelines recognize that exigent circumstances may require an exception to the normal competitive bidding process, subject to senior management approval. In light of the unique time pressures associated with the decision to support JPMC's acquisition of Bear Stearns, senior management at FRBNY carefully considered the issue and determined that an exception to the competitive bidding provisions of the Acquisition Guidelines was appropriate with respect to the selection of an investment manager. BlackRock was selected to manage the proposed collateral portfolio for its technical expertise, operational capacity, and track record.

3) (a) Please explain why Bear Stearns assets are being purchased through a limited liability corporation based in Delaware. (b) What is the status of your effort to establish the limited liability corporation?

On June 26, 2008, Bear Stearns' assets were transferred to Maiden Lane LLC, a limited liability company based in Delaware, which was incorporated on April 29, 2008. The decision to incorporate as an LLC was based on the tax pass-through feature of the LLC, the liability protection the LLC structure affords to its members, and the ability of its members to tailor the LLC form to suit their needs. The decision to incorporate in Delaware was based on the quality of Delaware law which is updated regularly to reflect current corporate developments, the flexibility of the Delaware statute, the speed in which administrative matters can be handled in Delaware, and our belief that it was appropriate in this context to incorporate in the United States.

4) (a) Please describe the process used by the Federal Reserve and BlackRock to select the Bear Stearns assets to be managed by the Delaware LLC. (b) Please provide any and all reports, memoranda, letters, or other written communications from BlackRock related to the selection and/or valuation of the assets.

(a) FRBNY determined that it was willing to accept as collateral for the proposed Bear Stearns credit facility only assets that met each of the following parameters: (i) U.S. dollar denominated; (ii) U.S. domiciled; and (iii) performing residential and commercial mortgages or investment-grade or Agency issued securities (and related hedges). A performing mortgage is a mortgage that was no more than 30 days past due (as of March 14, 2008), and an investment-grade security is a security rated BBB- or higher by all rating agencies that have rated the security (as of March 14, 2008), including at least one of the three principal credit rating agencies.

(b) See response to Question 1.

5. (a) Please describe in detail the precedent, if any, for the Federal Reserve managing the type of assets selected from Bear Stearns. (b) Please describe in detail the precedent, if any, for the Federal Reserve using an LLC to manage the assets.

(a) As explained in greater detail in the response to Question 7, FRBNY extended credit in connection with the acquisition of Bear Stearns by JPMC pursuant to section 13(3) of the Federal Reserve Act, which was enacted in 1932. Under section 13(3), in unusual and exigent circumstances, the Board may authorize any Reserve Bank to extend credit to any individual, partnership, or corporation if the Reserve Bank obtains evidence that the borrower is unable to secure adequate credit accommodations from other banking institutions. Credit extended under section 13(3) must be secured to the satisfaction of the Reserve Bank. From July 1932 to July 1936, several Reserve Banks made loans using section 13(3) authority to a number of individuals and businesses. Records indicate that these loans were secured by a diverse range of collateral, including common stock, commercial inventory, and receivables of the borrowing businesses.

(b) We have not identified any record indicating the prior use of a limited liability company to hold collateral securing an extension of credit made by a Reserve Bank pursuant to section 13(3).

6. (a) What is the Federal Reserve's plan for periodically reporting to the public on the value of the assets and the status of their disposition during the ten years the new Federal Reserve financing facility will be in place. (b) Will you provide the Committee with quarterly updates on the current valuations of the assets in comparison to the valuation on the date the assets were acquired?

(a) Beginning after June 26, 2008, the date the Bear Stearns financing transaction was closed, the Board's H.4.1. statistical release, "Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks," includes information related to Maiden Lane, the limited liability company formed to acquire and manage the collateral for the Bear Stearns/JPMC financing transaction. Among other things, the release discloses, as of the date of the release, the aggregate fair value of Maiden Lane's net portfolio holdings and the book value of the principal and interest on the loans made to facilitate the Bear Stearns acquisition. Consistent with generally accepted accounting principles, the assets and liabilities of Maiden Lane have been consolidated with the assets and liabilities of FRBNY in the preparation of the statements of condition shown on the release because the Reserve Bank is the primary beneficiary of Maiden Lane. The H.4.1. release is published weekly on Thursdays and is available on the Board's public website.

(b) The fair value of Maiden Lane LLC's net portfolio holdings as of the date of acquisition, June 26, 2008, is disclosed in the H.4.1. Statistical Release issued by the Board of Governors on July 3, 2008. Thereafter, Maiden Lane LLC's net portfolio holdings will be updated quarterly and published on the H.4.1 release. Table 2 of this release includes a footnote that states the date the last time prices of portfolio holdings were revalued.

7. Former Federal Reserve Chairman Paul Volcker recently expressed the concern that the Federal Reserves action in the Bear Stearns matter "extended to the very edge of its lawful and implied power, transcending certain long-embedded central banking principles and practices." (a) What is the legal basis for the assumption of control over the $30 billion in assets? (b) Please provide copies of any and all memoranda, reports, or other written assessments or analysis of the legal issues surrounding the Federal Reserve's role in the transaction.

The legal basis for the Federal Reserve extension of credit in connection with the acquisition of Bear Stearns by JPMC is explained in a memorandum, dated April 2, 2008 from the Board's Legal Division to the Board of Governors. A copy of that memorandum will be provided by the Board of Governors.

8. (a) If by disposing of these assets the LLC suffered a loss of $20 billion, what impact would that have on (1) the size of the Federal Reserve's balance sheet, (2) the Federal Reserve's annual remittance to the Treasury Department, (3) federal revenues, (4) the deficit, and (5) the debt held by the public? (b) What would be the impact on (a)(1)–(5) if the LLC realized a $20 billion gain?

(a) Consistent with generally accepted accounting principles, the assets and liabilities of Maiden Lane, the limited liability company that holds the assets serving as the collateral for the Bear Stearns/JPMC financing transaction and that is liable for repayment of the credit extended in the transaction, are consolidated with the assets and liabilities of FRBNY in the preparation of the financial statements of the Federal Reserve Banks. Under the credit agreement, the subordinated lender to Maiden Lane, JPMC, would absorb the first $1.15 billion of losses resulting from the decline in the value of the assets serving as collateral and any residual value of the collateral assets in excess of the obligations of Maiden Lane would be owed to FRBNY. The fair value of the net portfolio holdings of Maiden Lane is updated quarterly to reflect values at the end of each calendar quarter. If the revaluation of portfolio holdings indicates a decrease in value, FRBNY will reduce its carrying value of the asset and recognize an unrealized loss on any residual value not absorbed by JPMC. This loss, like any other Reserve Bank losses and expenses, will reduce the Bank's net earnings. The reduction in earnings would negatively affect the amount of the System earnings that are paid to the U.S. Treasury and the aggregate amount of federal revenues. Although the effect of such a reduction in System earnings on the overall Federal deficit and debt held by the public would depend on a number of economic and fiscal factors present at that time, and cannot be predicted reliably now, realized losses to the Reserve Bank, should they ultimately occur, would accrue to the government.

(b) Similarly, interest earned on the loan would accrue to and be payable to the government. Moreover, if, the revaluation of Maiden Lane portfolio holdings results in unrealized gains, FRBNY will increase its carrying value of the asset and will recognize an unrealized gain up to any unrealized losses previously recognized. Residual gains would then be accrued to JPMC up to its previously recognized loss. All remaining residual gains would then be recognized by FRBNY. These gains, like any other Reserve Bank gains and income, will increase the Bank's net earnings. The increase in earnings would positively affect the amount of the System earnings that are paid to the U.S. Treasury and the aggregate amount of federal revenues. Although the effect of such an increase in System earnings on the overall Federal deficit, and debt held by the public would depend on a number of economic and fiscal factors present at that time, and cannot be predicted reliably now, realized gains to the Reserve Bank, should they ultimately occur, would accrue to the government.

9. Please explain why JPM was unwilling to include the assets now being managed by the LLC in their merger deal with Bear Stearns?

An agreement of the Federal Reserve on Sunday, March 16, 2008, to finance a portion of the assets of Bear Stearns was necessary to secure JPMC's agreement at that time (i) to acquire the remainder of the assets of Bear Stearns and (ii) to assume or guarantee the liabilities of Bear Stearns to allow it to open for business without disruption on Monday, March 17, 2008. As Jamie Dimon, the chief executive officer of JPMC, testified before the Senate Banking Committee on April 3, 2008, JPMC informed the New York Reserve Bank on March 16, 2008, that JPMC was unwilling to acquire all of Bear Stearns, and JPMC could not accept the risk of acquiring all the assets and liabilities of Bear Stearns in light of the substantial pre-existing exposure of JPMC to similar assets and liabilities.

10. (a) Please provide a copy of the contract between the New York Federal Reserve and the asset manager, BlackRock Financial Management, which will manage the collateral pool relating to the JPM loan. (b) How will BlackRock be compensated for its services? (c) What is its maximum potential fee? (c) What is its minimum potential fee? (d) Please describe what independent check, if any, there will be to assure that BlackRock's valuation of the assets is accurate and that its management of them is prudent.

We would like to invite your staff to visit FRBNY so that we can provide details on these arrangements on a strictly confidential basis. BlackRock's valuation of the assets is based partially on valuations provided by other agents working for Maiden Lane, LLC. FRBNY retains ultimate control over the policies governing the management and disposition of the collateral assets. At all times since BlackRock has been engaged, the management and senior staff of FRBNY have been involved on a day-to-day basis with the details of the portfolio management process. Experienced analysts and supervisors from FRBNY's Markets Group, Bank Supervision Group, and other areas have been assigned to monitor the portfolio and to carefully review BlackRock's investment management decisions.

11. In Congressional testimony James Dimon, Chairman of JPM, disclosed that the Federal Reserve has lent Bear Stearns \$25 billion under a new program of direct lending available to major investment banks—separate from the \$30 billion exchange of assets. (a) What is the status of that additional loan, or loans? (b) Please provide a history of borrowing by BSC through the Primary Dealer Credit

Facility for the period of March 1, 2008 through June 30, 2008. (c) Also, please provide a history of borrowing by JPM through the Primary Dealer Credit Facility for the period of March 1, 2008 through June 30, 2008.

Aggregate information regarding borrowings extended at the Primary Dealer Credit Facility is available in the weekly H.4.1. Statistical Release by the Board, which is available at http://www.federalreserve.gov/releases/h41. The Federal Reserve has agreed with participants in its Primary Dealer Credit Facility to maintain the confidentiality of the details of their participation. This is necessary in order to prevent any stigma that might be perceived from use of the facility from attaching to participants. Were this information to be made public, the usefulness of the facility would be greatly impaired.

12. We understand that Jamie Dimon, Chairman of JPM, is a Class A Board Member of the Federal Reserve Bank of New York. What steps did the Federal Reserve take to ensure that Mr. Dimon's Board membership did not influence the negotiations regarding the purchase of Bear Stearns by JPM and the arrangement on the $30 billion in Bear Stearns assets.

Jamie Dimon, chief executive officer of JPMC, is one of nine members of the board of directors of FRBNY. Mr. Dimon did not participate in his role as a director of FRBNY in the negotiations between the Federal Reserve and JPMC. Neither Mr. Dimon nor any other FRBNY director participated in the approval of the credit facilities regarding Bear Stearns. Rather, Mr. Dimon participated solely on behalf of JPMC. FRBNY was represented at all times by its president, Timothy Geithner, and staff in negotiations with JPMC. Mr. Dimon has recused himself from any role as a member of the board of directors of the Reserve Bank in any matter related to the Bear Stearns credit facility.

Sincerely,

Timothy F. Geithner
President and CEO

Opening Statement
Treasury Secretary-designate Timothy Geithner
United States Senate Committee on Finance
January 21st, 2009
Prepared for Delivery

Chairman Baucus, Ranking Member Grassley, members of the Committee, it is an honor to come before you today.

I want to thank you for meeting with me over these last few weeks, and helping me understand your interests and concerns.

I am grateful to President Obama for asking me to lead the Treasury Department at this critical moment.

I am deeply grateful to my wife, Carole, and to my children and family for their support and sacrifice.

Throughout my career, I have had the great privilege of serving our country in institutions responsible for U.S. economic policy.

In these roles, I learned several important lessons about government and economic policy.

I believe that confidence in the strength and integrity of our financial system, confidence in our commitment to fiscal prudence, and confidence in the value of our currency are absolutely critical to the fortunes of all Americans.

I believe that markets are central to innovation and to growth, but that markets alone cannot solve all problems. Well-designed financial regulations with strong enforcement are absolutely critical to protecting the integrity of our economy.

I also believe that as America's economic fortunes become ever more tied to the rest of the world, we need to invest more at home to help Americans confront the challenges of trade and technological change.

Finally, I believe that our national security depends critically on our economic strength at home. We can have a great and positive impact on the global economic and financial system, but only if the quality of our ideas and actions win the support of other nations.

We now confront extraordinary challenges. A severe recession, here and in countries around the world. A catastrophic loss of trust and confidence in our financial system. Unprecedented foreclosure rates, small businesses struggling to stay afloat, millions of Americans worried about losing their jobs and savings, growing job losses, a deep uncertainty about what tomorrow holds. At the food bank where my wife and son volunteer, the lines are long and getting longer.

Our test is to act with the strength, speed, and care necessary to get our economy back on track, and to restore America's faith in our economic future.

We must meet that test, and I believe we can, if we take aggressive action in four areas:

First, we must act quickly to provide substantial support for economic recovery and to get credit flowing again.

The tragic history of financial crises is a history of failures by governments to act with the speed and force commensurate with the severity of the crisis. If our policy response is tentative and incrementalist, if we do not demonstrate by our actions a clear and consistent commitment to do what is necessary to solve the problem, then we risk greater damage to living standards, to the economy's productive potential, and to the fabric of our financial system.

Senators, the ultimate costs of this crisis will be greater, if we do not act with sufficient strength now.

In a crisis of this magnitude, the most prudent course is the most forceful course.

The American Recovery and Reinvestment Plan will meet that test.

It provides powerful and direct support to help get people back to work, to encourage private investment, and to break the cycle currently crippling our economy—a cycle where concern about growth hurts investment and spending, causes further job loss, and makes it harder for families and businesses to get access to credit.

This plan is a critical part of the solution, but it has to be accompanied by aggressive action to address the housing crisis and to get credit flowing again.

Last fall, Congress passed the Emergency Economic Stabilization Act. Your action—and I know it was a difficult decision for many of you—your action helped prevent an economic crisis from becoming a catastrophe. The actions of the Senate last week to authorize additional resources will enable us to take the steps necessary to help get credit flowing.

President Obama and I share your belief that this program needs serious reform.

I know there are serious concerns about transparency and accountability, confusion about the goals of the program, and deep skepticism about whether we are using the taxpayers' money wisely.

Many people believe the program has allowed too much upside for financial institutions, while doing too little for small business owners, families who are struggling to keep their jobs and make ends meet, and innocent homeowners.

We have to fundamentally reform this program to ensure that there is enough credit available to support recovery. We will do this with tough conditions to protect the taxpayer and the necessary transparency to allow the American people to see how and where their money is being spent and the results those investments are delivering.

And we are going to do that. This is an important program and we need to make it work.

Second, as we move quickly to get our economy back on track and repair the financial system, we must make investments that lay the foundation for a stronger economic future.

The strength of the recovery will depend critically on the investments and reforms we initiate now to expand access to health care and reduce its cost, to move toward energy independence, to sharpen and deepen the skills of American workers and to modernize our infrastructure.

These investments will make our economy more productive and more competitive.

Third, our program to restore economic growth has to be accompanied by a clear strategy to get us back as quickly as possible to a sustainable fiscal position and to unwind the extraordinary interventions taken to stabilize the financial sector.

We need to demonstrate with clear and compelling commitments now, that when we have effectively resolved the crisis and recovery is firmly established, that as a nation, we will return to living within our means.

Finally, we must move ahead with comprehensive financial reform now so that the U.S. economy and the global economy never again face a crisis of this severity.

Senators, in this crisis, our financial system failed to meet its most basic obligations.

The system was too fragile and unstable, and because of this, the system was unfair and unjust.

Individuals, families and businesses that were careful and responsible were damaged by the actions of those who were not.

We need to move quickly to build a stronger, more resilient system now, with much greater protections for consumers and investors, with much stronger tools to prevent and respond to future crises.

We have experienced a great loss of faith in our economy, but we have not lost the most fundamental of American abilities—the ability to change, to adapt, and to reform.

This will take time.

It will require action on a scale that we have not seen in generations.

And we will have to keep at it until we restore the confidence of Americans and the world in America's economic leadership.

This is my commitment to you, and the President's promise to the American people.

We are a strong nation with great resources. We can meet these challenges—we can't afford not to.

Our shared goal is a healthy, more stable, and more competitive free-market economic system that can once again do what it does best: encourage people to invest and invent, to innovate, create jobs, and build stronger communities and better lives.

Before I finish, I want to say how grateful I am to my colleagues at the New York Fed and across the Federal Reserve. Like the career staff at the Treasury, they are an exceptionally talented and dedicated group of public servants. Brave, creative, and pragmatic. It has been my privilege to work with them.

If you and your colleagues in the Senate give me the opportunity to serve as Secretary of the Treasury, I will do everything I can to justify your trust and confidence.

Thank you.

SENATE FINANCE COMMITTEE
STATEMENT OF INFORMATION REQUESTED OF NOMINEE

A. BIOGRAPHICAL INFORMATION

1. Name: (Include any former names used.)

   Timothy Franz Geithner

2. Position to which nominated:

   Secretary of the Treasury

3. Date of nomination:

   January 20, 2009

4. Address: (List current residence, office, and mailing addresses.)

   Home

   Office

5. Date and place of birth:

   August 18, 1961
   New York, NY

6. Marital status: (Include maiden name of wife or husband's name.)

7. Names and ages of children:

8. Education: (List secondary and higher education institutions, dates attended, degree received, and date degree granted.)

Johns Hopkins, School for Advanced International Studies, 9/83-5/85; M.A. in International Economics and East Asian Studies; awarded May 1985

Dartmouth College, 9/79-6/83, B.A. in Government and Asian Studies; awarded June 1983

Beijing Normal University, PRC, Summer 1982

Beijing University, PRC, Summer 1981

9. Employment record: (List all jobs held since college, including the title or description of job, name of employer, location of work, and dates of employment.)

President And Chief Executive Officer	Federal Reserve Bank of NY	New York, NY	Present to 11/03
Director Policy Review and Development Department	IMF	Washington, DC	9/01 to 10/03
Senior Fellow	Council on Foreign Relations	Washington, D.C.	2/01 to 9/01
Under Secretary (International Affairs)	U.S. Treasury	Washington, DC	12/98 to 1/01
Assistant Secretary (International Affairs)	U.S. Treasury	Washington, DC	9/97 to 12/98
Senior Deputy Assistant Secretary (International Monetary and Financial Policy)	U.S. Treasury	Washington, DC	2/97 to 9/97
Deputy Assistant	U.S. Treasury	Washington, DC	3/94 to 2/97

Secretary
(International Monetary and Financial Policy)

Special Assistant to the Under Secretary for International Affairs	U.S. Treasury	Washington, DC	4/92 to 3/94
Special Assistant to the Assistant Secretary for International Affairs	U.S. Treasury	Washington, DC	4/90 to 4/92
Assistant Financial Attaché	U.S. Treasury	Tokyo, Japan	6/90 to 4/90
Assistant to the U.S. Financial Services Negotiator	U.S. Treasury	Washington, DC	8/89 to 6/90
International Economist, Office of International Trade	U.S. Treasury	Washington, DC	7/88 to 8/89
Research Associate	Kissinger Associates, Inc.	Washington, DC	8/85 to 7/88
International Economist	OPIC	Washington, DC	6/84 to 6/85

10. Government experience: (List any advisory, consultative, honorary, or other part-time service or positions with Federal, State or local governments, other than those listed above.)

    None.

11. Business relationships: (List all positions held as an officer, director, trustee, partner, proprietor, agent, representative, or consultant of any corporation, company, firm, partnership, other business enterprise, or educational or other institution.)

    None.

12. Memberships: (List all memberships and offices held in professional, fraternal, scholarly, civic, business, charitable, and other organizations.)

    Council on Foreign Relations, Member, 1996 to Present
    Center for Global Development, Board of Directors, 6/03 to Present
    Group of Thirty, Member, 12/03 to Present
    Economic Club of New York, Trustee, 12/04 to Present

The Partnership for New York City, Ex-Officio Board Member, 6/06 to Present
RAND Corporation, Trustee/Executive Committee, 4/06 to Present
National Academy Foundation, Board Member/Director, 6/06 to Present
International Rescue Committee, Overseer, 4/07 to Present
Trilateral Commission, Member, 8/08 to Present
Bank for International Settlements, Director, 12/03 to Present
New York State Commission to Modernize Financial Services, Member, 9/07 to Present
Peterson Institute for International Economics, Director, 1/08 to Present

13. Political affiliations and activities:

    a. List all public offices for which you have been a candidate.

       None.

    b. List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

       None.

    c. Itemize all political contributions to any individual, campaign organization, political party, political action committee, or similar entity of $50 or more for the past 10 years.

       None.

14. Honors and Awards: (List all scholarships, fellowships, honorary degrees, honorary society memberships, military medals, and any other special recognitions for outstanding service or achievement.)

U.S. Treasury, Alexander Hamilton Award, 2000
Association of Diplomatic and Consular Officers, Retired Fellowship for Graduate Study in International Affairs, 1994
Asia-Pacific Young Professionals, 1987
Mobil Oil Corporation Grant, 1981
Xerox Corporation Grant, 1981

15. Published writings: (List the titles, publishers, and dates of all books, articles, reports, or other published materials you have written.)

06/08/08 Reducing Risk in the Financial System, Comment by Timothy Geithner, *Financial Times*

09/27/06 Safer Strategy for Credit Products Explosion, by Timothy Geithner, Callum McCarthy, and Annette Nazareth, *Financial Times*

10/01 Building Support for More Open Trade: Recommendations, Council on Foreign Relations, Independent Task Force on Trade Expansion, contributor Timothy Geithner

16. Speeches: (List all formal speeches you have delivered during the past five years which are on topics relevant to the position for which you have been nominated. Provide the Committee with two copies of each formal speech.)

Congressional Testimonies

07/24/08 Systemic Risk and Financial Markets; U.S. House of Representatives Committee on Financial Services

04/03/08 Actions by the New York Fed in Response to Liquidity Pressures in Financial Markets; U.S. Senate Committee on Banking, Housing, and Urban Affairs

Speeches:

06/09/08 "Reducing Systemic Risk in a Dynamic Financial System," Remarks before the Economic Club of New York

03/06/08 "The Current Financial Challenges: Policy and Regulatory Implications," Remarks at the Council on Foreign Relations Corporate Conference 2008

12/13/07 "Restoring Market Liquidity in a Financial Crisis," Remarks at the Second New York Fed-Princeton University Liquidity Conference

07/25/07 "The Economic Dynamics of Global Integration," Remarks at the Forum on Global Leadership: U.S. Competitiveness in a Globally Integrated Economy, Washington, D.C.

06/20/07 "Reflections on the Asian Financial Crisis," Remarks at the Trends in Asian Financial Sectors Conference, Federal Reserve Bank of San Francisco

06/13/07 "Asia, the World Economy and the International System," Remarks at the Economic Society of Singapore 2007 Annual Dinner, Singapore

05/15/07 "Liquidity Risk and the Global Economy," Remarks at the Federal Reserve Bank of Atlanta's 2007 Financial Markets Conference-Credit Derivatives

05/04/07	"Reflections on the Changing Global Economy," Remarks at the 46th ACI Financial Markets Association World Congress, Montreal, Canada
04/17/07	"Global Economic Integration: the Opportunities and the Challenges," Remarks at the Euro and the Dollar: Pillars in Global Finance Conference, Federal Reserve Bank of New York
03/23/07	"Credit Market Innovations and their Implications," Remarks at the 2007 Credit Markets Symposium hosted by the Federal Reserve Bank of Richmond
02/28/07	"Liquidity and Financial Markets," Remarks at the 8th Annual Risk Convention and Exhibition hosted by the Global Association of Risk Professionals, New York
01/11/07	"Developments in the Global Economy and Implications for the United States," Remarks at the Council on Foreign Relations' C. Peter McColough Roundtable Series on International Economics, New York
10/26/06	"Global Economic and Financial Integration: Some Implications for Central Banking," Remarks at the Columbia Business School Center on Japanese Economy and Business' 20th Anniversary Conference, Columbia University
10/04/06	"Progress toward Financial Stability in Emerging Market Economies," Remarks at the W.P. Carey Global Leader Lecture, Paul H. Nitze School of Advanced International Studies, Johns Hopkins University
09/15/06	"Hedge Funds and Derivatives and their Implications for the Financial System," Remarks at the Distinguished Lecture 2006, sponsored by the Hong Kong Monetary Authority and Hong Kong Association of Banks, Hong Kong
05/31/06	"Uncertainty and Transparency in the Conduct of Monetary Policy," Remarks at the Financial Services Leadership Forum Breakfast, New York
05/19/06	"Principals to Guide the Future Evolution of Financial Supervision and Regulation," Remarks at the Bond Market Association's Annual Meetings 2006, New York

05/16/06	"Implications of Growth in Credit Derivatives for Financial Stability," Remarks at the New York University Stern School of Business' Third Credit Risk Conference
04/05/06	"Risk Management Challenges in a Changing Financial Environment," Remarks at the New York Bankers Association Financial Services Forum Chairman's Reception
03/09/06	"U.S. Monetary Policy in the Global Financial System," Remarks at the Japan Society Corporate Luncheon
02/28/06	"Risk Management Challenges in the U.S. Financial System," Remarks at the Global Association of Risk Professionals 7th Annual Risk Management Convention & Exhibition, New York
01/23/06	"Policy Implications of Global Imbalances," Remarks at the Global Financial Imbalances Conference at Chatham House, London
01/11/06	"Remarks by President Geithner: Some Perspectives on U.S. Monetary Policy," Remarks at the New York Association for Business Economics
10/19/05	"U.S. and the Global Economy," Remarks at the Asia Society's CEO Forum, New York
10/18/05	"Challenges in Risk Management," Remarks at the Institute of International Bankers Luncheon, New York
09/25/05	"Remarks at the Institute of International Finance, Inc.'s Annual Membership Meeting," Washington, D.C.
04/20/05	"Remarks at the Bond Market Associations Annual Meeting," New York
04/19/05	"Financial Integration and Its Implications for International Cooperation," Remarks at the European Commission Conference
04/12/05	"Economic Policy and the Sustainability of U.S. Productivity Growth," Remarks at the Puerto Rico Bankers Association
04/01/05	"Perspectives on U.S. Monetary Policy," Remarks before Princeton University's Center for Economic Policy Centers
03/30/05	"Perspectives on Monetary Policy and Central Banking," Remarks before the Central Bank of Brazil, Brasilia, Brazil

02/09/05	"Remarks before the Economic Club of Washington, D.C.," Economic Club of Washington, D.C.
01/19/05	"A View from the Federal Reserve Bank of New York," Remarks at the Business Council of Fairfied County's Economic Luncheon
01/13/05	"Key Challenges in Risk Management," Remarks at the RMA/Risk Business KRI's Global Operational Risk Forum
12/08/04	"National Academy Foundation's 2004 Dinner," Remarks before the National Academy Foundation
11/17/04	"Hedge Funds and Their Implications for the Financial System," Remarks at the National Conference on the Securities Industry hosted by the AICPA and the Financial Management Division of the Securities Industry Association
10/14/04	"Challenges Facing the Global Payments System," Remarks at the SIBOS 2004 Atlanta Conference
10/01/04	"Changes in the Structure of the U.S. Financial System and Implications for Systemic Risk," Conference on Systemic Financial Crises at the Federal Reserve Bank Chicago
06/10/04	"The Bretton Woods Institutions in the 21st Century," Remarks before the Bretton Woods Committee
06/09/04	"The Changing Face of Risk Management," Remarks before the Institute of International Bankers
05/27/04	"Perspectives on the U.S. Financial System," Remarks before the Economic Club of New York
03/25/04	"Change and Challenges Facing the U.S. Financial System," Remarks before the New York Bankers Association's Annual Financial Services Forum

17. Qualifications: (State what, in your opinion, qualifies you to serve in the position to which you have been nominated.)

I currently serve as the President and Chairman of the Federal Reserve Bank of New York. Prior to that I served as the Director of Policy Review and Development at the International Monetary Fund. Having served under 5 Secretaries of the Treasury, the majority of my career has been spent at the

Department of the Treasury, first as a civil servant and eventually as a Presidential appointee. During this time, I served as both Under Secretary and Assistant Secretary for International Affairs of the Treasury.

B. FUTURE EMPLOYMENT RELATIONSHIPS

1. Will you sever all connections with your present employers, business firms, associations, or organizations if you are confirmed by the Senate? If not, provide details.

   Yes.

2. Do you have any plans, commitments, or agreements to pursue outside employment, with or without compensation, during your service with the government? If so, provide details.

   No.

3. Has any person or entity made a commitment or agreement to employ your services in any capacity after you leave government service? If so, provide details.

   No.

4. If you are confirmed by the Senate, do you expect to serve out your full term or until the next Presidential election, whichever is applicable? If not, explain.

   Yes.

C. POTENTIAL CONFLICTS OF INTEREST

1. Indicate any investments, obligations, liabilities, or other relationships which could involve potential conflicts of interest in the position to which you have been nominated.

   In connection with the nomination process, I have consulted with the Office of Government Ethics and Department of the Treasury's designated agency ethics official to identify any potential conflicts of interest. Any potential conflicts of interest will be resolved in accordance with the terms of the ethics agreement that I have entered into with the Department's designated agency ethics official.

2. Describe any business relationship, dealing or financial transaction which you have had during the last 10 years, whether for yourself, on behalf of a client, or acting as an agent, that could in any way constitute or result in a possible conflict of interest in the position to which you have been nominated.

See response to question 1 above.

3. Describe any activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat, or modification of any legislation or affecting the administration and execution of law or public policy. Activities performed as an employee of the Federal government need not be listed.

   None.

4. Explain how you will resolve any potential conflict of interest, including any that may be disclosed by your responses to the above items. (Provide the Committee with **two** copies of any trust or other agreements.)

   As noted above, I have consulted with the Office of Government Ethics and Treasury ethics officials to identify potential conflicts of interest. Any potential conflicts of interest that have been identified will be resolved in accordance with the terms of my ethics agreement. If I become aware of any potential conflict of interest in connection with the performance of my official duties following my appointment as Secretary, I will consult promptly with Treasury's ethics counsel in order to comply with all applicable laws and regulations.

5. **Two** copies of written opinions should be provided directly to the Committee by the designated agency ethics officer of the agency to which you have been nominated and by the Office of Government Ethics concerning potential conflicts of interest or any legal impediments to your serving in this position.

6. The following information is to be provided only by nominees to the positions of United States Trade Representative and Deputy United States Trade Representative:

   Have you ever represented, advised, or otherwise aided a foreign government or a foreign political organization with respect to any international trade matter? If so, provide the name of the foreign entity, a description of the work performed (including any work you supervised), the time frame of the work (e.g., March to December 1995), and the number of hours spent on the representation.

   Not applicable.

D. <u>LEGAL AND OTHER MATTERS</u>

1. Have you ever been the subject of a complaint or been investigated, disciplined,

or otherwise cited for a breach of ethics for unprofessional conduct before any court, administrative agency, professional association, disciplinary committee, or other professional group? If so, provide details.

No.

2. Have you ever been investigated, arrested, charged, or held by any Federal, State, or other law enforcement authority for a violation of any Federal, State, county or municipal law, regulation, or ordinance, other than a minor traffic offense? If so, provide details.

   No.

3. Have you ever been involved as a party in interest in any administrative agency proceeding or civil litigation? If so, provide details.

   Riches v. Bernanke et al. was a Section 1983 pro se case filed in the Northern District of California against numerous finance and treasury officials including Ben Bernanke, Alan Greenspan, Paul Volker and myself. The Court dismissed the case 30 days after it was filed without the defendants having responded to it.

   Vogt & Sather v. Peak Performance Technologies, Inc., et al. was filed in the District of Colorado. Plaintiffs asserted 94 claims against more than 100 defendants, including myself, Alberto Gonzales, and Colorado State Bar. The complaint asserts a conspiracy involving the Church of Scientology with the goal of harming the plaintiffs in a variety of ways.

   I was voluntarily dismissed from the lawsuit in January 2006 when the plaintiffs filed an amended complaint that asserted no claims against me. The rest of the defendants prevailed on a motion to dismiss two months later.

4. Have you ever been convicted (including pleas of guilty or *nolo contendere*) of any criminal violation other than a minor traffic offense? If so, provide details.

   No.

5. Please advise the Committee of any additional information, favorable or unfavorable, which you feel should be considered in connection with your nomination.

   None.

E. <u>TESTIFYING BEFORE CONGRESS</u>

1. If you are confirmed by the Senate, are you willing to appear and testify before any duly constituted committee of the Congress on such occasions as you may be reasonably requested to do so?

   Yes.

2. If you are confirmed by the Senate, are you willing to provide such information as is requested by such committees?

   Yes.

FINANCE COMMITTEE QUESTIONS FOR THE RECORD

United States Senate

Committee on Finance

Hearing on

Confirmation of Mr. Timothy F. Geithner to be

Secretary of the U.S. Department of Treasury

January 21, 2009

ANSWERS TO QUESTIONS FROM CHAIRMAN BAUCUS

Question 1:

Estimates of revenue lost because of offshore tax evasion range from $50 to $100 billion. The Finance Committee has had a number of hearings on the offshore tax evasion issue and I believe the next step is to pass legislation cracking down on offshore tax evaders, and I will be introducing a bill early in this session of Congress to address this problem.

Mr. Geithner, I hope you will take a close look at this legislation and help us to pass it from your new perch at the Treasury Department. Will you commit to setting aside time to help us develop a solution to this problem?

Yes, Senator Baucus, as soon as my tax team is fully in place, I look forward to setting aside time to review your forthcoming legislation and helping you, your staff, and other members of the Senate develop a solution to the problem of offshore tax evasion.

I share the President's commitment to aggressively address the problem of offshore tax evasion and complement you and other members of the Senate for the work you've already done on this important issue. If confirmed, I will treat offshore tax evasion as a high priority issue and examine a wide range of policy options to address these abuses, including increasing IRS enforcement efforts, requiring greater disclosure and taxpayer accountability, and changing the presumption for transactions in tax-secrecy jurisdictions.

<u>Question 2:</u>

Small businesses are struggling right now. A recent report estimates that 40% of December's job losses of 693,000 nationwide were small business job losses. Nearly all of the businesses in Montana are small. Banks are pulling their lines of credit and they have a dire need for operating capital, debt restructuring, and loan workouts. Some of the TARP money should be used to help these small businesses survive the current economic downturn.

First, I want you to make small businesses a high priority when implementing the Asset Backed Securities Lending Facility next month.

Second, I want you to look at the Community Development Financial Institutions network as a possible vehicle to loan TARP money to small businesses.

Third, I want you to find other ways to help small businesses. Congress has given you the money and authority to help. I want you to use a significant portion of those resources to help small businesses.

Can you commit to these steps and give me some specifics on how you will pursue these actions?

Small businesses are crucial to sustainable employment opportunities for Americans throughout the country. A major thrust of our efforts to stabilize the U.S. financial system is to ensure that credit begins to flow again to qualified small business borrowers and others whose access to credit has been unfairly curtailed or ceased up. Community banks, including many CDFI participants, are a vital lifeblood to credit for many small businesses. If confirmed, I will explore and utilize every prudent mechanism for restoring credit availability and I look forward to working with this committee and others in Congress to finding the quickest, most reliable manner to achieve this objective as it is very high among President Obama's economic priorities.

<u>Question 3:</u>

Your predecessor initiated the U.S.-China Strategic Economic Dialogue (SED). I think it is imperative we continue a high-level dialogue with China and we can waste no time doing so.

Do you plan on continuing an SED-like dialogue? What would that dialogue look like and what should it achieve?

I believe getting China to continue reforms is critical to our economy, as well as to theirs. After all, if China doesn't rebalance its economy, we risk falling into past patterns of Americans borrowing and consuming too much, and the Chinese saving and consuming too little. What's your view?

The U.S.-China economic relationship presents significant challenges, but also opportunities. It is one of our most important relationships. There are many specific issues in our economic relationship that require our careful and prompt attention. If confirmed, I am committed to a deep engagement between our senior economic officials to address differences and effectively resolve problems on these topics.

Question 4:

After September 11, 2001, the Treasury Department created an important new office – the Office of Terrorism and Financial Intelligence (TFI).

Last year, the head of TFI, Under Secretary Levey, testified before the Finance Committee. He has done a good job organizing his team, and coordinating with the rest of the administration to shut down terrorism financing around the globe.

We want you to take a close look at this office and put in place a strong leader. And we will be requesting regular updates on their performance this year.

Do we have a commitment from you that the head of TFI will testify before the Finance Committee, if requested?

If confirmed, I commit that the Under Secretary for Terrorism and Financial Intelligence will testify before the Finance Committee if requested

Question 5:

Mr. Geithner, as Treasury Secretary you will be responsible for the IRS, an agency with nearly 100,000 employees. During your tenure, the IRS will face many important administrative issues, including (1) bringing IRS technology into the 21st Century to improve electronic filing and to revamp outdated systems that are haywired together, creating information gaps that prevent the IRS from analyzing data to identify non-filers and underpayers and (2) reinvigorating the IRS workforce to stem the retirement brain-drain and to challenge IRS leadership to be innovative and committed to looking beyond their own programs with an eye toward improving the entire organization.

I want the IRS to have sufficient funding to be effective and efficient. Do I have your commitment that you will be an advocate for adequate IRS budgets so the organization can do its job?

Yes.

How will you make sure the IRS actually updates its information technology and doesn't squander IT funds on systems that don't work, like it has in the past?

We must do a more effective job in planning and executing an information technology strategy for the Internal Revenue Service. Technology has the capacity to improve the speed and accuracy of tax administration. For this reason, improving IRS information systems must be an important priority. If we hope to make progress, it is important that we seek the opinion of the best technology experts in government and the private sector to develop a strategy going forward. If confirmed, I will work closely with the IRS Commissioner and other federal officials to achieve this goal.

How can the IRS workforce, especially senior leadership, be motivated to stay at the IRS and develop innovative ways to improve the organization?

There are critical workforce issues confronting the entire Federal government, including the IRS. The Federal government we must do a better job in both recruiting and retaining employees, particularly senior leadership. The level of expected retirements at all ranks of our workforce must be considered as we formulate strategies to raise the attractiveness of government service. If confirmed, I will examine the workforce challenges confronting the IRS. As someone who has spent most of his professional career working for the Federal government, I know firsthand how important it is to attract top candidates to work in the public sector.

Question 6:

In 2003, the Office of Foreign Assets Control (OFAC) dedicated 21 full-time equivalents – in other words, job slots – to enforce the travel ban against Cuba. In contrast, OFAC dedicated two such personnel slots to tracking the funding networks of Osama Bin Laden and two others to track the funding networks Saddam Hussein. Is this how we should be spending our resources to fight the war on terror? How will you address this imbalance in resources?

Since 2003, I understand that Treasury has worked closely with Congress in realigning its resources to enable the Department to best address today's most pressing security challenges. If confirmed, I pledge to ensure that Treasury continues to dedicate the necessary resources to most effectively combat terrorism and the proliferation of weapons of mass destruction and other national security challenges.

Question 7:

What can the IRS do to stem the tide of scams and schemes – offshore arrangements like UBS, and abuses like the Madoff Ponzi scheme - that result in folks hiding their income from Uncle Sam?

I share the President's commitment to closing down tax loopholes. I look forward, if confirmed, to working with the committee to examine this issue.

If confirmed, I will be a strong advocate for the Internal Revenue Service and its efforts to secure sufficient funding to carry out its mission successfully. Tax enforcement is a key priority for the IRS and I look forward to working with IRS Commissioner Doug Shulman to ensure that the compliance and enforcement mission of the IRS receives the necessary support and funding.

Question 8:

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

A first objective is to seek ways to make the tax code more simple so that more taxpayers are able to complete their taxes without the additional financial burden of a paid preparer. However, there is little doubt that many taxpayers will continue to make use of paid preparers. For this reason, it is important that taxpayers have confidence that the advice they receive is competent. What steps we should take toward this objective I have not had an opportunity to study fully. I look forward to working with you and other members of the Committee to address this issue if I am confirmed.

Question 9:

In 1998, Congress set a goal of 80% electronically filed returns by 2007. In 2008, about 60% of returns were e-filed. What will you do to encourage e-filing so taxpayers get their refunds faster, errors are reduced, and the IRS can operate more efficiently?

I strongly support the President's promise to simplify the tax code. During the campaign, he outlined a proposal to develop a system that would dramatically simplify tax filings so that millions of Americans will be able to do their taxes in less than five minutes. If confirmed, I look forward to working with Congress on this and other ideas to simplify the tax code and increase the number of Americans that electronically file their tax returns.

Question 10:

Several months ago information was leaked that Treasury looked to utilize the GSEs to set mortgage rates at 4.5%. What are your thoughts on this proposal?

The primary objective of the proposal to provide 4-1/2% mortgages is to assure that affordable mortgages are available for qualified borrowers. We share the objective and have been and will continue examining proposals aimed increasing the flow of credit to qualified borrowers. There are a number of factors that have caused mortgage rates to be higher than they otherwise would be in a more normal environment. We will continue to examine the causes and to evaluate the various proposals, including this one, to determine whether or not they would be effective in achieving our objectives in a cost effective manner.

Question 11:

What actions still need to be taken with regards to AIG? Citigroup?

With respect to AIG, the Treasury and the Federal Reserve both have teams of people working to monitor and assess the condition of AIG and the status of the U.S.

government's investments in this institution. The funds provided to AIG by the government were provided on the basis of a complicated set of judgments about the risks to broader financial stability posed by the rapid and disorderly failure of a firm of that size in a very fragile market environment. Any future actions with respect to AIG would have to be undertaken in the context of a similarly careful set of judgments about strength of the firm itself and the conditions prevailing in markets at that time. The actions taken with respect to Citigroup to date have been to stabilize and strengthen the firm in order to allow it to perform its vital role in providing credit to households and businesses. I cannot speak to the need for any future actions with respect to Citigroup at this time, but I can assure you that as Treasury Secretary, I would require that any future actions with respect to AIG, Citigroup or any other institution be subject to careful scrutiny regarding the amount of taxpayer money being put at risk by acting relative to the costs of not acting.

<u>Question 12:</u>

I want you to cooperate completely with the Special IG for the TARP. Because oversight of the TARP in the original proposal was so weak I insisted on the creation of a Special Inspector General. Neil Barofsky was confirmed as Special IG by the Senate on December 8, and we will count on you to make sure he receives whatever he needs to do his job. Do you agree to cooperate with the Special IG and will you provide him with all the information and documents he needs as he carries out his oversight responsibilities?

I will cooperate completely with the Special IG for the TARP. I agree that oversight and transparency requirements in the original proposal were inadequate, and I intend to provide the IG with all the information, advice, and documentation he needs to fulfill his Congressionally-mandated oversight responsibilities.

<u>Question 13:</u>

(a) The U.K. is doubling efforts to shore up its financial sector and spur lending, including requiring banks that participate to enter into binding agreements to lend more money to borrowers. What are your thoughts on this proposal? Should the U.S. include more stringent requirements that TARP funds be used to lend?

The actions of the Senate last week to authorize additional resources under the Emergency Economic Stabilization Act will enable us to take additional steps to reinforce recovery.

If confirmed, I will carry out the reforms that President Obama and I believe are needed in this program. This program must promote the stability of the financial system and increase lending.

As a condition of federal assistance, healthy banks without major capital shortfalls will increase lending above baseline levels.

Banks receiving government capital will be required to provide detailed and timely information on their lending patterns broken down by category. Public companies will report this information quarterly, including a description of the factors that influenced their decisions, in conjunction with the release of their 10Q reports.

The Treasury will report quarterly on overall lending activity and on the terms and availability of credit in the economy.

(b) The U.K. also announced earlier this month that it plans to establish a separate fund to provide guarantees for loans made to small businesses. Small businesses in the U.S. are having similar difficulties obtaining financing they needs to continue operating. What are your thoughts on the proposal by the U.K.?

The Obama Administration is committed to using the full arsenal of tools available to get credit flowing again to families and businesses. We will ensure that support under this program is directed at making credit available to support recovery.

This is particularly important for small businesses.

We will work with the Federal Reserve, SBA, and other agencies to restart lending for small businesses. This will be an important focus for support that we will provide under the Emergency Economic Stabilization Act.

If confirmed, I look forward to working with Congress on this important issue.

Question 14:

In AIG Marketing Materials, the company claims that of the $150 billion bailout package, the "actual debt to be repaid" is $39 billion. The company claims that the preferred stock pledge and the credit default swap and securities lending special purpose vehicles have removed any obligation for about $110 billion. And it claims that "AIG is in the process of selling non-core businesses with estimated values far in excess of its total debt to the Fed." Is that your understanding of AIG's current position?

I would need to look more carefully at these particular materials to give you a complete answer to this question. I will ask the staff at the Federal Reserve Bank of New York involved in monitoring and assessing AIG's condition to confirm the validity of all the claims that AIG makes in its public materials.

__Question 15:__

The IRS estimates the tax gap, the difference between the taxes legally owed and those paid on time, to be $345 billion each year. In 2007, I asked Secretary Paulson to make a commitment to reach 90% voluntary tax compliance by 2017 - ten years to raise the rate from its current 83.7%.

(i) **Do I have your commitment that you will work to achieve 90% voluntary compliance within 10 years?**

I will work to improve the level of voluntary compliance and believe that, with adequate support from Congress, we can achieve 90% voluntary compliance within the next decade. The President is committed to implementing an effective program to close the tax gap and the Administration looks forward to working with you on this effort.

(ii) **Do I have your commitment that you will come testify before this Committee later this year to tell us what you are doing to implement Treasury's Tax Gap Plan and the progress you are making?**

Yes.

__Question 16:__

There is an ongoing to debate about whether and to what extent global economic imbalances contributed to our current financial and economic crisis. In particular, this debate focuses on the role of countries with large current account surpluses, such as China, in the current crisis.

What is your view on the role and extent to which these imbalances contributed to our current economic problems? Based on this view, how will you as Treasury Secretary work to unwind these balances in an orderly fashion? If these imbalances are not unwound, what is the likely impact on the U.S. economy?

Global imbalances reflect a complex interaction of savings and investments and many other forces. In the short term we need coordinated stimulus to strengthen demand here and in China. Once demand is stabilized we need a constructive dialogue with China that focuses on helping China move towards growth that relies more on domestic consumption and less on exports.

__Question 17:__

International Monetary Fund (IMF) Managing Director Strauss-Kahn and others have called for a large, coordinated fiscal stimulus. To date, few countries have advanced concrete fiscal stimulus plans close to the 2 percent of GDP Strauss-Kahn recommends.

Do you agree that large and coordinated global stimulus initiatives are necessary in the current crisis? What will you do to persuade our economic partner countries to design and implement coordinated stimulus plans on the scale Strauss-Kahn and

others recommend? If such plans fail to materialize or are not implemented, how will that affect the impact of our own economic recovery plans?

Yes. We will work with our economic partners to make sure they understand that the recovery of each individual country relies on every one of us providing a fiscal stimulus. If such plans fail to materialize, a slowdown in worldwide demand will ensue, exacerbating the downturn both here in the US and abroad.

Question 18:

The IMF is in need of reform to increase developing country representation and voice in the Fund. Proposed IMF quota changes – an important element in this necessary reform – require Congressional approval.

Do you support IMF reforms, including proposed changes to quotas that will give developing countries greater say in the Fund? If so, how will the Obama Administration advocate for these reforms to secure Congressional approval?

Yes. President Obama has said that he wants to reform the IMF to increase developing country representation. We need to send a strong signal that we are ready to give developing countries a voice within the IMF that is commensurate with their importance to the world economy. We will consult closely with Congress on how to bring about IMF reforms that are in the best interest of the institution, the U.S. taxpayer, and the global economy.

Question 19:

The current global economic crisis has made the IMF's already dwindling financial resources a more pressing concern. The IMF is proposing selling some of its existing gold holdings in order to raise more useable resources. Congress must approve the sale for it to move forward.

Do you support the IMF's gold sale proposal? If so, how will the Obama Administration advocate for its approval in Congress? Do you believe Congress should handle the gold sale issue together with quota reform or address both issues separately?

The sale of IMF gold is designed to fund the IMF's operating budget, that is, to support its work on data dissemination and standards, surveillance, global economic forecasting. It makes sense to ensure that the IMF can carry out these central functions without having to rely on income from crisis lending. The IMF may well need more resources to shepherd emerging economies through this crisis, but the sale of IMF gold is not intended for that purpose (nor would it raise enough money). Rather than dealing with IMF reform on a piecemeal basis, it is probably makes sense to handle the gold sale issue and quota reform at the same time.

<u>Question 20:</u>

Mr. Geithner, on January 21, 2009, the New York Times ran an op-ed piece entitled "Questions for Mr. Geithner." The article posed the following questions, which I would like you to answer.

a. The American tax code is so complex that even Treasury secretary nominees can easily make mistakes on their returns. Furthermore, while income tax rates are 10 percent to 35 percent for individuals and 35 percent for corporations, because of the proliferation of deductions, credits, exclusions and loopholes, the revenue from income tax amounts to only 10 percent of gross domestic product. Should you give priority to simplifying the code and enforcing compliance before raising rates?

— CHARLES O. ROSSOTTI, the commissioner of internal revenue from 1997 to 2002

IRS Commissioner Charles Rossotti is correct that our country should make tax simplification and compliance an important priority. The President shares his commitment to this objective, as is evidence by his proposal to allow millions of Americans to be able to do their taxes in less than five minutes.

b. Ordinary taxpayers would like an answer to this question: Why have they been billed more than $45 billion to rescue Citigroup from failure when, as president of the Federal Reserve Bank of New York, you were its primary supervisor? Three major problems led to Citigroup's downfall: bad investment policy; overexpansion, which overwhelmed Citigroup's management; and an inadequate capital base. Why was Citigroup's supervision inadequate to deal with these problems?

There are many reasons to be deeply concerned about the performance of supervision and regulation with respect to many of our largest financial institutions. Perhaps most important from the perspective of financial stability was the failure of risk management. Firms made business decisions that exposed them to significant risks, and risk management failed to constrain the business judgments or keep pace with the challenges arising from the complexity of the exposures created. To a significant degree, these risk management weaknesses contributed to the severity of the crisis and its potential impact on the real economy. Citigroup's supervisors, including the Federal Reserve, failed to identify a number of their risk management shortcomings and to induce appropriate changes in behavior. The Fed and other regulators are in the process of carefully evaluating the sources of the current problems and the changes that need to be made to prevent this situation in the future.

c. The Treasury and Federal Reserve have been selecting which companies in American industry and finance will get taxpayer money. What criteria do you use to decide?

The broad criteria for eligibility for funds under the EESA are defined in that Act. Within the parameters of this Act, the TARP Capital Purchase Program--which provided funds for the purpose of encouraging institutions to build capital in order to increase the flow of financing to the U.S. economy--was made available to all qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies. Subject to a minimum and maximum subscription amount for each institution, Treasury determined the precise amount of capital provided to each institution in conjunction with that institutions primary federal regulator. There were also circumstances in which it was determined that default by a highly-rated or large firm, or a firm deeply imbedded in the financial infrastructure, posed an unacceptably high risk of impairing the functioning of the financial system or meaningfully restricting access to credit for creditworthy borrowers throughout the economy. In these circumstances, funds were provided to individual institutions under programs other than the Capital Purchase Program.

d. During the banking crisis of the late 1980s, assets of failed savings and loans were acquired by the government's Resolution Trust Corporation. The trust corporation then sold off the assets in an orderly fashion. Would you consider requesting Congress to revive the Resolution Trust Corporation, so you would not have to decide which companies to save and which not to save? Would you consider re-establishing the trust corporation now for commercial banks that are likely to fail?

— ANNA JACOBSON SCHWARTZ, an economist at the National Bureau of Economic Research and the author, with Milton Friedman, of "A Monetary History of the United States, 1867 to 1960"

The Resolution Trust Corporation (RTC) was created in the wake of the Savings and Loan (S&L) crisis to create a mechanism by which assets of failed S&L institutions were disposed or resolved. The reason the RTC did not have to decide which institutions to save was because it was taking assets only from institutions that had already failed. Today, we are looking for ways to address the problem of troubled assets on bank balance sheets that do not require causing institutions to fail because bank failures are costly and disruptive. While the RTC model provides some insight into ways to dispose of troubled assets, applying it in current circumstances would still require deciding which institutions to assist.

With the termination of the Resolution Trust Corporation, all of its remaining assets, liabilities, and duties for the resolution of S&Ls were transferred to the FDIC. Today, the FDIC serves as the appropriate agency and mechanism for resolving failed commercial banks and thrifts.

e. Do you believe that money from the Treasury's Troubled Asset Relief Fund should be exclusively used to preserve our financial system, or should it be used to assist distressed non-financial institutions like manufacturers and retailers? If non-financial institutions are eligible, how do you decide which are deserving?

I share the view expressed in NEC Chairman Summers' letter of January 15th that as we carry out our programs under the Emergency Economic Stabilization Act, our actions should reflect the original purpose of that legislation.

As Dr. Summers also indicated in that letter, the Administration has no intention of using any funds under this Act to implement an industrial policy.

f. Do you believe raising taxes on savings and investment, as would occur if the Bush tax cuts expire in 2010, will help or hurt our economy?

Our immediate priority is to work with Congress to provide substantial tax relief for families and businesses through an economic recovery plan. The President pledged to cut taxes for 95% of working Americans. For businesses, we propose to cut taxes for companies that are making job-creating investments. Beyond that, it is premature to speculate on the tax provisions that expire in 2010.

g. How do we more effectively regulate the financial services industry without adding unnecessary regulations that cripple our ability to compete globally?

— MITT ROMNEY, a former governor of Massachusetts

I believe that markets are central to economic growth and our ability to compete globally, but that markets alone cannot solve all problems. Well-designed financial regulations with strong enforcement are absolutely critical to protecting the integrity of our economy. If confirmed, I look forward to working closely with Congress to develop a smart and effective regulatory system that will meet our current needs as well as the challenges and opportunities we will face both domestically and globally in the years ahead.

h. In the past, you have praised the "resiliency" of the American financial system. But a resilient financial system would demand that banks maintain stricter capital standards in normal times so that when a crisis hits, they don't all have to tighten lending at the same time. What exactly did you mean by "resiliency"?

— ROBERT SHILLER, professor of economics at Yale

Ensuring that U.S. banks maintain adequate capital reserves is a critical component of a well-functioning banking system. The financial crisis has revealed that many U.S. and foreign banks did not have adequate capital reserves to offset the losses that they sustained requiring dramatic policy action to address this problem. Our regulatory system failed to prevent individuals and businesses from taking excessive risk that exposed the system more than just the organizations or individuals taking the risks. This process threatens the resiliency of our financial services system. I believe that we must have much stronger safeguards in place to protect markets and investors against the risks we've witnessed in the past year.

i. The income tax code favors those with employer-provided health insurance over those who buy their own health insurance or pay medical bills out of pocket. It also favors homeowners over renters, through the mortgage interest deduction. Is this tax treatment efficient or fair? Might you favor a more level playing field?

Measuring efficacy and fairness of the present U.S. tax code can only be undertaken in full view of the tradeoffs allowed or imposed by the Code on the wide range of beneficiaries and participants. I support the goal of fairness, and look forward to working with the Congress in considering realistic steps that can be taken to improve both fairness and simplicity.

j. President Obama supports the estate tax. Why should a person who leaves his money to his children pay more in taxes than another person with the same lifetime income who spends all his money on himself?

— N. GREGORY MANKIW, a professor of economics at Harvard

During the campaign, President Obama proposed extending the rate and exemption level that will apply in 2009. However, I understand the strong emotions on both sides of this issue and I look forward to working with all of the Members of the Committee to develop a fiscally responsible solution that provides certainty to families and is consistent with President Obama's principle of restoring tax fairness. Additionally, I should note that President Obama wants to minimize the impact that the estate tax has on small businesses and family farms. His proposal to extend the rate and exemption level that will apply in 2009 ensures that less than 1% of small businesses and farms would be impacted by the estate tax.

k. The American financial regulatory system is highly fragmented, with authority divided among federal and state governments, the Federal Reserve, the comptroller of the currency, the Securities and Exchange Commission, etc. Do you favor an overhaul of the system and, if so, what should the new system look like?

— JOHN STEELE GORDON, the author of "An Empire of Wealth: The Epic History of American Economic Power"

The financial crisis has highlighted the urgent need to overhaul the oversight of our financial system. We must move ahead with comprehensive financial reform to build a stronger, more resilient system with much greater protections for consumers and for investors, with much stronger tools to prevent and respond to future crises.

l. This country has long benefited from the world's confidence in our financial markets. Are financial regulatory reforms necessary now to restore investors' confidence and revive our economy?

Our financial system failed to meet its most basic obligations. The system was too fragile and unstable, and because of this, the system was unfair and unjust. Individuals, families, and businesses that were careful and responsible were damaged by the actions of those who were not. So we need to move quickly to build a stronger, more resilient system with much greater protections for consumers and for investors, with much stronger tools to prevent and respond to future crises. This is critical to restore investor confidence and for our economy going forward.

m. Should debt securities that are held by regulated banks and pension funds be rated by multiple independent credit reports that have been commissioned by a federal agency, or should we continue to let the issuers of debts decide who will rate their risks?

Currently, credit rating agencies are paid by issuers for the ratings that they receive. If confirmed, I look forward to working with the SEC and Congress to consider ways of addressing this conflict of interest as well as possible reforms of the role and use of these ratings under SEC rules.

n. Should large financial institutions incur higher reserve requirements or other regulatory penalties when they become "too big to fail"?

— ROGER B. MYERSON, a professor of economics at the University of Chicago and a winner of the 2007 Nobel Memorial Prize in Economic Sciences

All financial institutions should be properly regulated to protect against systemic risk. These requirements ought to test adequacy of capital against a broader range of possible outcomes. If confirmed, I will lead a comprehensive review of existing capital requirements.

Question 21:

The Department of Treasury maintains oversight of U.S. Customs and Border Protection's (CBP) customs revenue functions. But in recent years, this oversight function has received neither the proper staffing, nor been adequately prioritized. Will you provide necessary resources to ensure the Treasury Department engages in adequate oversight of CBP? How will you prioritize this oversight function?

If confirmed, I will aggressively advocate on behalf of the resource needs of the Treasury oversight functions, including the customs revenue functions performed by the U.S. Customs and Border Protection.

Questions from Senator Grassley

Question 1:

The Congressional Budget Office projects debt held by the public to grow from the fiscal year 2008 figure of $5.8 trillion to $7.2 trillion for fiscal year 2009. Likewise, as a percentage of the economy, the figure would grow from 40.8% to 50.5%. Both are dramatic increases. To put it in context, from 2001 through 2008, debt held by the public grew from 33.1% to 40.8%.

A. Do you believe there is a ceiling on the amount of deficits and debt held by the public?

Deficits of this magnitude are not sustainable over the long term and will require serious budget reforms to achieve a sustainable fiscal position that stabilized the debt to debt ratio at reasonable levels.

B. If you believe we need to be mindful of some limit on deficits and debt, do you believe we should employ this caution against proposals that spend above the baseline, including health care reform?

Yes, we have to be careful to identify how to pay for new commitments to long term programs. In terms of healthcare reform, what is most vital is that we are instituting the type of reforms that will help to slow the growth of health care costs in both the private sector and in our major entitlement costs – at the same time expanding coverage and improving quality. If there are upfront costs in a comprehensive healthcare reform plan we should carefully seek to reduce wasteful, duplicative and low priority spending in some areas where additional up front investments in healthcare could be beneficial if they were part of a comprehensive plan to reduce long-term growth in our nation's healthcare spending.

Question 2:

According to CBO, only less than half of the spending in the House Stimulus package will be spent in the next two years. Some argue that we need to be focusing more on fixing the financial system, since what has been tried hasn't worked, than on a stimulus package.

A. Do you think this is true?

A comprehensive program to help repair the financial system and support credit flows is necessary for recovery. Financial recovery has to be pursued along side the Recovery and Reinvestment Plan.

B. In your testimony today you stated that you think CBO's estimates could be improved. Explain why CBO's estimates are not accurate, including which assumptions should be revised.

Concerning the CBO analysis mentioned today in my hearing, there are a few points that I wish to stress. First, the analysis did not look at the President's entire plan, including such provisions as the bonus depreciation and fiscal aid to states proposals that we believe will have very quick spend-out rates. Secondly, on the spending items that CBO reviewed, we believe that they relied on more traditional assumptions of the spend-out rates of similar transportation and energy projects and did not specifically take into account the provisions put forward by the President and being currently worked on with Appropriators that are specifically designed to ensure the fast-acting spend-out rates that would be needed fiscal stimulus over the next few years.

The Administration believes that, when the entire package is reviewed and when the more specific provisions are taken into account, it will be clear that the design and composition of the American Recovery and Reinvestment Plan will lead to the faster spend out rates that are needed to re-start economic demand.

Question 3:

Do you have any evidence that huge amounts of government spending ever brought a nation's economy out of a recession?

The President's plan is meant to jumpstart our economy making a down payment on long-term economic growth. In many areas -- from infrastructure to clean energy to health care – there is a lot of potential to invest money and create jobs right away by focusing on meritorious projects the can be quickly started.

Conservative and liberal economists agree that short-term deficit spending is necessary in order to stimulate the economy. Looking back on the 1930s, I share the belief of most economists that we were effective in ending the Great Depression only after very substantial fiscal and monetary policy stimulus, along with a comprehensive strategy to stabilize the banking system.

Question 4:

In your response to Senator Kyl's question about transfers funds to state and local governments, you stated that you believe that entities should be subject to conditions and that you are open to all suggestions. Describe what conditions you would impose on government entities to ensure that federal funds are being used in the best way possible.

In your response to Senator Kyl's question about transfers funds to state and local governments, you stated that you believe that entities should be subject to conditions and that you are open to all suggestions. Describe what conditions you would impose on government entities to ensure that federal funds are being used in the best way possible.

The President and Congress have been working together on a set of new conditions to ensure that this package gets resources out both quickly and effectively. These include tightening restrictions on federal awarding and state investment of recovery funds, to ensure that government entities are not sitting on unused funds; explicitly targeting ready-to-go projects that have already been approved and can be done quickly and effectively; and unprecedented levels of transparency and oversight so average Americans can help participate in the process of holding government accountable. There will be an oversight board with independent advisers in place to identify issues before they become problems. And all information about how these funds are being disbursed and invested will be posted online in a user-friendly format for people to review.

Question 5:

The CBO states that only $136,323,000 of the $355,532,000 (or less than 39%) in estimated outlays from the American Recovery and Reinvestment Act of 2009 will occur in 2009 and 2010. In addition, the Joint Committee on Taxation estimates that the government will lose revenue of $231,676,000 of the net total of $275,378,000 from all of the tax provisions in 2009 and 2010. Therefore, when the spending and tax provisions are combined, less than half of the stimulus spending and tax relief occurs in 2009 and 2010. In your view, is this less than 50% figure an appropriate figure for a stimulus bill?

The President's plan is designed to provide a very substantial boost to growth in 2009 and 2010. The proposed mix of spending and tax provisions were chosen to maximize this objective. We are open to considering ways of improving the short term impact of the proposals.

<u>**Question 6:**</u>

Mr. Geithner, as you know, I wrote to you last June asking for details about the portfolio of assets received by the Federal Reserve as part of the Bear Stearns rescue last March. I received no reply for months. In fact, despite repeated requests to receive a full response before the Senate voted on the broader $700 billion dollar package, it was only after that vote that you provided the information I was seeking. It's hard to imagine a situation where the legislative need for information was more urgent than just before that vote to authorize the spending of $700 billion.

a. **Why did you withhold the information until after the vote?**

I very much appreciate your frustration with the pace at which you were provided the information you requested. The review process within the Federal Reserve took longer than was necessary and appropriate. I can assure you that the delay was in no way related to the process that was unfolding around the TARP. I understand that staff at the New York Fed have met with your staff and that your staff has been satisifed with the information that has now been provided. If confirmed, I will work with you to see that you have available to you all the information you require to ensure that the taxpayer's interests are protected.

b. **What assurances can you provide that you will not be as slow to respond to my future requests for information if you are confirmed?**

President Obama has emphasized his desire, which I share, to work closely with both parties on Capital Hill to ensure that we can address our nation's urgent problems. At this point in time, it is critical that the Administration and Congress consult closely with one another. And, as I have indicated, I will make certain that your requests are given prompt responses.

<u>**Question 7:**</u>

I appreciate the briefing and answers to follow-up questions that your staff eventually provided regarding the Bear Stearns deal. However, I am disappointed with the level public disclosure about the assets being held by the Federal Reserve through Maiden Lane, LLC. Specifically, it appears that the reported valuation of those assets may be overstated. The reason is that much of the debt in the portfolio is guaranteed by Freddie Mac and Fannie Mae, which are in-turn guaranteed by the Federal Government. In other words, a rosy scenario for Maiden Lane, LLC is not necessarily a rosy scenario for the American taxpayer.

a. **Isn't it true that if the defaults on those loans are high, then the taxpayer is still left holding the bag even if the Federal Reserve gets its money back from Maiden Lane, LLC?**

The Federal Reserve holds a range of government, government guaranteed and agency securities on its balance sheet. We have provided the Committee staff with the detailed composition of the assets in the Maiden Lane, LLC that are guaranteed by Fannie Mae and Freddie Mac. The risks assumed by the government sponsored entities and by the Federal Reserve have to be measured in relation to the benefits they provide the financial system and the overall economy.

b. Why isn't general data about the loans underlying the securities in the portfolio regularly reported to Congress and the public in order to provide a more accurate picture of the true risk to the taxpayer? Specifically, is there any reason that the percentages of loans in default, the percentages of loans over 90 days late, and similar aggregated statistical information cannot be released?

As you know, the critical imperative behind all of the government's extraordinary actions over this period has been to stabilize the financial system. Consistent with its accounting and disclosure practices, the Federal Reserve reports publically on the value of the portfolio of assets held in Maiden Lane, LLC on a regular basis. Confidentiality around the specific characteristics and performance of individual loans in the portfolio is maintained in order to allow the asset manager the flexibility to manage the assets in a way that maximizes the value of portfolio and mitigates risk of loss to the taxpayer.

c. If you are confirmed, what assurances can you provide that there will be more meaningful disclosure about the performance of the Bear Stearns deal?

The Board of Governors of the Federal Reserve System is responsible for setting broad policy on accounting and disclosure of the activities of the Federal Reserve Banks. If confirmed, I look forward to working with you and with Chairman Bernanke on ways to respond to your suggestions and concerns.

d. What specific additional disclosure would you support?

If confirmed, I look forward to working with you and with Chairman Bernanke on ways to respond to your suggestions and concerns.

e. What do you plan to do to ensure that there is improved transparency regarding the AIG rescue and the TARP program?

If confirmed, I will work with you and your committee to provide all appropriate information to strengthen transparency and safeguard taxpayer funds.

f. **Do you support providing GAO with full access to the books and records of entities that received TARP funds?**

If confirmed, I would be pleased to work with you and the GAO to examine way to help the GAO carried out its important oversight functions.

Question 8:

Given your statement in today's hearing that you believe that third party information reporting can improve compliance, do you believe that repealing the 3% withholding requirement as passed by the House is a good proposal? Do you support this proposal.

I appreciate the opportunity to discuss with you measures that will improve tax compliance. If confirmed, I look forward to hearing from Commissioner Shulman and members of Congress on ways we can improve compliance. Recent steps taken to enhance information reporting have improved compliance and simplified tax filing and serve as a model for future action. With respect to the withholding provision, I have not had an opportunity to study this provision closely but, if confirmed, I will examine this proposal along with other ideas in this area.

Question 9:

I understand that the current contracts with the collection agencies expire on March 1 and that the IRS must decide by February 1 whether the contracts will be extended. I understand that the IRS is studying the private debt collection program but that, as of an October briefing with my staff, the study was flawed. Since it is unlikely that I will be briefed on this study before February 1, I would like your commitment that Treasury will not terminate this program until there has been a complete and thorough accounting of this program.

If confirmed, I will ask IRS Commissioner Shulman to provide me with a complete and thorough examination of this program before the approaching date for action in this area.

<u>**Question 10**</u>:

Do you have any home equity loans outstanding? If yes, please provide a detailed accounting of the how the funds were used.

Yes. The Committee has a full accounting of my asset and liabilities. I do not have additional information available at this time. I would be happy to provide additional information to the Committee as necessary.

<u>**Question 11**</u>:

When did the IRS first contact you regarding your 2003 and 2004 self-employment tax liabilities on your IMF income?

May of 2006.

<u>**Question 12**</u>:

Provide all correspondence with the IRS regarding your 2001 and 2002 tax returns, during the 2003 and 2004 audit or otherwise.

I have provided all such correspondence in my possession.

A. Did the IRS inquire about your 2001 and 2002 self-employment tax liability on your IMF income during the audit of your 2004 and 2005 tax return?

I do not recall any such inquiry.

B. Did you inform the IRS that you were employed by the IMF during 2001 and 2002?

I do not recall any conversation with the IRS during the 2006 audit about my employment at the IMF in 2001 and 2002.

<u>Question 13</u>:

Provide the exact dates of when you filed your 2001 and 2002 tax returns and when you filed your 2001 amended tax return.

I provided those returns to the Committee in December 2008. I do not have a record of the exact dates the original 2001 and 2002 returns were submitted, but I believe that I filed them on or prior to the due date. The first amended return for 2001 was signed by my accountant on July 17, 2002, and I believe I submitted it promptly thereafter. I signed amended 2001 and 2002 returns on November 23, 2008 and they were sent to the IRS on November 24, 2008.

A. When did you determine that the statute of limitations for those years had expired?

In concluding the 2006 audit, the IRS agent and my accountant informed me that I owed taxes back to 2003. In November 2008, my lawyer advised me that he believed that although I was not legally obligated to go back to 2001 and 2002, I should file amended returns to cover self-employment taxes for those years.

B. How did you determine that statute for these years had, in fact, expired? Provide all communication with external parties on this issue or documentation of research conducted on this issue.

Again, I was so advised (orally) by my lawyer in November 2008.

<u>Question 14</u>:

I understand that the accountant who represented you in the audit of your 2003 and 2004 returns was not the same accountant who initially prepared the returns for those years.

A. Is this true? If yes, why did you use a different accountant?

Yes. I was not fully satisfied with his services. And in responding to the IRS audit, I thought it was more appropriate to use a different accountant who could take a fresh look at the issue.

B. Did the accountant who initially prepared your 2003 and 2004 returns inquire, or did you otherwise discuss, why there was no social security or medicare tax withholding on your Forms W-2 for those years?

I don't recall any discussion of this with my accountant, other than the email that I provided to the Committee.

C. Did you inform the accountant who initially prepared your 2003 and 2004 returns inquire, or the accountant who represented you in the audits of those returns, that you were employed by the IMF in 2001 and 2002?

I don't recall any specific conversations about this, other than the email that I provided to the Committee. It is likely, however, that in preparing my 2003 returns, I would have provided him the previous tax year's returns.

D. Did you provide these accountants with all of the IMF documentation you provided to the Committee?

I do not recall precisely what documents I provided to the accountant; I believe I provided him with the basic documentation of sources of income.

Question 15:

In 2006 you were audited by the IRS and filed amended tax returns for tax years 2003 and 2004 because you had failed to pay self-employment taxes for those years. Why didn't you file amended returns for tax years 2001 and 2002 at the same time? Given you had no legal obligation to file amended returns for tax years 2001 and 2002 in 2006, why did you feel it was appropriate to file amended returns for those years in 2008, but not in 2006?

At the conclusion of the 2006 audit, I was told what I owed and I paid that amount. It did not occur to me to file amended returns for 2001 and 2002.

In November 2008, as part of the transition team vetting process, the errors I made in 2001 and 2002 were drawn to my attention, and I decided it was appropriate to correct the error because I did not want there to be any question about whether I had fully met my tax obligations.

Question 16:

You have repeatedly cited that fact that an accountant advised you in 2004 that as an employee of the IMF you were exempt from self-employment taxes. However, on December 19, 2008, you told Finance Committee staff you knew you had to pay self-employment taxes but expected the issue to be resolved when filing your income tax return. Did you ever believe you were exempt from self-employment taxes? If the answer is yes, why have you cited the complexity of the tax code as a factor in your errors? If no, why have you presented the advice from the accountant as an explanation for your errors?

Since I paid self-employment tax on my consulting income in 2001, I did not believe I was exempt from self-employment taxes. Because the IMF reported my income on a W-2 as an employee, I erroneously did not file a form SE as a self-employed person with respect to my IMF income. I referred to the accountant's 2004 advice merely to point out that he did not catch the error regarding self-employment tax on IMF income, either. But again, I am not blaming my accountants for any of my errors; I have accepted full responsibility for them myself.

Question 17:

You have cited the fact that you hired an accountant to file an amended 2001 tax return and this accountant did not notice you failure to pay self-employment taxes. Why did you seek out an accountant to file an amended tax return for 2001? Did you provide this accountant with any information from the IMF on your tax allowance or how IMF employees are supposed to meet their tax obligations? What information did you provide to the accountant?

I retained the accountant to file an amended 2001 return because of an error I had made relating to a Keough contribution for my spouse that I had intended to make but did not. I do not believe I provided the accountant that type of information from the IMF. I did provide him a copy of my original 2001 return and certain supporting documents, and he prepared an amended return with multiple changes: eliminating the Keough contribution as a deduction; excluding a small amount of interest income that had been received by my son; and adjusting both my deduction for real estate taxes and my Maryland state income tax deductions. In fairness to the accountant, while I provided to him the amounts I had received from my three employers in 2001, I did not give him my W-2s, and I did not specifically ask him to check for any error related to self-employment tax (because I did not believe I had made such an error).

Question 18:

You provided the Finance Committee with statements from the IMF breaking you tax allowance down into amounts for "Federal Tax Allowance,"" State Tax Allowance," and "SE Tax Allowance." These statements show that your tax allowance was deposited into a checking account. You also provided the Committee with copies of checks made out to State and Federal revenue authorities for the exact same amounts as noted on the statement from the IMF for make state and federal estimated tax payments. Did you ever question what your "SE Tax Allowance" was for? When you were writing checks to cover the "Federal Tax Allowance" and "State Tax Allowance," did you ever think "SE Tax Allowance" was given to you to pay a tax you owed?

Looking back now, it is clear to me that the IMF statements to which you refer should have prompted me to realize that it was necessary for me to file a form SE and pay self-employment taxes. I did not realize this and regret the error.

Question 19:

Mr. Geithner, you bring to the table heavy experience in debt management and related issues. We are facing the largest Federal budget deficit and largest amount of debt held by the public since World War II. That gloomy statistic is true in absolute dollar terms and in terms of the percentage of the economy. As an example, the Congressional Budget Office projects debt held by the public to grow from the fiscal year 2008 figure of $5.8 trillion to $7.2 trillion for fiscal year 2009. Likewise, as a percentage of the economy, the figure would grow from 40.8% to 50.5%. Both are dramatic increases. To put it in context, from 2001 through 2008, debt held by the public grew from 33.1% to 40.8%; roughly one percent a year.

Mr. Geithner, do you believe there is a ceiling on the amount of deficits and debt held by the public? If you believe we need to be mindful of some limit on deficits and debt, do you believe we should employ this caution against proposals that spend above the baseline, including health care reform?

Yes, we have to be careful to identify how to pay for new commitments to long term programs. In terms of healthcare reform, what is most vital is that we are instituting the type of reforms that will help to slow the growth of health care costs in both the private sector and in our major entitlement costs -- at the same time expanding coverage and improving quality. If there are upfront costs in a comprehensive healthcare reform plan we should carefully seek to reduce wasteful, duplicative and low priority spending in some areas where additional up front investments in healthcare could be beneficial if they were part of a comprehensive plan to reduce long-term growth in our nation's healthcare spending.

Question 20:

On November 12, 2008, I sent a letter to Secretary Paulson and Chairman Bernanke regarding the Emergency Economic Stabilization Act. I was hoping to get a response before the vote on the Resolution of Disapproval on the additional $350 billion but Treasury staff only told my staff they were working on it and asked for patience given that Treasury as received much Congressional correspondence regarding the bailout. The questions I raised in that letter are still very relevant to understanding the use of TARP funds. Provide complete responses to the questions raised in that letter, which is attached.

You raised a number of important questions in your letter to Secretary Paulson, and I share many of your concerns on these matters. If confirmed, I will be in a position to work with existing Treasury staff who have been implementing EESA and will be in a position to address your concerns. We intend to require certain conditions be attached to aid received by institutions participating in the second tranche of TARP. Included in those conditions will be strong but sensible restrictions on executive compensation. In particular, we will require that for firms receiving government support, executive compensation above a specified threshold amount be paid in restricted stock or similar form that cannot be liquidated or sold until the government has been repaid. As you will also be aware, the Treasury Department has recently released a new rule requiring the CEO of an institution receiving TARP funds to certify the firm's compliance with the TARP's executive compensation standards. Our intention is to implement this program in a transparent, professional manner so that you and other members of Congress can evaluate the program with relevant information.

Question 21:

It appears that the $700 Billion TARP program will not be enough. When will the administration be requesting additional bailout funding?

We are in the process of putting together our plan for the use of the second tranche of funds under the Emergency Economic Stabilization Act. We have no current plans to request further resources. However, if we determine that further resources may become necessary, we will be clear with the Congress as to why these resources are necessary, how we intend to deploy them, and what objective we hope to achieve. We will be open and transparent so that you and others can evaluate the effect of our program.

Question 22:

What do plan to do to ensure that there is improved transparency regarding the AIG rescue and the TARP program?

We strongly believe that the transparency of this program must be improved. This is why the Obama Administration has outlined a set of commitments to improve transparency in a letter from NEC Chairman Summers to Congressional Leadership on January 15th. We will communicate about our goals and objectives. The Administration has committed that the President will certifying to Congress substantial new commitments of funds that may be necessary to forestall a serious economic dislocation. In addition, the Treasury will:

- make public for each investment the amount of assistance provided, the value of the investment, the quantity and strike prices of warrants received, and the schedule of required payments to the government.
- report on the terms of pricing for each investment compared to recent market transactions, and
- post this information as quickly as possible on the Treasury's website so that the American people can monitor the status of each investment.

If confirmed, I look forward to working with Congress and with the Congressional Oversight Panel on Economic Stabilization, the General Accounting Office and others to ensure that we are effective in meeting our goal of significantly improving the transparency of this program.

Question 23:

Do you support providing GAO with full access to the books and records of entities that received TARP funds?

If confirmed, I would be pleased to work with you and the GAO to examine way to help the GAO carried out its important oversight functions.

<u>Question 24</u>:

During the hearing today, I asked specific questions about the Special Purpose Vehicles in which the Federal Reserve Bank has partnered with JP Morgan Chase and AIG.

A. **You stated that you believed that they currently have an appropriate transparency and disclosure regime. Describe this regime in detail and explain why these vehicles should not be subject to the same disclosures under the TARP program.**

The Board of Governors of the Federal Reserve System is responsible for setting broad policy on accounting and disclosure of the activities of Federal Reserve Banks. If confirmed, I would be open to working with Chairman Bernanke on ways to respond to your suggestions and concerns.

B. **Given the contribution of federal funds to these SPVs, explain why you think these vehicles should not be subject to oversight by the Securities and Exchange Commission or the Special Inspector General for the TARP.**

The Board of Governors of the Federal Reserve System is responsible for setting broad policy on accounting and disclosure of the activities of Federal Reserve Banks. If confirmed, I would be open to working with Chairman Bernanke on ways to respond to your suggestions and concerns.

C. **Why isn't general data about the loans underlying the securities in the portfolio regularly reported to Congress and the public in order to provide a more accurate picture of the true risk to the taxpayer? Specifically, is there any reason that the percentages of loans in default, the percentages of loans over 90 days late, and similar aggregated statistical information cannot be released?**

As you know, the critical imperative behind all of the government's extraordinary actions over this period has been to stabilize the financial system. Consistent with its accounting and disclosure practices, the Federal Reserve reports publically on the value of the portfolio of assets held in Maiden Lane, LLC on a regular basis. Confidentiality around the specific characteristics and performance of individual loans in the portfolio is maintained in order to allow the asset manager the flexibility to manage the assets in a way that maximizes the value of portfolio and mitigates risk of loss to the taxpayer.

D. If you are confirmed, what assurances can you provide that there will be more meaningful disclosure about the performance of the Bear Stearns, AIG and other bailouts taking place outside of the TARP?

The Board of Governors of the Federal Reserve System is responsible for setting broad policy on accounting and disclosure of the activities of the Federal Reserve Banks. If confirmed, I look forward to working with you and with Chairman Bernanke on ways to respond to your suggestions and concerns.

E. What, if any, specific additional disclosure would you support?

If confirmed, I look forward to working with you and with Chairman Bernanke on ways to respond to your suggestions and concerns.

Question 25:

What contact, if any, did you have with Robert Rubin, or anyone else representing Citigroup, in the three weeks ahead of the unusual government intervention in that company? If any contact, what was specifically said by any party?

As part of my responsibilities as President of the New York Fed, I had a number of discussions with senior Citigroup executives and Board members in the weeks leading up to the most recent package of support. I did not, however, participate in the negotiations with this firm.

Question 26:

In your testimony today, you stated that you supported more transparency and oversight for the market. I introduced a bill to require hedge funds to be registered

so we at least know how many and who they are. You've said we need more oversight.

Do you support requiring registration of hedge funds?

What suggestions do you have to bring improve transparency of the operations and activities of hedge funds?

The financial crisis has highlighted the urgent need to overhaul the oversight of our financial system. With an objective of bringing greater transparency and oversight, I believe that we should consider requiring registration of hedge funds. If confirmed, I look forward to working with Congress on this.

Question 27:

In response to my question to you during the hearing about the role of the credit rating agencies, you stated that there were systematic failures by these agencies in measuring risk.

Do you agree that these agencies should be regulated?

If yes, who do you think should be responsible for overseeing these agencies?

What recommendations do you have for improving the transparency of these agencies?

Credit ratings agencies have played a central role in our capital markets and should be regulated. Congress moved to do so in 2006 with significant new authorities granted to the SEC. If confirmed, I look forward to working with the SEC and Congress to bring greater accountability and transparency to ratings agencies and addressing conflicts of interest.

Question 28:

Section 382 of the Internal Revenue Code limits the ability of acquiring companies that acquire target companies to offset the taxable income of the acquiring company with the Net Operating Losses of the target. This provision was not enacted lightly by Congress, but rather after extensive scholarly reflection by the staffs of the

Senate Finance Committee and the Joint Committee on Taxation, as well as after reflection by the House Ways & Means Committee. It has been an established part of the law ever since 1986.

This law was changed when Treasury issued Notice 2008-83. Many tax law scholars have opined that Treasury simply did not have authority to make this change. The respected law firm of Jones Day, one of the country's largest law firms, at one point estimated that this Treasury Department waiver of this act of Congress could cost the US Treasury $140 billion dollars in taxes that would have otherwise been paid. It is troubling to me that this Notice was issued on September 30, 2008 the Treasury virtually waived section 382, the day after the House said no to the first bail-out bill and two days before Wells Fargo acquired Wachovia on October 2, 2008.

A. How do we re-establish the rule of law?

If confirmed, I will respect the constitutional limits on the Treasury Department's authority, as will all those who work for me. I understand there is a high level of concern on Capitol Hill about this issue, specifically within the Finance Committee. I am aware that legislation has been introduced and that Senator Grassley has called for an Inspector General's report on this issue. I look forward to reviewing that report when it is completed. I realize that this is a complex issue that raises concerns about Treasury's authority, differential treatment of the financial services industry, and budgetary transparency. I promise to more closely examine the issue and work with the Committee if I am confirmed.

B. How should Congress handle this?

Our constitutional system of checks and balances provides authority for each co-equal branch of Government to respond to actions taken and decisions made by another branch. I won't presume to advise Congress how to respond, but, if confirmed, I will pledge to support and uphold the Constitution, including the limits on the Department's authority.

C. How do we deal with the mess that has been created, and how to we ensure there are no future problems like this?

If confirmed, I will review the Treasury Department's guidance review process to ensure that all guidance issued is within the authority granted to the Department by the Constitution and by Congress.

D. How do we make sure that our Constitutional separation of powers are respected and protected – that is that the executive branch doesn't attempt to pass legislation overriding acts of Congress?

If confirmed, I will implement and administer the laws that Congress enacts and the President signs, as will all who work for me.

Question 29:

Chief Counsel Korb has made public comments about the need to change the strict liability standard under IRC section 6707(A). However, I have not seen any proposals from Treasury to amend this statute. Do you agree that the standard must be changed? If yes, explain why you think this must be changed and provide suggestions for change.

I have been advised that proposed and temporary regulations under this statute were published this past autumn. If confirmed, I and my staff will work with the IRS to review the statute, regulations and comments to those regulations in order to identify any changes that should be made or proposed.

Question 30:

Section 1205 of the Pension Protection Act of 2006 ("PPA") mandates Treasury to report to Congress on the effectiveness of the IRS in administering the provisions relating to the Internal Revenue Code ("IRC") section 512(b)(13) exclusion from the unrelated business income tax for payments made to controlling organizations from controlled entities and on the extent to which such payments meet the requirements of section 482. The report is required to include the results of any audits of controlling organization or controlled entity and recommendations relating to the tax treatment of payments from controlled entities to controlling organizations. This report was due on January 1, 2009. Congress has not received the report and it is not known whether the IRS has begun the required audits or has initiated any work on this report. My staff informs me that the audits were not included in the FY09 Exempt Organizations workplan. Provide a detailed status report including major milestones and estimated submission date to Congress.

If confirmed, I and my staff will work with the IRS to establish the major milestones and an estimated report submission date.

__Question 31__:

Section 1211 of the PPA mandates Treasury to study certain acquisitions of interests in insurance contracts in which certain exempt organizations hold an interest. Provide a detailed status report including major milestones and estimated submission date to Congress.

I understand that to collect data necessary for this study the IRS issued a form that taxpayers were to file this past autumn. If confirmed, I and my staff will work with the IRS to incorporate this data into the required study.

__Question 32__:

Section 1226 of the PPA mandates Treasury to study donor advised funds. A report to Congress on this study, including responses to four specific questions, was due in August 2007. I asked for an update on this report during Commissioner Schulman's confirmation process and my staff was briefed by Treasury and IRS staff on July 10, 2008. This study is now more than a year overdue. Provide a timeline with specific milestones for the completion of this report.

I understand that substantial work on this study has been completed. If confirmed, I and my staff will work with the IRS to establish milestones for completion of the report.

__Question 33__:

Section 1241 of the PPA mandates Treasury to issue regulations to implement a mandatory payout requirement. I understand that the Advanced Notice of Proposed Rulemaking that was issued in August 2007. I asked for an update on the issuance of these regulations during Commissioner Schulman's confirmation process and my staff was briefed by Treasury and IRS staff on July 10, 2008. I understand that there are a number of issues that remain to be resolved. Describe

the issues and provide a timeline with specific milestones for issuance of these regulations.

I understand that substantial drafting has been done regarding this guidance project. If confirmed, I and my staff will work with the IRS to establish milestones for issuance of the regulations.

Question 34:

Mr. Geithner, the Treasury Department continues to play an important role in the administration of our customs laws. While the Department has delegated certain customs authorities to the Department of Homeland Security pursuant to the Homeland Security Act of 2002, Treasury retains the sole authority to approve certain regulations and reserves the right to promulgate regulations concerning customs revenue functions. Treasury also retains the authority to review, modify, or revoke determinations and rules concerning customs revenue functions.

First, if confirmed, what steps will you take to ensure that the Department devotes appropriate resources to administer its customs portfolio, particularly with respect to oversight of customs regulations?

Second, under the delegation of authority outlined in Treasury Department Order No. 100-16, the Treasury Department and the Department of Homeland Security (DHS) must coordinate on certain customs efforts. Do you have any ideas for improving the working relationship between Treasury and DHS if you are confirmed? Do you have any ideas for improving Treasury's oversight of customs revenue functions?

Lastly, if confirmed, do you intend to prioritize Treasury's consultation with the Senate Finance and House Ways and Means Committees regarding the oversight and administration of customs revenue functions? If so, do you have any ideas for improving Treasury's working relationship with the Finance and Ways and Means Committees on customs issues?

When the Department of Homeland Security (DHS) was established, there was a detailed discussion between the Administration and the Congress on how to allocate resources associated with the administration of customs revenue functions. At that time, in the interest of minimizing distractions from the new department's overarching security mission, it was agreed that the bulk of customs revenue resources would go with Customs to Homeland Security. I am informed that after nearly six years of experience, there have been suggestions that some reallocation of resources of between the two department's may more effectively insure that critical economic and revenue considerations are fully considered in the implementation of customs policy. If confirmed, I and my staff would work closely with the Committee to examine these options.

In addition to the issue of resources, close cooperation with DHS, is necessary to implement the two department's joint customs responsibilities. I am told that while informal cooperation has been good, there may be a benefit from formalizing the dialogue and information flow between the two departments.

With respect to consultations on Customs revenue functions with Senate Finance and House Ways and Means Committees regarding the oversight and administration of customs revenue functions, I understand there is frank and open communication with Treasury at the staff level. I will review with my staff ways to strengthen that relationship further.

Question 35:

Mr. Geithner, the Treasury Department oversees implementation of the International Trade Data System (ITDS), which will establish a single electronic portal system for the collection of import data and distribution of that data to participating federal agencies. The ITDS is critical to the customs modernization effort. It will provide federal agencies with access to more timely and accurate information and will drive increased efficiency in the processing of imports into the United States.

Treasury is responsible for coordinating participation among federal government agencies, which is essential to the success of the ITDS. Do you plan to prioritize resources for ITDS? How will you ensure that Treasury meets its goal of having ITDS fully implemented no later than the date the Automated Commercial Environment is fully implemented?

Lastly, given Treasury's role as chair of the ITDS Interagency Steering Committee, I would like to underscore the need to define a set of standards to be used for collecting ITDS data elements as soon as possible. What is your view?

I understand that the funding used to develop ITDS, which is an integral part is part of the Automated Commercial Environment (ACE), the new trade processing system that Customs and Border Protection (CBP) is developing, comes from the budget of the Department of Homeland Security. Treasury and many of the other participating agencies provide advice to DHS on prioritizing those resources for ITDS. I am informed that under current plans ITDS is intended to be completed no later than ACE is fully completed. I am also informed that both CBP and the ITDS Board of Directors consider the development of a standard set of ITDS data elements to be a top priority.

Question 36:

Mr. Geithner, in the previous Administration, Secretary Paulson took a leading role in establishing and leading the Strategic Economic Dialogue with China. I supported that engagement with China, and hope that this Administration will continue to utilize the SED. However, the way the SED was managed sometimes blurred lines of responsibility within our federal government, and trade is one example of that. If confirmed, do you anticipate that the SED with China will be maintained? If so, do you anticipate that Treasury will be the lead agency for managing the SED? If so, do you anticipate interjecting Treasury in the management of portfolios such as trade that fall largely within the jurisdiction of other agencies?

The US China SED presents significant challenges but also opportunities. It is one of our most important relationships. There are many specific issues in our economic relationship that require our careful and prompt attention. These include currency issues, inadequate intellectual property rights protections, product safety, and non-tariff barriers. A deep engagement between our senior economic officials on these topics -- and on the issues of macroeconomic policy and financial stability, energy issues and the environment -- to address differences and effectively resolve problems is a priority. Exactly what form that will take is something that we are considering.

<u>Question 37</u>:

President Obama has committed to eliminating restrictions on family travel and remittance regulations for Cuban-Americans. Since these restrictions were put into place in response to widespread abuse, how will Treasury guarantee that the elimination of these restrictions will not reopen the door to abuse or benefit the Cuban regime?

If confirmed, I pledge to work closely with the Under Secretary for International Affairs and the Office of Foreign Assets Control at the Treasury Department and my National Security Council and State Department counterparts to examine our policy toward Cuba. I also recognize that this and other questions must be answered in the context of President Obama's wider policy toward Cuba. I look forward to working with Congress and my colleagues in the Administration on this important issue.

<u>Question 38</u>:

Under your leadership, how will Treasury pursue enforcement actions in the case of Cuba-related travel service providers? In addition, what specific enforcement actions will Treasury take to guarantee the prohibition of commercial activities with Cuba beyond those allowed under the law (agriculture sales and telecommunications, for example)?

The Undersecretary for International Affairs and OFAC play a critical role ensuring our national security. If confirmed, I will work to ensure that rules and procedures in place are fair, efficient, transparent, and not arbitrary. I am committed to taking great care to follow congressional intent and working closely with members of Congress to ensure that OFAC's activities with regard to Cuba are achieving its important objectives without unnecessary hurdles or unreasonable administrative delays.

<u>Question 39</u>:

Under your leadership, how will Treasury enforce restrictions on Cuban products entering the United States market?

If confirmed, I pledge to work closely with the Under Secretary for International Affairs at the Treasury Department and my National Security Council and State Department counterparts to examine our policy toward Cuba. I look forward to working with Congress on this important issue.

Question 40:

Mr. Geithner, if confirmed as Treasury Secretary, will you commit to enforcing the Cuban Asset Control regulations?

Yes. If confirmed, I pledge to work closely with the Under Secretary for International Affairs at the Treasury Department and my National Security Council and State Department counterparts to examine our policy toward Cuba. I look forward to working with Congress on this important issue.

Question 41:

As one of the principal sponsors of PL 109-8, the 2005 bankruptcy reform legislation, I authored a provision to punish credit card companies that do not agree to re-negotiate debt when a consumer makes a pre-bankruptcy offer to repay a significant portion of a credit card balance. Section 502(k) of the Bankruptcy Code was intended to help consumers reduce their credit card debts and avoid filing bankruptcy. According to a January 3, 2009 New York Times article, last year, some lenders and the Consumer Federation of America got together and proposed a credit card loan modification program to implement this new provision, but the Treasury Department under the prior Administration flatly rejected their proposal. It is imperative that section 502(k) be given full effect, particularly during difficult economic times when consumers are struggling with too much debt. Will you commit to re-examine this decision by the Bush Administration, which I believe has prevented section 502(k) from delivering all the benefits to consumers that Congress intended back in 2005?

If confirmed, I will work with the career staff at Treasury to re-examine the decision to limit the implementation of the credit card loan modification program under Section 502(k) of the Bankruptcy code, as I will need to understand the context and exact details of that decision. In addition, I commit to work with this committee to support efforts of consumers and financial institutions to re-negotiate debt payments before resorting to the extreme remedy of bankruptcy.

Question 42:

Do you think shareholders in the banks and corporations that were bailed out should have received dividends or should they be handled like other stock holders who have lost money and couldn't possibly sell their stock for six years?

We believe it is important to ensure that the capital provided under the program goes to its intended uses of supporting financial stability and promoting lending. As we implement the Emergency Economic Stabilization Act going forward, we will prevent shareholders from being unduly rewarded at taxpayers' expense. Payment of dividends by firms receiving support must be approved by a firm's primary federal regulator. For firms receiving exceptional assistance, quarterly dividend payments will be restricted to $0.01 until the government has been repaid.

ANSWERS TO QUESTIONS FROM SENATOR BINGAMAN

(1) **Domestic automakers. One of the lessons of the credit crisis is that systemic failures have effects that are more severe and unfold more rapidly than we tend to anticipate. In the context of automobile manufacturing, a study by the Center for Automotive Research suggests that a 50% contraction of the "Detroit 3" automakers would result in an immediate loss of 2.5 million jobs, assuming the balance does not get picked up by foreign companies. Because I am concerned about this scale of loss, I am supportive of providing support to the domestic automobile manufacturers through the TARP program. In a letter he recently sent to Members of the Senate, former Treasury Secretary Summers stated that the Obama Administration will make future TARP funds available to auto companies only "in the context of a comprehensive restructuring design to achieve long-term viability." What would such a design look like?**

The auto industry is the backbone of America's manufacturing base and millions of American jobs rely directly or indirectly on a viable industry. The Bush Administration extended assistance on terms that will require the auto companies to come forward with serious restructuring plans, with concessions from all stakeholders involved. The goal of short term government assistance should be to provide the industry the temporary window it needs while demanding the long-term restructuring that is required. The bipartisan legislation passed by the House, which was later adapted by the Treasury Department for their term sheets with GM and Chrysler provides a good framework and if confirmed, as Secretary, I am committed to reviewing that framework to ensure a stronger and more viable auto industry going forward.

(2) **Tax reform. The leading macro contributor to our financial downturn was an overleveraged economy. There are numerous policy areas that brought us to an overleveraged state. One of them is the Tax Code, which allows corporations to deduct interest while subjecting corporate profits to tax. In other words, our Tax Code has a bias for debt financing over equity financing. As the Senate's tax-writing panel, should the Finance Committee eliminate this bias for debt financing? How should we go about doing so?**

I think this is an issue that needs to be examined in detail, particularly in the context of tax reform. Today, the tax code gives preferential treatment to debt, and taxpayers go to great lengths to characterize certain transactions as debt deals, even though they look a lot more like equity deals. This is done solely to get tax benefits and the steps taken are not always economically efficient. That is an issue that deserves study, perhaps clarifying how the tax code defines debt and equity.

(3) <u>Bank lending</u>. **Bank lending to existing U.S. corporations is down sharply – as much as 40% by some measures. To emerge from this recession, it is clear that banks must begin lending again to these companies. While we had hoped that the infusion of TARP funds would get our banks to begin lending again, bank executives continue to prefer to buy old loans, which are already discounted, to making new loans. Economist Nouriel Roubini says that another TARP-like program will be required to get banks lending again. Do you agree?**

Substantial challenges lie ahead that will require the Administration and the Congress to work together closely. Despite the enormous response that has been marshaled, the actions to date have not yet provided the basis for repair and recovery of the system that we need. If confirmed, I will work closely with this committee to ensure that we have a shared understanding of the magnitude of the challenges we face and an open process of working together to address these challenges.

(4) <u>Municipal finance</u>. **One of the least discussed aspects of the financial crisis is its impact on municipal governments. The financial crisis has significantly impacted state and local governments by limiting their access to capital, impairing their ability to issue debt to build schools, roads, hospitals, and other essential infrastructure. This has had serious consequences for communities across my state. I was very pleased, therefore, that President Obama on January 8 proposed having the US Federal Reserve buy municipal bonds to cut borrowing costs. This is a step in the right direction. But significant challenges remain - particularly with shorter term and variable rate debt instruments issued by state and local governments. Would your Treasury Department use its existing authority to provide liquidity facilities to support this debt?**

As you mentioned today at the hearing, there is no question that the credit crisis has imposed a particularly heavy burden on the financing of state and local governments. This is a serious concern to me and to the new Administration, and if confirmed, I look forward to working with you and the Committee on policy options to address this problem.

ANSWERS TO QUESTIONS FROM SENATOR BUNNING

1. I understand that you initially prepared your returns for 2001 and 2002 yourself, but that you had an accountant prepare your 2003 return. When your accountant inquired about Social Security tax in March 2004, you referred him to an individual at the IMF. This individual explained that you had to pay self-employment tax, but you and your accountant later ignored the advice. Can you explain who was this person and why did you ignore her advice?

My accountant spoke to a person at the IMF about the rollover of my IMF pension. I do not recall who that person was. I asked my accountant why the person at the IMF would say she filed self-employment taxes, since I was an employee, not an independent contractor. The accountant replied, "Clearly, you aren't an independent contractor, so I'm not sure why she would say that. She may need a tax advisor. . . . Employees (that are U.S. citizens) of the IMF, like the UN, are exempt from employment taxes such as Social Security. I think what Kimberly [the IMF employee] was saying was incorrect or wrong. You don't pay self-employment taxes (the equivalent of Social Security and Medicare) on wages."

2. Yes or no, would you have paid your back taxes for 2001 and 2002 if you were not considered for nomination to be Treasury Secretary?

It was only as a result of the transition team vetting process that the issue of the 2001 and 2002 returns came to my attention. If I had not been considered for this nomination, I might never have known this.

3. What, if any, decisions on interventions by the Federal Reserve or the Treasury during the current crisis did you disagree with at the time? And were there any such decisions that you did not participate in?

The decisions over this period often had to be made quickly, and on the basis of much less information than one would like to make public policy judgments of this magnitude. With time we will be able to look back and undertake a more meaningful assessment of these judgments, and doing this carefully and thoroughly will be a critical part of designing a system that will be more robust and less vulnerable to the type of situation in which we find ourselves.

4. During your time at the New York Fed, have you disagreed with any of the monetary policy or regulatory actions of Chairman Greenspan or Chairman Bernanke? If so, please explain.

As Vice Chairman of the Federal Open Market Committee, I helped shape and supported the monetary policy decisions by the FOMC under Chairmen Greenspan and Bernanke. I also helped shape regulatory policies over this period, although those policies are the responsibility of the Federal Reserve Board.

5. What processes and criteria were used to decide on the initial round of Capital Purchase Program investments in the largest institutions? Who decided what firms would receive funding? Please provide documentation (written and email) of the approval/inclusion of each firm included in the original round of CPP investments (on or about October 14, 2008).

If confirmed, Treasury will provide a full explanation in response to these questions.

6. What was your personal involvement in supervising Citigroup's risk management efforts at the New York Fed? Did you support decisions in 2006 to undo restrictions on the firm's expansion and risk management reporting? Please provide documentation (written and email) showing the process by which those decisions were reached and the justifications for the decisions.

The Federal Reserve and other responsible supervisors made those decisions on the basis of a judgment that the firm had made sufficient progress in implementing a new compliance risk management program. Nonetheless, we continued to carefully review any expansion proposal undertaken by Citigroup, and we continued to encourage the firm to refrain from any significant acquisitions until it tightened internal controls and addressed certain regulatory issues that were present both in its domestic operations as well as its operations outside the United States. I will ask the Federal Reserve to provide any documentation that it is appropriate in response to your questions.

7. During his time on the Board of Citigroup, did you have any contact with your old boss, former Treasury Secretary Rubin, about the New York Fed's decisions to relax restrictions on Citigroup or the firm's risk management practices?

I do not recall any such contact, and as a general matter, I conducted these type of discussions on supervisory issues with the Chief Executive Officer and relevant Board members.

8. What steps did you take, if any, to address the risks of the derivatives markets? I do not mean efforts to improve the functioning of the markets, such as the central clearinghouse, but the systemic risks of the products and markets more generally.

The systemic risks of the derivatives markets were a major focus of my work while I served at the New York Fed – not only to make the infrastructure of those markets more mature and more robust, but also to make sure the institutions at the center of the derivatives markets were managing their risks more effectively. In addition to working directly with the firms that represented almost all of the volume in these markets, I engaged lead regulators from the U.S. and around the world – from the SEC, Switzerland, Germany, France, the United Kingdom, and Japan – to encourage these firms to have a better sense of the risks they were exposed to in credit derivatives as well as their risks from a broad range of other complex financial products. These efforts, I believe, helped make the system stronger.

Nonetheless, we will have to take a broad look at the framework that surrounds derivatives and incentives created for institutions that participate in these markets.

9. What was your involvement in the second government investment in Citigroup?

I support the actions taken by the USG to strengthen the financial system, and Citigroup, and protect U.S. taxpayers and the U.S. economy.

I participated in internal discussions with the Secretary of the Treasury, the Chairman of the Federal Reserve and the other heads of agencies on broad options, but I removed myself from any direct role in discussions with the firm on Friday evening, November 21, 2008.

10. Is it true that you were the primary architect of the AIG bailouts? Why did the first few interventions in AIG fail?

As the President of the Federal Reserve Bank of NY, I was involved with, and engaged in extensive conversations with Chairman Bernanke and Secretary Paulson about all aspects of the actions we collectively undertook to stabilize AIG in September of 2008 and again in November of 2007. I also engaged with John Reich of the OTS as AIG fell under the OTS's oversight, as well as with the NY state insurance commissioner Eric Dinallo. But I would not say that I was the primary architect.

After the initial intervention, AIG's capital and liquidity position continued to deteriorate and there was a potential for a destabilizing downgrade of the firm by the rating agencies on the heels of the firm's pending announcement of significant loss in Q3 of 2008. A significant factor in the failure of the first package of support to definitively stabilize the firm was the marked deterioration in conditions across many sectors of the economy, particularly the insurance sector both in the U.S. and in Europe.

11. Was your former boss, former Treasury Secretary Rubin, or anyone else at a firm you regulated involved in your being hired at the New York Fed?

I believe Bob Rubin was consulted by the Board of Directors of the New York Fed in conjunction with my being considered for the position of president of that institution.

12. The New York Fed oversees the Fed's Large Financial Institutions regulation. Therefore, as President of the New York Fed, one of your most important responsibilities is regulating and preventing the collapse of systemically important banks. And that has been your job since 2003, which means it was your job to watch those institutions during the time they acted most irresponsibly and made the decisions that eventually led to our current crisis. All one has to do is look at the near-total collapse of Citigroup to see that you failed at that job. Why did you fail at that job and why should that not disqualify you from overseeing the entire financial system?

There were systematic failures of risk management and supervision across the financial system, and addressing these failures will require comprehensive changes to financial regulation here and around the world. As President of the New York Fed, I led a number of initiatives to strengthen the financial system ahead of this crisis. Those efforts were important and effective in addressing many of the weaknesses at the center of past financial crises, and they helped limit the damage caused by the present crisis. But those efforts were inadequate.

ANSWER TO QUESTION FROM SENATOR CANTWELL

1. **The current economic crisis and resulting credit crunch highlight both the necessity for Americans to save, and the difficulty of doing so. Savings builds capital and helps families weather rainy days. Our economy has suffered from too-great an emphasis on debt as a method of financing; it is my belief that we must now encourage the nation to focus on savings as a core contributor to economic recovery. And we must make it easier for Americans to save.**

   The problem of saving is particularly acute for low-income families, who even during better economic times have difficulty putting food on the table and keeping a roof over their heads. Low-income individuals need a method of savings that enables them to set aside relatively small amounts of money in order to start down the path of economic self-sufficiency.

   The annual federal income tax refund that many low-income families receive, bolstered by the Earned Income Tax Credit (EITC) and the child tax and other credits, is often very large relative to their overall income. When the individual receives that refund, there is a window of opportunity for the individual to save and for the government to encourage that savings. Enabling taxpayers to check a box right on the federal tax return form and set aside some of that refund in a U.S. Savings Bond is a simple policy for encouraging savings among a broad spectrum of the population that otherwise has trouble building wealth.

   U.S. Savings Bonds have a 75-year history of helping Americans save, especially smaller-balance and first-time savers. During the 1960s, you could buy a savings bond by checking a box on your tax refund, using Form 1040. Yet recent changes by the Bureau of Public Debt have accelerated a trend to de-emphasize the savings bond program.

   Mr.Geithner, what is your view of the role savings plays in our national recovery and savings bonds in particular? Would you support a call to re-introduce the savings bond purchase option to the annual federal tax filing process?"

   The President has proposed several ideas that would give all American workers the opportunity to save. Half of the American workforce has no 401(k) or other employer-based retirement plan. To address this problem, the President has proposed the adoption of automatic workplace IRA's and expanded tax credits for saving. In the months ahead, if confirmed, I look forward to working with you on consideration of these ideas as well as other savings incentives, such as the savings bond proposal that you raise. You correctly note that an important time to highlight the role of savings in a family's overall economic health is upon receipt of their tax refund. For those receiving the Earned Income Tax Credit, greater awareness of savings opportunities might be particularly useful. You have suggested that our Savings Bond program should be promoted more broadly in connection with tax filings. This sounds like a useful idea that deserves careful consideration. I hope to have the opportunity to talk further with you on the President's suggestions as well as the full range of savings ideas.

Questions for the Record
From Senator Crapo
For Mr. Geithner
Treasury Nomination Hearing
January 21, 2009
Senate Finance Committee

1. **Some newspaper articles are suggesting that Treasury is considering moving toxic mortgages from private bank's balance sheets to a publicly owned bad bank. The government or the publicly owned bad bank would buy the assets at fair value. This appears to have the same problem as the reverse auction idea -- the government will purchase these questionable assets at a price higher than what private buyers are willing to buy. Are you considering this idea, and if so, how will you make sure the taxpayer is protected and that the government will not overpay?**

I am considering a range of ideas and initiatives to restore stability to the financial system. I look forward to working with you on assessing these alternatives. Protecting the taxpayer is my highest priority and we intend to utilize structures that ensure incentive alignment and impose a burden on any financial institution that participates in TARP programs.

2. **According to today's Washington Post article: "As banks sink, financial analysts increasingly are warning that government intervention is inevitable and could come at the expense of shareholders, perhaps in the form of nationalization. This appears to be driving away investors and hastening the intervention. As with the government's summer promise to save Fannie Mae and Freddie Mac, but only if necessary, the last resort has become the expected outcome." What steps do you intend to take so that investors will not stay on the sidelines and can be part of the solution?**

Encouraging private investment in our banks and drawing private capital that is now on the sidelines is critical to ensuring that our financial institutions are stable and that our capital markets can return to more normal and healthy functioning. We will be mindful of the need to provide the proper incentives to encourage the participation of private capital as we implement the Emergency Economic Stabilization Act. This is necessary for our financial institutions and our financial system to play its normal role of providing the credit that the economy needs. If confirmed, I will seek to ensure that our actions create the conditions that will improve the possibility that private capital will come in and replace the government's role as quickly as possible.

3. **Some have suggested that in the short run we need to create a new federal facility that would provide financing to the commercial real estate market and other consumer loans, such as student loans. Do you agree with this statement, and if so, how quickly do you believe such a facility can be up and running?**

Programs that draw private capital in to support new lending to households and businesses – such as for small business loans, credit cards, auto loans and student loans – can have an important impact on supporting the availability of credit to households and businesses. Under the Emergency Economic Stabilization Act, the Treasury has committed to work with the Federal Reserve to provide the funding to support a return to more normal functioning of credit markets. We are evaluating a number of options to increase lending. If confirmed, I will work to ensure that an effective new program is up and running as soon as is practical. As you rightly indicate, if a new federal facility is effective in achieving the objectives, positive consideration could be given be expanding the program to cover a wide range of assets and thus provide support for areas including commercial real estate.

4. **What principles are you going to push for as we begin the dialogue of rethinking our current regulatory structure, and would a merger or rationalization of the roles of the SEC and CFTC be a valuable reform?**

My first priority in thinking about our regulatory structure will be improving the capacity of our financial system to withstand shocks. There is no doubt in my mind that our financial system, as we have witnessed during this crisis, failed to meet its most basic obligations. The system was too unstable, too fragile, and too weak to withstand high levels of stress. As such, people who did everything right and played by the rules and were careful were hurt by the actions of those who took too much risk and too little responsibility. That, to me, is the sign of a system that is unfair and unjust and very much in need of reform.

If I am confirmed, I will move quickly and work with Congress to build a stronger, more resilient system with greater protections – as a very high priority – for consumers and investors. Getting these basic objectives right is more critical than worrying about the exact structure of our regulatory agencies. I'd like to work with you and learn more about your views on the best options for redesigned regulatory structures. I know we can preserve the unique strengths of our financial markets in providing individuals and entrepreneurs access to capital and credit while also making our system more safe, more sound, and more just.

5. **While the U.S. should continue to utilize international and multilateral efforts to fight terror financing and weapons proliferation by rogue states, what is your commitment to continuing the use of U.S. economic sanctions to effect change where other efforts prove insufficient to safeguard our national security? What steps can and should be taken to make existing sanctions and other U.S. financial tools more effective in combating terror financing and weapons proliferation?**

As President Obama has said, the number one priority for his Administration every day is to keep the American public safe. Terror financing and weapons proliferation by rogue states are a threat to U.S. national security and of great concern to me. If confirmed, I will work with my counterparts in the Intelligence and Law Enforcement communities, as well as those at the Department of Defense and State, to maximize the reach and effectiveness of sanctions, and to support the work of career staff at Treasury to pursue and freeze the assets of non-state actors and individuals who support terrorism. Vigorous sanctions are an essential means for forcing nations that foster terror financing and weapons proliferation to choose between defiance and responsible engagement with the world.

6. A broad range of emergency federal credit programs have been instituted in the past months to address the current capital markets' dysfunction. These temporary programs have been one reason for the increase in cost of funds for FHLBanks and, in turn, the thousands of financial institutions that count on FHLBank funds to lend in their communities. Can I have your assurances that you will look into this and support policies that will enable FHLBanks to more effectively fulfill their critical mission of providing liquidity?

Yes. If confirmed, I will focus on making sure that the FHLBanks are sufficiently strong tocontinue to achieve their core mission of providing liquidity and supporting community banks and thrifts. This will be a complex butimportant challenge for us over the next several months.

7. The tax policies included in the economic recovery package should be designed to provide an immediate, short-term stimulus to companies in need of money to run their business and employ American workers. Most of the proposals under consideration will not help many businesses impacted by the depressed economy because they do not have current earnings. Specifically, many of these companies cannot use additional credits or deductions because they do not have current tax liability. What are your thoughts on innovative proposals designed to allow taxpayers to borrow against their future tax savings? For example, should we include in the package proposals that allow taxpayers to temporarily monetize their own tax assets like AMT credits, R&D credits or net operating losses (NOLs)? Please explain.

President Obama's economic recovery proposals are designed, in part, to explore ways of increasing capital available for businesses to invest in people and other resources to generate economic activity. In particular, his net operating loss carry back recommendation would allow companies to balance recent losses against gains booked in the past five years. As members of Congress add their ideas to the President's plan, a necessary aspect of the legislative process, the Obama administration's economic team will continue to discuss the merits of various ideas and work with Congress to enact much needed legislation to stimulate the economy. I look forward to working with you on the tax ideas you and others have brought to our attention, many of which are included in the President's program.

8. I have been concerned with some of the U.S. Treasury Department's Office of Foreign Assets Control's (OFAC) reinterpretations of congressional intent regarding agricultural sales to Cuba. For example, OFAC's payment of cash in advance requirements for agriculture commodity sales to Cuba and the administrative delays and periodic denials of Treasury Department licenses to travel to Cuba to engage in sales related activities are unnecessary hurdles that are hindering progress. Can I have your assurance that you will work with me and others in Congress to eliminate excessive restrictions impacting agriculture trade and travel with Cuba?

It is important to have tax policies that work in tandem with our foreign policy and advance our national interest. OFAC plays a critical role ensuring our national security and we should ensure that rules and procedures in place are fair, efficient, transparent, and not arbitrary. I am committed to taking great care to follow congressional intent and working closely with members of Congress to ensure that OFAC's activities with regard to Cuba are achieving its important objectives without unnecessary hurdles or unreasonable administrative delays.

ANSWERS TO QUESTIONS FROM SENATOR ENSIGN

Question 1

Appropriate stimulus would be helpful now, but the wrong types of stimulus can create the next bubble. Are you concerned about the possibility of inflation developing, and are how will the government address this? What does this mean for the effectiveness of short-run stimulus measures, and do you believe the short-run benefits are worth the long-run costs?

With a severe recession here and around the world, a catastrophic loss of trust and confidence in our financial system, and millions of Americans worried about losing their jobs and their savings, we confront extraordinary challenges. We must move quickly and boldly to get our economy back on track. It is also important, however, that our program to restore economic growth be accompanied by a clear and compelling strategy to get us back as quickly as possible to a sustainable fiscal position.

It is critically important to balance short-run and long-run objectives, and I think it is right for us all to worry about whether certain stimulus measures could create another bubble or other detrimental long-run costs.

I believe that President Obama's plan provides the appropriate type and level of stimulus to stimulate consumer demand quickly and save or create 3.5 million jobs for American workers, while also making an important down payment on strategic long term priorities such as reducing the cost of health care. This plan helps achieve both short and long term objectives and is an important strategy to put in place right away.

Question 2

As you know, the U.S. has the second-highest nominal corporate income tax rate in the world. With an eye toward attracting investment, many countries around the world are lowering their corporate tax rates. The reason is simple – lower tax rates and simplified tax codes help to generate greater investment, jobs, and growth. Shouldn't the United States be leading the charge to enact lower corporate tax rates?

The competitiveness of U.S. companies depends on many factors such as labor costs, health care costs, research and development, technology investment, and worker education. U.S. tax rates are a factor as well. However, I believe the rate that matters to U.S. companies is the effective tax rate -- that is, the rate that companies pay after deductions and credits.

Nevertheless, let me be clear. I share the President strong desire to encourage U.S. companies to invest in research and development and to create jobs here in America. I believe the ability of companies to develop new products through research and development is vital to our long-term competitiveness and a key driver of job growth.

I also share the President's desire to help small businesses. They are an important part of our economy and a critical source of new jobs. And, unlike some large businesses that have capital reserves to ride out economic downturns, small businesses are particularly vulnerable during tough economic times such as these.

I look forward to working with you to ensure the competitiveness of American businesses, large and small, during this challenging economic period and far into the future.

Question 3

A huge amount of money continues to be spent on bolstering the financial markets. Is it working? There is evidence of lowered inter-bank rates. Are the banks translating into more, and more affordable, business, consumer, and mortgage loans?

I am disappointed to report that while our efforts to date, I believe, have had enormous impact and averted a truly disastrous alternative, we have not done enough to bolster new lending activity. This remains a core goal of mine and I believe some of our actions in the last 6 months can serve as important templates for how TARP can be used to stimulate lending. Our task is not merely economic, but also psychological – we intend to take steps to try to restore confidence to the finance sector -- for both investors and managers of these companies. With this confidence, a strong balance sheet, additional TARP programs, and continued low inter-bank rates as you identified, I believe we will see an increase in lending activity. I am committed to carefully monitoring bank intermediation and lending and reporting this activity to the public on a regular basis, particularly for institutions that participate in TARP.

Question 4

With your Wall Street experience, what do you see as the likely response in the bond markets to increasingly larger deficits and a looming fiscal cliff that our country is headed towards as the baby boomers start to retire and collect social insurance checks? As Treasury Secretary, how would you assure the bond markets that U.S. debt is not headed for default as these risks evolve?

The ability of our government to finance operations by raising money in the bond market is critical and we must be vigilant to assure the good faith and credit of our commitments. Even as we embark on a large and urgent recovery package to save or create 3.5 million jobs and restore the stability of our financial system, we must commit to a process of getting ourselves back on track to a sustainable fiscal position. We need to show the

world and all our creditors that, when we have effectively resolved the crisis and recovery is firmly established, that we as a nation will return to living within our means. To achieve this, the administration will need to make tough decisions and reform or eliminate programs that don't work. It will need to adhere to PAYGO rules as part of a strategy to pay for long-term fiscal commitments. It will address our biggest long-run fiscal challenge – the rising cost of healthcare.
If confirmed, I look forward to working with you and this Committee as well as the Budget and Appropriations committees to meet these challenges.

Question 5

The Treasury has a leading role in the G-20. Creating a new international financial architecture has been a serious topic of discussion in that group. Some countries apparently want a significant increase in regulation. I worry about the unintended consequences of this exercise and how additional regulations could compromise economic recovery. What are your plans on proposing new regulation on financial service firms, and do you commit that this process will be openly reviewed with Congress before agreeing to proposals from other countries in venues like the G-20?

Financial regulation remains first and foremost a national issue. As I said during my testimony, we will seek to improve the regulatory structure in a way that provides the safeguards we need without creating undue burden on financial market participants; we look forward to working with Congress on these issues. Nevertheless, we must also remember that this crisis has taught us the importance of international linkages in financial markets. Therefore, we look forward to taking into consideration the best thinking on how to coordinate our efforts with our partners in the G-20, the Financial Stability Forum, and the IMF, among others.

Question 6

President Obama's team has called for putting additional TARP funds toward a "sweeping effort" to address foreclosures and reduce mortgage payments for "responsible homeowners." As Treasury Secretary, specifically how would you use TARP funds to reduce or address foreclosures? How do you plan to determine who are "responsible homeowners" that deserve government assistance and who are irresponsible homeowners that should be allowed to continue unassisted in the foreclosure process? Do you think that state recourse laws contributed to the problem?

President Obama has made clear that a robust plan to stabilize the housing market and keep responsible families in their homes is a central part of his overall economic and financial rescue plan. Through a focus on affordability, aid to borrowers to help them stay in their homes, and continued vigilance to keep mortgage spreads low, we can provide programs that help borrowers in a variety of circumstances. Certainly, there will be shared sacrifice, and families will have to make hard choices. But for those that want to stay in their homes and make it work, I will work with Congress to identify and implement the most effective and efficient solutions.

While there have been important steps taken to stabilize our housing market, the response to date has been inadequate. The Hope for Homeownership program has not achieved the foreclosure mitigation goals it was designed to achieve. And millions of families are facing the prospect of foreclosure over the next several months. If confirmed, I will work with Congress to amend the H4H program in an effort to make the program more effective as part of our overall approach to foreclosure mitigation.

Question 7

As originally conceived, the TARP program was supposed to bring a measure of consistency and stability to the federal government's responses to the financial crisis by providing a clear framework for action. Instead, it has exacerbated the ad hoc nature of the government's actions to date. The markets need predictability from the TARP program, otherwise they will be paralyzed waiting for the next unexpected government intervention. As Treasury Secretary, how would you bring stability and predictability to the TARP program?

Support provided under the TARP program has helped prevent a financial catastrophe, and the actions of the Senate last week will enable us to take additional steps to reinforce recovery. However, I share your concerns that this program needs reform. The way in which the program has been implemented to date has caused confusion about the goals of the program. If confirmed, I will work to ensure that we have a shared understanding of the magnitude of the challenges we face and an open process of working together to address these challenges. Our expectation and our hope is that we will be able to come forward relatively quickly with a comprehensive plan. I will also work diligently to ensure that we operate as one government to meet the challenges we face, with strong coordination among all major financial regulators.

Question 8

Very soon the bipartisan 2001 and 2003 tax relief will expire. I believe that much of this tax relief stimulated the economy and that we should extend relief into the future. Allowing tax relief to expire will force a massive tax increase on American families, seniors, and small businesses at the worst possible time. Do you think we should extend those cuts for individuals on a longer-term basis?

Our immediate priority is to work with Congress to provide substantial tax relief for families and businesses through an economic recovery plan. For families, our plan makes a down payment on the President's commitment to cutting taxes for 95% of working Americans. For businesses, we propose to cut taxes for companies that are making investments and creating jobs.

The President has instructed his economic team to draw on the best ideas from all quarters and avoid ideological solutions. For this reason, the plan includes both investments and tax cuts to create 3.5 million jobs, raise incomes, and promote recovery.

Over the longer term, the important thing to recognize is that the President's plan is a net tax cut intended to boost long-term economic growth. It provides tax cuts to relieve the squeeze on middle class families and to help them afford things like college, health care and a secure and dignified retirement. His plan also advances the goal of restoring fairness to our tax system.

Question 9

As you know, there is a lot of capital on the sidelines right now. People and companies are sitting on cash and assets they might otherwise invest due to economic hardship and uncertainty. At the same time, there is much discussion among policymakers about making significant changes to the regulatory and tax landscape for the financial sector. Such changes could produce a chilling effect on investment, keeping that capital frozen rather than placed back into the markets. How do you intend to balance systemic reform with maintaining an atmosphere conducive to investment? How will you work with market participants to find that balance?

I believe that markets are central to economic growth and our ability to compete globally, but that markets alone cannot solve all problems. Well-designed financial regulations with strong enforcement are absolutely critical to protecting the integrity of our economy. If confirmed, I look forward to working closely with Congress to develop a smart and effective regulatory system that will meet our current needs as well as the challenges and opportunities we will face both domestically and globally in the years ahead.

Question 10

In a June 2008 speech, you stated that, "the Federal Reserve has broad responsibility for financial stability not matched by direct authority" and that we need a more "unified framework that provides a stronger form of consolidated supervision." This has been interpreted as a call for strengthening the Federal Reserve's power and authority. Do you still believe that? If so, what specific new powers for the Fed would you propose?

I believe stronger regulation is necessary to make financial markets work well. Our financial system architecture is unsound and outdated. We need a fundamental redesign. Among other things, this includes better prevention and detection methods, better enforcement authority, resolution regime for systemically important nonbanks and better checks on excessive risk. I look forward to working with Congress as we move ahead to building a more effective financial regulatory framework.

Question 11

The IRS has implemented a Free File Program for the past six years and the private sector participants in that program have done a good job in serving those of our citizens who need support and assistance like the working poor, the elderly, and other disadvantaged citizens. Unfortunately, some have suggested that the IRS should design and build its own tax Web Portal to replace the current Free File Program. I oppose this effort. The government should not be competing against private sector participants in the tax software preparation market. What will you do to discourage the IRS from wasting money on such counter-productive efforts?

I strongly support the President's goal of simplifying the tax code and the tax preparation process. During the campaign, he outlined a proposal to develop a system that would dramatically simplify tax filings so that millions of Americans would be able to do their taxes in less than five minutes. Estimates of this proposal suggest that it could save Americans millions of hours and billions in preparer fees.

I am eager to hear your views about the best way to achieve this important objective, leveraging the Free File experience and both public and private sector advantages for optimal quality and efficiency. The IRS already receives most Americans' financial information directly from employers and banks. President Obama has proposed for the IRS to use this information to give taxpayers the option of pre-filled tax forms to verify, sign, and return to the IRS or online.

Experts estimate that the Obama proposal will save Americans up to 200 million total hours of work and aggravation and up to $2 billion in tax preparer fees – allowing families to keep more of their hard earned dollars, which is particularly important during these tough economic times when every penny counts.

If confirmed, I look forward to working with you on this project to ensure the IRS does not waste money or engage in counter-productive efforts and that we are achieving effective tax simplification in a safe, fair and efficient way.

Question 12

Recently, Dr. Robert Shapiro, chair of the New Democrat Network's Globalization Initiative, wrote an article where he described a way to find a "free" $420 billion to stimulate the economy. The money is held by our own companies outside the U.S., but current tax law strongly discourages firms from bringing capital back to the U.S. In fact, several years ago, Congress passed a temporary law allowing firms to repatriate capital from their foreign affiliates at much lower tax rates. The result of the temporary change to a lower rate resulted in $34 billion in additional revenues to the Treasury and $312 billion of capital into the U.S. Given that more than ever we need to add capital to our market, do you agree that it makes sense to remove once again this self-imposed tax barrier? Lowering the tax on repatriation would be cheaper to the taxpayer and would actually increase money to the Treasury again.

I can appreciate that some economists believe the immediate stimulative effects of a repatriation tax holiday outweigh the costs in incentives for offshore production and potentially deteriorating the federal tax base. I would be happy to discuss with you the evidence that leads you to support a repatriation holiday and to share the contrary evidence that leads me to be more skeptical. For one thing, the previous "one time" tax relief for repatriated dividends appears not to have demonstrably created new jobs despite the promises of beneficiary firms to do so. For another thing, several economists believe the repatriation tax holiday actually increased incentives to shift profits offshore, encouraging the very behavior it was intended to reduce.

I know this is an issue that is important to you and I'm eager to better understand your position and the empirical data and experience that has helped you reach the conclusion that you have. If confirmed, I will work with you on the issue of the competitiveness of U.S. firms, including tax issues such as repatriation.

<u>Question 13</u>

The original purposes of the TARP was to get distressed debt off of the books of financial institutions, so they would clean up their balance sheets and continue to provide credit. You have stated that this remains a goal. Did you know that U.S. tax law strongly discourages firms from renegotiating their indebtedness with holders of that debt, because the IRS will send a tax bill for the amount of debt cancelled? I have suggested temporarily changing the tax law to allow firms to renegotiate their debts without triggering additional taxation. Doesn't it make sense to allow businesses to handle their debt problem in this way, especially when they can do so without taxpayer money?

I am in favor of simplifying the tax code such that businesses and individuals get the most out of their tax dollars, particularly at a time when our economy faces nearly unprecedented challenges. If confirmed, I look forward to working with you and other members of this committee to develop proposals that would make tax law work in favor of middle class families and enable our businesses to remain competitive, globally.

ANSWERS TO QUESTIONS FROM SENATOR KERRY

1) The housing crisis caused serious damage to our economy. Similar problems are facing the commercial real estate industry and the credit card industry. In your role as the President and Chief Executive Officer of the Federal Reserve Bank of New York, you were intimately involved in the decisions to bailout the financial industry. What have you learned from this experience about what worked and what did not work? And how will your past experience shape your response to the second phase of the rescue attempt?

Financial crises, by their very nature, require strong actions, which only governments can take. The housing crisis caused serious damage to our economy, and in a crisis of such magnitude, policymakers needed to respond more aggressively and proactively than they did. However, government tools were not adequate to allow policymakers to respond with the strength, speed and care necessary to arrest the contagion early and get our economy back on track. For instance, more should have been done to avert unnecessary foreclosures.

More needs to be done still to restore lending and the effective functioning of credit markets. We have to reshape and redesign the program of financial stability to ensure that there is credit available to support recovery. We will do this with conditions to protect the taxpayer and ensure transparency.

We must also couple our critical efforts to restore financial system stability with investments that restore economic recovery and growth. The history of financial crises shows that governments too often fail to act with sufficient speed and force. If we do not do what is necessary now to solve the problem, we risk much more serious damage to living standards and negative long term consequences for the economy.

2) The housing crisis triggered our economic downtown and foreclosure need to be addresses as part of the situation. As house prices continue to decline, many borrowers, as many as 15 to 20 percent, find themselves "under water" on their mortgages. As the economy slows and unemployment rises, more households are having difficulty making their mortgage payments. Sheila Bair, Chairman of the Federal Deposit Insurance Corporation, has developed a plan to reduce foreclosures by working with banks to provide fixed rate mortgage loans at a lower interest rate to eligible delinquent borrowers. According to the FDIC, this plan is expected to initially help 2.2 million borrowers get new loans; after some borrowers re-default, 1.5 million would ultimately keep their homes. The plan would cost an estimated $24.4 billion. There are two key elements to the proposal. First, housing payments for delinquent borrowers two months or more behind would be reduced to 31% of gross monthly income. To get there, mortgage rates could be set as low as 3% for five years, before increasing at an annual rate of 1 percentage point until they hit the prevailing market rate. Loan terms could be extended as long as 40 years. Second, to encourage servicers and investors to participate, the government would

share up to 50% of the losses if a borrower who had been helped ended up in default anyway. The risk of re-default had been one obstacle to getting lenders on board with systematic modification plans. According to FDIC estimates, this plan is expected to initially help 2.2 million borrowers get new loans; after some borrowers re-default, 1.5 million would ultimately keep their homes. The plan would cost an estimated $24.4 billion. What do you think about this proposal and will you support the enactment of this type of plan as Treasury Secretary, or do you have another proposal to address foreclosures?

I believe that we must work with Congress immediately to implement smart, aggressive policies to reduce the number of preventable foreclosures. Confronting this challenge is an absolute imperative if we are to restore the health of our housing sector and financial system as a whole. We plan to reduce preventable foreclosures by helping to reduce mortgage payments for economically stressed but responsible homeowners, reforming our bankruptcy laws and strengthening existing initiatives like Hope for Homeowners. While our goals are 100% in line with the goals of the Bair proposal – reducing preventable foreclosures – and I intend to work very closely with the FDIC and other federal regulators, we are still in the process of examining all of the specific options for how best to implement a plan that would most effectively achieve this goal.

3) Many subprime and Alt-A mortgages have been sold as bonds to investors under what are called "structured investment vehicles." As we all know, too many of these instruments have declined in value. Many homeowners who are stuck in subprime loans and face foreclosure are unable to make appropriate loan modifications because their loans were included in "structured investment vehicles". As Treasury Secretary, what action would you support to change existing laws and help borrowers whose loans were included in "structured investment vehicles" obtain loan modifications? Are there changes in law that could help speed this process?

We are committed to implementing smart, aggressive policies to reduce the number of preventable foreclosures. One way to reduce the number of preventable foreclosures is to help reduce mortgage payments for responsible homeowners suffering temporary hardship due to the economic downturn. Structured investment vehicles have complicated the ability of borrowers to obtain loan modifications. In general, structured finance products such as CDOs, SIVs, and auction-rate securities played a significant part in facilitating the contagion that led to our financial crisis. Product innovation outstripped the capacity of internal risk management and regulatory oversight to keep up. We plan to examine all possibilities for changing the tax and regulatory structure affecting mortgage loan modifications as part of our plan to reduce preventable foreclosures and keep people in their homes.

4) Too many American families are facing bankruptcy due to the recent changes in our economy. Unfortunately, I am concerned that many credit card

companies, who are also facing bankruptcy, are abusing families behind on their credit card payments. For example, if you make late payments or exceed your credit limit, some credit card companies shift your account to the default penalty interest rate on your credit card, sometimes exceeding 30 percent. If your credit card company does decide to shift you to a higher interest rate, expect the penalty price to apply not only to future charges but to your past charges. Some credit card companies are undertaking a practice called double-cycle billing where the consumer is charged interest on the average daily balance of two months of charges instead of just one. What actions will you take to combat these abusive credit card practices? What legislation is necessary to stop these practices?

President Obama has proposed a number of initiatives to improve credit card transparency and empower consumers to better protect themselves. He has also proposed banning certain credit card practices such as universal defaults and retroactive rate charges. The Federal Reserve has recently finalized new regulations that apply to the credit card industry. If confirmed, I will review the proposal and the Federal Reserve rules to determine what statutory changes are needed to protect cardholders from abusive credit card practices.

I do now, and would as Treasury Secretary, if confirmed, continue to place a high priority on enforcement of all banking rules.I intend to work with Congress as well as other federal regulators to ensure effective consumer protection.

5) The Emergency Economic Stabilization Act of 2008 limited executive compensation for executives of companies that are participating in the Troubled Asset Relief Program (TARP). These restrictions include a limitation on the amount of compensation that can be deducted as an ordinary and necessary business expense. The definition of compensation was expanded to include performance pay and stock options. I have introduced legislation that would index the current limitation of $1 million and repeal the exemption for performance based pay and bonuses. What is your opinion on limiting the amount of executive compensation which can be deducted?

Excessive executive compensation that provides inappropriate incentives has played a role in exacerbating the financial crisis. This issue has been and should continue to be closely examined by the public, shareholders, boards of directors, Congress, and the incoming Administration, including Treasury and the SEC. If confirmed, I will charge my staff at Treasury, including the Internal Revenue Service, with ensuring that the regulations implementing the executive compensation provisions of the Economic Emergency Stabilization Act (EESA) are fully complied with. I will also ask them to study your proposal to limit the deductibility of executive compensation.

One specific control we would plan to impose on TARP recipients is that executive compensation above a specified threshold amount be paid in restricted stock or similar form that cannot be liquidated or sold until government assistance has been repaid. In addition, we would limit TARP recipients' ability to pay dividends. One specific measure would be a requirement that TARP recipients wishing to pay dividends obtain approval from their primary federal regulator. In addition, in the case of TARP recipients receiving exceptional assistance, quarterly dividends would be strictly limited until the government has been repaid. These controls are described in National Economic Council Director-Designate Summers' January 15, 2009 letter to the Congressional leadership.

Questions from Senator Hatch

Question 1:

Do you think that fundamental and wholesale reform of the tax code is politically possible during this new administration? Or, do you believe that it might make more sense from a practicality standpoint for the Administration and Congress to pursue a series of incremental reforms that simplify the code and improve the incentives for both households and firms?

Determining the best strategy to reform the tax code is something that can only be accomplished with close consultation and work with you and other members of Congress. I share the President's support for simplifying the tax code, restoring fairness, and encouraging pro-growth, pro-job tax policies. I also share his desire to provide middle-class tax relief and find ways to help American companies create jobs and be globally competitive. At the same time, there is a lot of work that needs to be done to eliminate unnecessary tax shelters and loopholes. We also must find ways to increase compliance and close the tax gap. If confirmed, I will work with you to improve our tax system. I believe our most urgent tax priorities are to find ways to create jobs, encourage business investment through the adoption of the economic recovery plan, and provide for long-term economic growth.

Question 2:

As you may know, Chairman Baucus and I have sponsored legislation for many years to make the research credit permanent. In 2001, we were able to get a permanent research credit passed in the Senate as part of the big tax cut bill we passed that year. Unfortunately, the permanent provision fell out in conference with the House. It seems to me that we have an extraordinary opportunity to make this vital provision permanent by including it in the stimulus bill Congress is now working on. Can you tell me if you see a better opportunity to make the research credit permanent down the road?

I share the President's desire to encourage U.S. companies to invest in research and development. The ability of companies to develop new products through research and development is vital to our long-term competitiveness and a key driver of job growth.

The President supports making the R+D tax credit permanent and I look forward to working with you and the rest of the Committee to accomplish this goal.

Question 3:

This week, shares of U.S. banks were down 20 percent to their lowest level in more than a decade. Do you anticipate more funding is needed beyond the original $700 billion to successfully implement the goals of TARP?

Right now we are focused on carefully designing and executing a comprehensive financial recovery program to complement the President's economic recovery and reinvestment plan. This program will ensure that the banks at the core of the financial system are strong enough to provide the credit necessary to sustain a robust economic recovery. It will provide substantial support to the capital markets more generally because a fully functioning market infrastructure is central to restarting lending to small- and large-businesses and corporations, commercial residential real estate lending, student loans markets, and auto finance markets. It will involve aggressive action to prevent foreclosures and support the housing and mortgage markets.

I believe strongly that we have to take all these measures in a clear and forceful way that allows people to see the impact quickly. This is a dynamic situation and we will have to monitor economic and credit market conditions very carefully. We have to be prepared to act flexibly and with speed if conditions worsen appreciably, to devote more resources if that is necessary to secure our objectives, and we have to make it clear that we will continue to act until we have restored the strength and vitality of the U.S. financial system.

Question 4:

Do you believe that nationalizing our financial institutions is necessary to save our economy?

I believe that the best outcome for the economy is a financial system that resides in private hands, with appropriate and effective oversight and regulation, and strong incentives for private market participants to invest. We nonetheless face a situation in which the U.S. government is currently providing extraordinary support to many financial institutions in order to avoid a catastrophic collapse in the functioning of the system and in the flow of credit to households and businesses. We believe these aggressive actions are necessary to prevent the need for an even greater outlay of funds in the future. However, we will make sure that the support the government is providing comes with strong, carefully designed conditions to protect the taxpayer, to provide much greater transparency about how the money is being spent and the results being generated, and to improve the possibility that private capital comes in and replaces government capital as quickly as possible.

Question 5:

In a report analyzing TARP expenditures through December 31, 2008, the CBO estimates the Treasury has paid participants of TARP (financial institutions and Big

3 auto manufacturers) roughly $64 billion over the market value of the assets Treasury received. Not only are we purchasing troubled assets from financial institutions but it seems we are doing so at an enormously inflated price. Are you confident that we are not throwing money down a sink hole?

I intend to carefully study the reports of the CBO as well as the GAO and the Congressional Oversight Panel. I believe it is essential that Treasury design its programs, consistent with EESA, to protect the taxpayer and to provide positive return on investments to the maximum extent possible. We must ensure effective oversight that thtese goals are achieved. For example, under the CPP, Treasury will purchase up to $250 billion of senior preferred shares on standardized terms, including a 5 percent dividend for 5 years, which then increases to 9 percent. The government will not only own shares but will also receive warrants for common shares in participating institutions. These warrants should allow the taxpayer to benefit from any appreciation in the market value of the institution.

Treasury's imperative is investing in banks of all sizes around the country to help stabilize the financial system and get credit flowing to our communities. The goal is not to make these investments for short-term gains, but rather to protect taxpayers by ensuring the stability of the financial system and by earning a return on these investments when they are eventually liquidated.

Question 6:

Would a refundable "make work pay" credit (even a permanent one) encourage capital formation, make workers more productive, and raise pre-tax wages? How about a cut in the corporate tax rate? Expensing of plant and equipment? Indexed depreciation allowances? Lower tax rates (extended permanently) on capital gains?

I believe that the competitiveness of U.S. companies depends on many factors such as labor costs, health care costs, research and development, technology investment, and worker education. U.S. tax rates are a factor, as well. I believe, moreover, that the rate that matters to U.S. companies is the effective tax rate, that is, the rate that companies pay after deduction and credits.

With respect both to lowering tax rates on capital gains and to refundable tax credits, I believe that investment, work and savings, and their relationship to productivity, are critical to the economic future of the country. Any option in this area needs to be evaluated against multiple criteria, including its impact on economic growth, job creation, work incentives, the promotion of our standard of living, and the tax principle of fairness. The President has said that the refundable tax credits should be available only to those Americans who work. We also need to evaluate proposals based on the requirement of being fiscally responsible and maintaining an adequate tax base.

ANSWERS TO QUESTIONS FROM SENATOR KYL

TERRORISM FINANCE AT TREASURY

1. **Mr. Geithner, in recent weeks, the press has reported on some extraordinary actions related to the U.S. effort to prevent Iran's quest to obtain a nuclear weapon; these actions were the result the work of the Treasury Department:**

    a. **In New York City, it was announced that the Treasury and Justice Departments determined that a large office building on Fifth Avenue was owned by a firm, Assa Corp, which is a front for Bank Melli, an Iranian bank which is barred from doing business in the United States since it is involved in facilitating the movement of nuclear materials for the Iranian government.**

    b. **Less than two weeks ago, the Treasury Department led an investigation involving the venerable Lloyd's of Great Britain. According to the reports, this bank agreed to a fine of $350 million for its illegal handling of financial transactions for the terrorist states, Iran and Sudan. In this case, Lloyd's was involved in stripping Iranian and Sudanese identifiers from transactions so that they wouldn't draw attention and be barred from the U.S. financial system.**

    c. **These are just a few of the examples of the outstanding work of the Treasury Department.**

I agree wholeheartedly that the Department of the Treasury has done outstanding work in ratcheting up the pressure on Iran, both by vigorously enforcing our sanctions against Iran and by sharing information with key financial actors around the world about how Iran's deceptive conduct poses a threat to the integrity of the financial system. The Treasury Department's action with respect to a Bank Melli front company and part owner of the Fifth Avenue property, undertaken in coordination with the Department of Justice, was the latest in a series of designations targeting Iranian entities involved in proliferation activities and their subsidiaries and supporters. This Iranian scheme to use a Melli front company in the United States to funnel money back to Iran is part of a larger pattern of behavior which has led the United States, the European Union and Australia to designate Bank Melli, and the United Nations Security Council to issue a call for vigilance with respect to all Iranian banks.

The Lloyds Bank action was a criminal action taken by the Department of Justice and the Manhattan District Attorney's Office. Treasury's civil investigation of Lloyds is being conducted by the Office of Foreign Assets Control and is ongoing. Treasury has also been instrumental in working with the private sector to establish new industry guidelines and practices with respect to the processing of international wire transfers that will make it easier for financial institutions worldwide to comply with their obligations under U.S. and international law in the future.

If I am confirmed, I will work to ensure that Treasury continues its outstanding work in these important areas.

2. **During the campaign, the President said "[w]e should also pursue other unilateral sanctions that target Iranian banks and Iranian assets."** ***(AIPAC, June 4, 2008)*** **Do you agree?**

   If confirmed as Secretary of the Treasury, I would consider the full range of tools available to the U.S. Department of the Treasury, including unilateral measures, to prevent Iran from misusing the financial system to engage in proliferation and terrorism.

3. **Do you pledge to keep this a robust function of the Treasury Department under your leadership and make sure that the Department requests sufficient resources to execute this function?**

   I am fully committed to the mission of the Office of Terrorism and Financial Intelligence (TFI) and, if confirmed, I will work to ensure that this office has the resources necessary to fulfill its vital mission. With the creation of TFI, Treasury has emerged as a key player in the national security policymaking process with broad responsibilities for combating threats to U.S. national security and safeguarding the international financial system against illicit use.

4. **Do we have your commitment to strongly resist any attempt to take this function away from the Treasury Department, which has been so successful as the above examples highlight?**

   I am fully committed to Treasury continuing to exercise its unique authorities to combat threats to U.S. national security and to safeguard the international financial system against illicit use. If confirmed, I will work to ensure that Treasury's Office of Terrorism and Financial Intelligence retains this important role and that the Department continues to be a vital part of our national security team.

5. **Mr. Geithner, when you came by my office, we discussed the outstanding work done by Under Secretary Stuart Levey, who has in many ways revolutionized the way the United States enforces and deters violations of our sanctions. He has traveled the world and warned of the reputational risk and possible sanctions that attach when financial institutions do business with Iran; many times these institutions do not know that they are being misled and deceived and are involved in Tehran's illegal terrorism and proliferation programs. He is credited, rightly in my mind, with turning up the heat on Iran. Do you agree?**

   a. **Now, despite these aforementioned efforts, and the efforts of our international partners, some banks continue to ignore the U.S. and**

U.N. designations and conduct business with sanctioned Iranian entities. If foreign banks continue to conduct business with Iran in violation of U.S. or U.N. sanctions, will the Treasury Department pursue punitive measures against such banks?

I agree that the team led by Under Secretary Levey has done an outstanding job on Iran and other issues. I can assure you that the Treasury Department, through its Office of Foreign Assets Control (OFAC), will continue to vigorously investigate any possible violations of U.S. sanctions with respect to Iran. To the extent that any entities or individuals continue to do business with Iran in violation of U.S. sanctions, OFAC will take appropriate enforcement actions, including the imposition of civil penalties and/or the referral of cases to the Department of Justice for possible criminal prosecution. Enforcement of our sanctions laws, particularly with respect to Iran, will remain a high priority for the Department if I am confirmed.

VALUE OF THE DOLLAR

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.

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.

1. **As Secretary of the Treasury you have responsibility for managing dollar policy, do you support a strong dollar?**

   A strong dollar is in America's national interest. Maintaining confidence in the long-term strength of the United States economy and the stability of the U.S. financial system is good for America as well as our trading and investing partners. As Secretary of Treasury, if confirmed, I will act to achieve those goals.

2. **According to CBO, Treasury will need to issue an additional $1.4 trillion in debt to finance our government's operations in FY 2009. As a result, debt held by the public will rise nearly 10 percentage points to 50.5 percent of GDP. Does issuing more government debt make the dollar stronger or weaker?**

Our top priority right now is getting the economy moving again and creating jobs with a robust economic recovery plan. In the short-term, deficits of these size are needed in order to prevent a much worse deterioration of our economy that would involve more job loss, declining incomes, and lost opportunity.

Our program to restore economic growth has to be accompanied by a clear strategy to get us back as quickly as possible to a sustainable fiscal position. We need to demonstrate with clear and compelling commitments now that – when we have effectively resolved the crisis and the recovery is firmly established – we will return to living with in our means. These are the actions that will provide the basis for maintaining confidence in the long-term strength of the United States economy and the stability of the U.S. financial system.

3. What do you intend to do to strengthen our nation's currency?

If confirmed, I will be committed to supporting the long-term strength of the United States economy and the stability of the U.S. financial system. The American Recovery and Reinvestment Plan will provide substantial support to get the U.S. economy back on track and restore faith in America's future. Acting decisively to secure the stability of the U.S. financial system and get credit flowing again with effective programs under the Emergency Economic Stabilization Act is also critical.

These are the actions that should allow us to maintain confidence in the long-term strength of the United States economy and the stability of the U.S. financial system. This is good for America as well as our trading and investing partners.

CORPORATE FINANCE

According to CBO, the tax rate on debt financed corporate investment is **a negative** 6.4 percent and the rate on equity-financed investment is 36.1 percent, a difference of 42.5 percent. Most economists believe this differential distorts the efficient allocation of capital, causes companies to take on relatively more debt and become more susceptible to bankruptcy. Increasing the capital gains tax rate would increase the tax rate on equity-financed investment further.

1. **Wouldn't eliminating or reducing this distortion have a positive impact on the economy?**

   In general, reducing distortions in business investment and financing decisions attributable to the tax system would have positive economic effects. However, many factors affect investment and financing decisions, including especially the proper functioning of credit and equity markets. In the current economic environment, our focus needs to be on restoring markets.

2. **Doesn't that suggest a need to keep capital gains and dividends tax rates low?**

   In general, reducing tax distortions has positive economic effects. Under current law, at the end of 2010, the maximum tax rate on capital gains will increase to 20 percent and the maximum tax rate on dividends will increase to 39.6 percent. Without a change to current law, the differential between the effective tax rate on debt and equity will increase. President Obama has proposed limiting the capital gains tax rate to 15 percent for taxpayers with incomes below $250,000. He has also proposed continuing to tax dividends at the same rate as capital gains. President Obama's proposal thus would reduce the differential between the effective tax rate on debt and equity that under current law would otherwise result.

REBATE CHECKS

About this same time last year, Congress was contemplating stimulating the economy by providing individuals and families with rebate checks. At the time, I argued that past experience suggested these checks would be largely ineffective because individuals would save most of the money. Marty Feldstein, who initially supported the idea of sending people rebate checks, wrote in an August Wall Street Journal editorial, "recent government statistics show that only between 10 percent and 20 percent of the rebate dollars were spent. The rebates added nearly $80 billion to the permanent national debt but less than $20 billion to consumer spending."

1. **With that in mind, it's pretty hard to argue that last years' rebate checks were a successful stimulus; so if last year's stimulus bill failed to prevent our nation from entering a recession, how will the economic stimulus bill the new Administration is proposing do any better?**

   Our view is that the American Recovery and Reinvestment Plan is designed in a way that will help improve the prospects that a larger portion of the tax benefit is actually spent. The two reasons for this is that:

   a) It is an initial down payment on a reform that President Obama would like to both make permanent and to pay for. Our hope is that this is going to be an enduring change in withholding tax treatment for Americans that are eligible and, thus, would have a more powerful effect on spending than the last round of rebates, and

   b) This proposal is designed in a way that, as opposed to the last rebate proposal where it was a one-time check, the American people will see a change in withholding statements every week. And they will have a reasonable expectation that it will be continued. We believe that this proposal will have more impact on spending behavior and have more effectiveness.

2. **CBO now estimates less than half of construction funds in the stimulus bill will be released into the economy over the next four year! Less than $4 billion would reach the economy by September – so most of the infrastructure money wouldn't hit the economy until its already recovering. And only 7 percent of the energy money will be spent in the next 18 months. So how can this spending be justified?**

   Estimates of how soon and how effective individual components of President Obama's economic recovery program will influence economic growth must be viewed within a range of likely outcomes. We disagree with projections that infrastructure spending would move slowly through the economy. Almost all states have projects that were approved in the past year or more after rigorous evaluation, but could not start due to an erosion of state revenues. Economists generally agree that direct spending would be an efficient way to create jobs and provide relatively quick stimulus. The President's program is designed to ensure that recipients of infrastructure can spend the money quickly, or will commit to returning the money to be reallocated. Much of the economic recovery proposal devoted to energy policy is targeted to increasing energy efficiency in federal and public K-12 schools. These lower tech investments would multiply by increasing short-term employment gains among lower-skilled workers and lower the federal government's expenditures on energy. I look forward to working with you and others to improve the Administration's plan and helping restart the U.S. economy.

3. **Professor Christina Romer, President Obama's Council of Economic Advisors' Chairwoman Designee wrote in a March 2007 paper with her husband that a dollar of tax cuts raises GDP by about three dollars, significantly more than the multiplier many economists ascribe to changes in spending. Do you agree with Dr. Romer?**

Dr. Romer has recently written a paper with Jared Bernstein in which they explain their multipliers for different types of spending. That paper, "The Job Impact of the American Recovery and Reinvestment Plan" – released January 9, 2009 – explains the difference in the multipliers. They note that the multipliers for the American Recovery and Reinvestment Plan are based on a leading private forecasting firm and the Federal Reserve's FRB/US model. The multipliers were considered "for the case where the federal funds rate remains constant, rather than the usual case where the Federal Reserve raises the funds rate in response to fiscal expansion, on the grounds that the funds rate is likely to be at or near its lower bound of zero for the foreseeable future."

The Romer/Bernstein paper gave as the output effects of a permanent stimulus of 1% of GDP as follows:

- In Quarter 1, Government purchases would be 1.05 and tax cuts would be 0.00.
- In Quarter 4, Government purchases would be 1.44 and tax cuts would be 0.66.
- In Quarter 8, Government purchases would be 1.57 and tax cuts would be 0.99.
- In Quarter 16, Government purchases would be 1.55 and tax cuts would be 0.98.

So, due to the fact that the Fed funds rate is likely to be much lower than it was back in March of 2007, the multiplier has changed. The "bang for the buck" of the combination of the spending proposals is approximately $1.57 for every $1 spent.

Of course, the "bang for the buck" depends on the proposals as well as how they are legislatively crafted. If confirmed, I look forward to working with the Finance Committee on these issues as the legislation moves forward.

4. **If so, should the proposed stimulus bill rely more heavily on reductions in revenue than increases in spending?**

President Obama has put forward an economic recovery plan that includes strategic investments that are based on what yields the highest rate of return for the economy.

In some cases, the highest rate of return can be realized through direct government spending. In other cases, a high rate of return can be made in some tax cut proposals. For this reason, we have proposed a mixture of both tax cuts and direct spending to comprise his proposal.

5. **How can you argue that many provisions of the stimulus bill will have any appreciable simulative effect? Which ones?**

   A key measure of President Obama's American Recovery and Reinvestment Plan is that it should save or create at least 3 million American jobs by the end of 2010. Proposals that create and save jobs have a definite stimulative effect.

   The elements of the President's proposal that are related to such items as school repair, infrastructure and energy will likely have job growth in the manufacturing and construction industries. Proposals, such as the middle-class tax cut and fiscal relief to states are likely to help save or create jobs in all sectors of the economy.

   When then-President-elect Obama met with the bipartisan Congressional leadership, he said he wanted 40% of the "stimulus" package to be tax relief. The package unveiled by the House allocates only 32% to tax cuts. And even there, a big portion of the tax cuts are really spending -- and will be scored as such by Congress -- because they provide money through the tax code to people who do not pay income taxes. These are the "refundable credits."

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   What portion of the "stimulus" package will be dedicated to actual tax cuts i.e. revenue reductions?

   The answer partly depends upon the legislative process. As you know, there are currently two bills that are moving through the Congress. At this point, it is unclear what the final product will be. President Obama has proposed both spending and revenue proposals that he feels provides the right combination to bring growth back to this economy. Of course, if confirmed, I look forward to working with the Committee as these bills proceed.

7. **Will you work with the Senate Finance Committee to increase the tax relief potion to equal 40% of the package?**

   It is important to consider the totality of the plan. As you know, President Obama has proposed significant tax reductions. If confirmed, I will work with you and the entire Finance Committee to find the optimal mix of spending and revenue provisions that provide the needed growth and recovery to the economy.

STATE & LOCAL ASSISTANCE

A major component of the "stimulus" package, as described by the Obama Administration and embodied in the legislation proposed in the House, is about $200 billion in assistance to state and local governments. Since state and local spending has not fallen off, there is no gap or hole in demand for the federal government to fill. As such, this information implicates one of the important tests for a stimulus package: Will it work?

1. **Since state/local spending has been increasing, not decreasing, why will adding even more federal spending effectively "stimulate" economic growth?**

   I appreciate and share your commitment to pursuing the most effective measures possible to jumpstart our economy. That is why the President and his economic team favor a balanced package that includes state fiscal relief alongside substantial up-front government investments and tax cuts for middle class families and business to create jobs. Economists across the political spectrum and a range of independent organizations have confirmed that state fiscal relief can be an extremely effective way of avoiding economic contraction. In today's recessionary environment, states are facing increased fiscal burdens alongside declining tax revenues.

   Left unaddressed, these states will have to either cut back on spending or raise taxes to fill those budget gaps. In fact, several states have already been forced to raise taxes or fees. By avoiding these increases or subsequent budget cuts, appropriately designed state fiscal relief can avert a downward economic spiral and save jobs.

2. **I would like some assurance – on a program by program basis – that the dollars taken out of the private economy to finance this massive stimulus spending bill will be used more effectively by the government than they would be used by individual Americans and businesses in the economy, i.e. the Summers test? For each component, explain how investment and job creation will result.**

   As you know, the President feels strongly that the recovery and reinvestment act include substantial tax relief – both for individual families and to provide businesses with incentives to make investments and create jobs. In addition, government investments that are designed to be temporary and address critical unmet needs can help not only stimulate the economy in the near term but help increase productivity and economic competitiveness in years ahead. Some specific proposals include:

   - an up-front investment in computerizing medical records today will not only help create jobs in the private sector, but help lower the cost of health care and make American businesses more competitive going forward;

- the development of a clean energy economy – where we will double the production of alternative energy in the next three years;

- the modernization of more than 75% of federal buildings;

- improving the energy efficiency of 2 million American homes – saving consumers and taxpayers billions on our energy bills;

- equipping tens of thousands of schools, community colleges, and public universities with 21st century classrooms, labs, and libraries;

- retrofitting America for a global economy by updating the way we get our electricity, expanding broadband lines across America so that a small business in a rural town can connect and compete with their counterparts anywhere in the world;

- investing in science, research, and technology that will lead to new medical breakthroughs, new discoveries, and entire new industries,

- to provide immediate relief to states, workers, and families who are bearing the brunt of this recession;

- and the plan is designed to put Americans back to work, in new jobs that pay well and can't be outsourced – jobs like building solar panels and wind turbines, constructing fuel-efficient cars and buildings, and developing the new energy technologies that will lead to even more jobs, more savings, and a cleaner, safer planet in the bargain.

The goal is to invest in what works – in order to save or create jobs. If confirmed, I would look forward to working with you and other members of the committee to refine this package to ensure that the investments we make help create jobs and turn our economy around.

3. **Would you be willing to work with Republicans to structure a portion of the state aid as a loan? The argument for loans is that states will make wiser spending decisions if they have to repay the funds.**

If confirmed, I would be happy to work with you and other members of Congress to strengthen the recovery package. In this area, the President does support providing state fiscal relief in grant form through established channels like the federal Medicaid match because they have proved effective in past stimulus measures and can be put in place quickly. But I understand your concern about maximizing effectiveness of our interventions overall, and believe that we can identify common areas to move forward in that respect.

<u>CITIBANK, WACHOVIA & WELLS FARGO</u>

Press accounts indicate that the Federal government initially directed Citibank to purchase Wachovia in order to strengthen the financial system. In the weeks that followed Wells Fargo ended up purchasing Wachovia, not Citibank.

1. **How closely did you work with Secretary Paulson on the decision relating to Citibank both with respect to the acquisition of Wachovia and the position you took on that when Wells Fargo came into the picture, as well as the judgments that you and others made regarding what Citibank needed and what it would need?**

   To my knowledge, the government did not direct Citigroup to purchase Wachovia. Instead, Citigroup agreed to acquire the banking operations of Wachovia under an open bank assistance transaction in which the FDIC fully protected the depositors of Wachovia. The decision by the FDIC to facilitate the acquisition in this manner was supported by the Board of Governors of the Federal Reserve and the Secretary of the Treasury in consultation with the President. Throughout most of the period in September and October, which includes the period in late September when Wachovia came under strain, regulators across the relevant agencies consulted closely with one another on the actions that were being undertaken to deal with the spreading distress in our financial system.

   As president of the Federal Reserve Bank of New York, I was involved in, along with other Federal Reserve officials as well as officials from the FDIC and OCC, many of those consultations and conversations, including conversations about the degree of assistance Citigroup was seeking in connection with the acquisition of Wachovia as well as conversations about Wells Fargo's subsequent bid for the firm. As for any particular positions I may have taken in this context, these are complicated negotiations involving considerable coordination across firms and regulators and each of us expressed our views and worked to reach the consensus that you ultimately saw reflected in the actions that were taken.

<u>INCOME TAX RETURN</u>

1. **How many times did you sign the tax allowance application? Was that once a year for three or four years?**

   I do not remember how often the IMF distributed these applications, but I believe that form was an annual form. I worked at the IMF from 2001 – 2003, so I probably signed the application three times.

2. **You know that were doing something by signing this; that you were applying for something. What did you think you were doing when you first signed this?**

   As I said in response to your question at the hearing, I believe that form is intended to ensure that the allowance the IMF provides is calculated correctly. I signed it in the mistaken belief that I was complying with my obligations.

3. **Were there any written communications between your tax preparer and you relative to the audit which concluded that you owed additional taxes for 2003 and 2004?**

Yes. I have supplied all such communications in my possession to the Committee.

4. **Did you realize that the same mistake that was made in 2003 and 2004 was probably made for 2001 and 2002 but that the statute of limitations had run out and you didn't have to pay the tax for those other two years?**

   I did not realize that until I was going through the transition team's vetting process, and when it was drawn to my attention as part of that process, I decided it was appropriate to go back and correct the error, which I did.

5. **Was your state of mind such that it didn't even occur to you that you were taking advantage of the statute of limitations by not going back to 2001 and 2002 obligations that were identical to the 2003 and 2004 obligations?**

   I believe my state of mind at the time was focused on 2003 and 2004. At the conclusion of the audit I was told what I owed and I paid that amount. I did not think about this again until late last year, when the subject came up as part of the transition team vetting process.

Mr. Geithner, we had a long exchange during your hearing about whether you knew that you would have owed Self Employment taxes for 2001 and 2002, but that you did not have an obligation to pay those taxes because the statute of limitations had

run. After reviewing the hearing transcript, I realized that you never answered the specific question, so I would like to try again.

Please answer yes or no to the following question: At any time during or after the 2006 audit (but before you were contacted by the Obama transition team about a possible appointment), did you know or suspect that you should have paid your Self Employment taxes for 2001 and 2002, since the 2006 audit required that you pay those taxes for 2003 and 2004?

I believe now that I should have paid taxes for 2001 and 2002 at that time, but I did not believe that at the time of the 2006 audit.

Please answer yes or no to this question: At any time during or after the 2006 audit (but before you were contacted by the Obama transition team about a possible appointment) were you told or did you otherwise become aware that you did not have a legal obligation to pay the 2001 and 2002 Self Employment taxes because the statute of limitations had run (or that the audit could not reach that far back)?

I was aware in 2006 that the audit did not reach back beyond 2003.

ANSWERS TO QUESTIONS FROM SENATOR SCHUMER

As you know, for more than five years, I have been one of the leading voices in the Senate pushing China on its currency policy. First, Senator Graham and I pursued a bill to apply a tariff to all Chinese imports; then we joined with Senators Baucus and Grassley on a bill that passed the Finance Committee 20-1 but never saw floor action.

President Obama talked a little bit about Chinese currency policy towards the end of the campaign, but has not offered many specifics. What I would like to know is whether you think the economic problems facing the nation and the world make confronting China over its trade policies in the short term MORE important and urgent, or LESS important.

I would really like to understand the Administration's view on this, because some argue that our precarious economic position means we should wait, but others say that we have a window now to take meaningful action. On which side of that economic coin does the Administration fall?

President Obama - backed by the conclusions of a broad range of economists - believes that China is manipulating its currency. President Obama has pledged as President to use aggressively all the diplomatic avenues open to him to seek change in China's currency practices. While in the U.S. Senate he cosponsored tough legislation to overhaul the U.S. process for determining currency manipulation and authorizing new enforcement measures so countries like China cannot continue to get a free pass for undermining fair trade principles. The question is how and when to broach the subject in order to do more good than harm. The new economic team will forge an integrated strategy on how best to achieve currency realignment in the current economic environment.

ANSWERS TO QUESTIONS FROM SEN. SNOWE

Question 1

Thomson Financial News, a leading financial and legal publisher, describes the Lehman Brothers Failure as the point that "sent the already fragile financial system into a deep downward spiral" and which former Treasury Secretary Paulson has said was both "tragic" and "regrettable."

According to a December 15 *New York Times* editorial, there are conflicting accounts as to how Lehman – an institution in existence before the Civil War -- was allowed to collapse. In testimony before Congress on September 24, Federal Reserve Chair Bernanke said that the Fed and Treasury declined to commit public funds to support Lehman. He testified that the failure of Lehman posed risks but that the firm's troubles had been well known for some time and investors recognized that bankruptcy was a significant possibility. "Thus, we judged that investors and counterparties had time to take precautionary measures."

The same *Times* editorial then said that Chair Bernanke changed his story and on December 1 said that "legal constraints" had prevented the Fed from rescuing Lehman. And the paper reports that a spokesman for the New York Fed, which you lead, also said that the Fed had no legal authority to intervene. Secretary Paulson also used a December 18 speech in New York to say the government's hands were legally tied, given the Federal Reserve and Treasury "don't have wind-down authority to deal with a non-bank."

Mr. Geithner, which is it? Did the Fed and Treasury allow Lehman to fail because it felt that the financial system could absorb such a collapse? Or did the Fed believe it lacked the legal authority to act? If the answer is the second, then given that Lehman's failure, according to Chair Bernanke, was a "longtime coming," why didn't the Fed ask for legal authority for a rescue if it felt that would be necessary?

I do not believe the Federal Reserve should have asked for that authority then, nor do I believe it should do so now. Under section 13(3) of the Federal Reserve Act, the Fed is prohibited from taking equity or unsecured debt positions in a firm. At its core, this restriction reflects the importance of maintaining the line between the responsibilities and authorities of the fiscal authority, and those of the monetary authority. That is not to say that the U.S. government does not need to institute a robust resolution regime for nonbanks. We have been aware for some time now that our system lacks a mechanism for resolving a systemically important insolvent nonbank that is analogous to what the FDIC is for depository institutions. The absence of any clear rules outlining the procedures for the orderly resolution of a nonbank financial institution requires the government to undertake ad hoc solutions in those situations where it judges the risk to financial stability from a disorderly default to be sufficiently high. The policy challenges created by this omission in our broader regulatory framework are significant, and have been starkly evident since the rapid deterioration in the funding conditions of Bear Stearns last March. Instituting a resolution regime for nonbanks would provide for greater clarity over how and why public funds would be used in this context, and would make government action in response to a distressed firm more transparent and predictable.

Given the view that Lehman's collapse was a "long-time coming," which seemingly provided time for analysis, how did you and your colleagues not understand the implications a collapse could have?

We were concerned about the potential for Lehman's default to disrupt other segments of the financial markets. This concern led us to first take considerable steps to try to avoid that default by trying to find a buyer for the firm once it was evident that the firm's liquidity position had eroded to the point where it would likely be unable to fund itself without significant support. Once it became clear that Lehman was not likely to be able to avoid a default, we worked as carefully and quickly as possible with other U.S. and global regulators to insulate the system from the effects of that default as much as possible. We also undertook an extensive derivatives close out exercise at the New York Fed on the Sunday afternoon preceding Lehman's declaration of bankruptcy on Monday morning. Finally, we significantly broadened the scope of the Federal Reserve's liquidity provision.

What lessons can be learned from Lehman's failure to ensure that the ill health of a single company in the future does not threaten the entire economy?

Every regulator should be taking a very careful look at what went wrong, where and why, at where we failed to use our existing tools and authorities to meet our responsibilities to protect the system from this type of deep distress, and at where our existing tools and authorities were not adequate to allow us to fulfill those responsibilities. It will likely turn out to be a little bit of both of these, and there is a significant effort underway to dimension the changes to our system of regulation and oversight that will be necessary to prevent this type of event in the future. Critical to this reform will be the development of the regime for resolving a systemically important nonbank financial institution.

<u>Question 2</u>

TARP has been criticized because it seems to have been operated in an ad-hoc manner. Although Congress was told that funds would be used to purchase illiquid securities, money went to injecting capital into banks, promoting the consumer loan market, and assisting AIG, Citigroup, Chrysler, GM, and GMAC. As Treasury accesses the second half of the TARP money, it is imperative that there be a concrete

plan for using the funds. To that end and although it was short on details, I was pleased to read Mr. Summers' January 12 and 15 letters to Congressional leaders that discussed plans to provide additional assistance to community banks, small businesses, municipalities, and consumers.

Specifically what programs do you have in mind to make that a reality – as we need to have concrete assurances this will happen?

I have since the time TARP was proposed last September said that safeguarding taxpayer dollars is a top priority. That's why I was disturbed to read a January 10 *Bloomberg* article with the headline, *Paulson Bank Bailout in 'Great Stress' Misses Terms Buffett Won.* Bloomberg concluded that Warren Buffett received 43.5 million Goldman Sachs warrants valued at $3.6 billion. In contrast, Treasury injected twice as much taxpayer money into Goldman Sachs a month later, in October, and got 12.2 million warrants worth $882 million. Moreover, *Bloomberg* noted that "If the Treasury had received the same terms as Buffett, taxpayers would have become the biggest investors in most of the bailed-out banks and existing stakes would have been diluted." With the Congressional Budget Office having reported last Friday that TARP investments are already worth $64 billion less than what Treasury paid for them, I am deeply concerned taxpayers are not being protected.

What's your view? Are taxpayers getting a fair deal, or are we getting fleeced? How will you ensure that taxpayers get properly rewarded for their investment?

I share your concerns and believe that the TARP program needs important reforms. Towards that end, I intend to make sure that the TARP funds are used to promote new lending activity, to implement aggressive measures to address the foreclosure crisis, in addition to stabilizing financial institutions. These details will be provided in the coming weeks. If confirmed, I look forward to working with Congress to ensure these programs are effective.

Throughout the process, if confirmed, I will ensure that the Treasury Department adheres to a very high standard of transparency and disclosure to the public about our objectives and actions. I will also ensure that strong measures of accountability are instituted for participating institutions and make sure that we carefully protect taxpayer resources.

<u>Question 3</u>

I am deeply concerned about a Government Accountability Office (GAO) report released last December and a Congressional Oversight Panel report released January 9 that concluded that more oversight over the Troubled Asset Relief Program (TARP) is necessary. Notably, both reports criticized Treasury for failing to insist on adequate transparency over how institutions receiving capital injections

as part of TARP are using the funds to promote the flow of credit and modify the terms of residential mortgages to strengthen the housing market.

Moreover, I was especially disturbed to learn that the Associated Press reported on December 22 that when it contacted 21 banks that received at least $1 billion in government money, not one could provide specific answers on how the money is being used. Worse still, the *New York Times* on January 18 suggested in its article *Bailout is a Windfall to Banks, if Not to Borrowers* that "An overwhelming majority [of the banks receiving TARP money] saw the bailout program as a no-strings-attached windfall that could be used to pay down debt, acquire other businesses or invest for the future." In fact, one banker whose institution received TARP funds said, "Make more loans? We're not going to change our business model or credit policies to accommodate the needs of the public sector as they see it to have us make more loans."

I understand from Mr. Summers' January 15 letter to Congressional Leaders that, as a condition of assistance, healthy banks without major capital shortfalls will increase lending above baseline levels and that banks will also have to implement mortgage foreclosure mitigation programs. That is, banks will no longer be able to seemingly flaunt Congress' intent. My question is two-fold: First, will these requirements apply to banks that have already received funds or will this be applied on a going-forward basis? Second, how precisely will these requirements be enforced?

Notably, with respect to executive compensation, GAO found that Treasury has not yet determined how it will monitor adherence to agreements mandating that financial institutions receiving funds limit their tax-deductible compensation and do not make golden parachute payments. That said, I was pleased to note that Treasury last Friday issued a new rule to require the chief executive officer (CEO) of an institution receiving TARP funds to certify annually it has complied with TARP's executive compensation standards. Although this is encouraging, can we have your commitment that your Treasury Department will review those filings to ensure they are accurate? Should Congress pass legislation requiring the Internal Revenue Service to ensure these rules are being adhered to?

To promote oversight and address additional deficiencies I learned about at TARP IG Barofsky's confirmation hearing last November, I introduced legislation to strengthen the IG's authority to safeguard taxpayer dollars. Among other provisions, my bill would waive applicable hiring standards to ensure the IG can quickly acquire staff, allow the IG to investigate any program receiving TARP funding, mandate the Treasury Secretary consider the IG's recommendations, and require a study of whether banks are utilizing the funds they have received to spur additional lending. All of these provisions were incorporated into legislation that the Senate passed on December 10. While the House did not take up the bill, Congress must pass this legislation this year to ensure TARP functions as Congress

intended. Can we count on you to work with us to make that happen – *OR* that, no matter what, Treasury would adopt the recommendations of the IG?

The Obama Administration is committed to using the full arsenal of tools available to get credit flowing again to families and businesses. We will ensure that support under this program is directed at making credit available to support recovery. To this end, healthy banks that take government capital under the Emergency Economic Stabilization Act will be required to increase lending above baseline levels. Transparency -- in the form of a requirement that banks receiving capital to provide detailed and timely information on their lending patterns broken down by category -- will provide a very public monitor on firms behavior. Public companies will report this information quarterly, including a description of the factors that influenced their decisions, in conjunction with the release of their 10Q reports. This will allow the public to track what kind of lending decisions firms receiving support are making and help make these firms more accountable for their lending decisions. It is not our intention at this time to seek to apply these conditions retroactively to firms that have received capital under the first tranche.

I also believe it is important that the Treasury Department apply the highest standards of oversight to this program. As you note, the Treasury Department has recently released a new rule requiring the CEO of an institution receiving TARP funds to certify the firm's compliance with the TARP's executive compensation standards. If confirmed, I will be committed to ensuring that firms receiving support under this program carry out this obligation fully and faithfully. I do not believe it is necessary that Congress pass legislation requiring that the Internal Revenue Service ensure these rules are being adhered to.

With regards to the Inspector General, we will work closely with the Inspector General to achieve our shared goal of ensuring that the performance of this important set of financial stabilization activities is consistent with the intent of the Emergency Economic Stabilization Act and that programs carried out under this authority are subject to effective oversight and accountability.

<u>Question 4</u>

With RealtyTrac having estimated on January 15 that 2.3 million households were the subject of a foreclosure filing in 2008 -- up 81 percent from 2007 -- I am deeply concerned that far too little has been done to keep endangered families in their homes. In fact, as of mid-December, the Hope for Homeowners program Congress passed last summer had attracted just 312 applications out of the 400,000 borrowers it was supposed to help. And the problem is only likely to get worse, as according to TransUnion LLC, a credit reporting firm, the proportion of consumers with mortgages that are 60 days or more past due will hit 7.17 percent in the fourth quarter of 2009, compared with an expected delinquency rate of 4.67 percent at the end of 2008. And given that all of these foreclosures will only further depress prices

and threaten communities, addressing this crisis, which has shaken families and the economy to their core, will be critical to restoring growth. The decline of housing markets, which represents one-sixth of our national economy, was truly a tripwire that has sent our economy spiraling into recession.

As you know, Secretary Paulson decided not to use TARP funds to help endangered homeowners. That being said, I was pleased to read Mr. Summers' January 15 letter to the Congressional Leadership that the Obama Administration plans to use between $50 billion and $100 billion in TARP rescue funds to address the foreclosure crisis. Can you provide us some details about the proposals you might have?

I have been fortunate to have benefited from tremendous input on different plans to help stem mortgage foreclosures. Many of these ideas are already in the public domain. We are seeking to deploy a systematic program that addresses each of the root causes of the housing crisis with a particular focus on affordability and foreclosure mitigation. I am committed to the targets in Dr. Summers' letter and share your frustration that more has not been done to date.

Question 5

Although there is widespread agreement on the necessity of passing stimulus legislation, one area in which there is some debate is on the size of a package. President Obama and Congress are now considering passing an over $800 billion bill. That said, some economists, such as Nobel Laureate Joseph Stiglitz and former Federal Reserve official and Bush Administration economist Larry Lindsey, believe that a package closer to $1 trillion is warranted. On the other hand, we have some colleagues who are concerned that passing an $800 billion is too expensive and will increase the debt.

Christina Romer, who President Obama has nominated to Chair the Council of Economic Advisors, and Jared Bernstein, who is staffing Vice President Biden, estimated on January 10 that the Obama plan would create 3.3 million to 4.1 million new jobs by the fourth quarter of 2010, but still leave the unemployment rate at an uncomfortable high of 7.0 percent. Could we experience faster job growth if we increased the size or altered the composition of the package that President Obama has outlined?

In my judgment, an economic stimulus bill must accomplish two objectives. First, it must provide immediate assistance to those who have been dislocated by the recession and avert an economic calamity. Second, it must sow the seeds for growth. One issue that has received little attention is how we allocate stimulus dollars between those two priorities. What percentage of a bill do you believe should go toward helping people now versus making investments to restore growth?

A key measure of President Obama's American Recovery and Reinvestment Plan is that it should save or create at least 3 million American jobs by the end of 2010. Proposals that create and save jobs have a definite stimulative effect. In order to accomplish this goal, our plan will include both investments and tax reduction to boost short-term demand and lay the foundation for sustained recovery.

There are no easy solutions or quick fixes, but the plan we are moving toward will be large enough to meet the magnitude of the challenges we face. If confirmed, I look forward to working with you and the entire Senate Finance Committee to find the right balance and best plan for both immediate assistance and to lay the foundation for a sustained recovery.

Question 6

It is imperative that we revamp our regulatory system so that another rescue package is never again necessary. To this end, last September, I introduced the *Federal Board Certification Act of 2008*, legislation that is designed to better assess the risk characteristics of the mortgage-backed securities that led to the financial crisis. More specifically, the bill would establish a voluntary Federal Board of Certification to certify the risk characteristics of mortgage-backed securities. The Board would verify that mortgage securities accurately represent the level of risk that the underlying mortgages pose to investors. Do you believe this legislation is worthwhile, and can I have your commitment to work to make it law either in its current or modified form?

On a more macro level, the public and Federal regulators must know if financial institutions are causing systemic risk to the economy. At the same time, we must be sure that any additional regulation is truly necessary and does not threaten legitimate transactions or economic growth. Given your experience as President of the New York Fed, and your stated desire to build "shock absorbers" for the financial system so that the failure of one firm doesn't ripple through the markets, how would you move to overhaul the regulation of financial markets in a way that protects investors for the long term?

Recent events have led me to the conclusion that much stronger regulation is necessary to make financial markets function properly. Our financial system architecture is unsound and outdated. We need a fundamental redesign. Among other things, this includes better prevention and detection methods, better enforcement authority, resolution regime for systemically important nonbanks and better checks on excessive risk. I look forward to working with Congress as we move ahead in building a more effective financial regulatory framework.

Question 7

Mr. Geithner, as you are well aware, the Federal Reserve and Treasury on November 25 announced a program to boost consumer spending by thawing frozen credit markets and making it easier for households to borrow money for cars, tuition bills, and new homes as part of a broad effort to stimulate economic growth. Under the $200 billion proposal, a portion of the funds will go to investors to support small business lending. More specifically, a lending facility will be created that the Small Business Administration's (SBA's) 7(a) industry can access to sell loans on the secondary market and create liquidity once again for small business borrowers.

As Ranking Member of the Senate Committee on Small Business and Entrepreneurship, I support Treasury and the Federal Reserve's action with respect to the SBA's 7(a) loans. It was truly a crucial first step to jumpstarting SBA lending and helping our nation's small businesses access the capital they need to drive economic growth and job creation. All that said, more must be done. In particular, I renew my request that Treasury and the Federal Reserve to expand its action and also allow for the purchase of SBA 504 loans, as I have proposed in the *10 Steps for a Main Street Economic Recovery Act* that I introduced last November. In light of the Obama Administrations' promises to help improve the small business credit crisis, can I count on you to strongly consider working with Federal Reserve Chairman Bernanke to make the SBA's 504 loans eligible for this program?

I am extremely concerned about the decline in credit for small businesses generally and in particular in the two major SBA programs. This is disturbing because, as you well know, small business is the engine of over 70% of new job growth, and because the small businesses being hurt are largely innocent victims of this financial crisis. Too many entreprenuers with excellent credit histories are seeing their credit lines dry up. If confirmed, I very much want to work on a strong and comprehensive initiative to restart small business lending and would very much like to discuss with you how we can use existing vehicles such as the TALF as well as possibly new initiatives to expand lending in both the 7(a) and 504 program.

Question 8

Under current law, individuals who have reached age 70.5 generally must begin to withdraw funds from their IRAs or defined contribution retirement plans, including 401(k), 403(b), 457, and TSP plans. Failure to take a required minimum distribution may result in a 50 percent excise tax on the difference between what must be withdrawn and the amount actually distributed. As you know, Congress rightly suspended required minimum distribution rules for 2009 as part of the *Worker, Retiree, and Employer Recovery Act of 2008*. Unfortunately, Congress has not suspended the rules for 2008 or 2010, as I, joined by Senator Lincoln, proposed in the *Retirement Account Distribution Improvement Act of 2009*.

After a year in which the Dow lost 34 percent and with the American Association of Retired Persons having said that retirement accounts may have lost as much as $2.3

trillion between September 30, 2007, and October 16, 2008, I believe that both retroactive and forward-looking relief is absolutely vital. Retirees should be able to recontribute 2008 withdrawals and should not have to make any withdrawals in 2010 given that it will take several years to recoup their staggering losses.

Mr. Geithner, as you know, President Obama has expressed sympathy for this issue on the campaign trail. But would you and President Obama agree with me that additional relief is warranted?

Our country is facing a set of economic challenges that rival any that have come before. We are witnessing a severe recession, historic declines in housing prices, growing job loss and a concern that these negative trends are accelerating. Most Americans are all too aware of the difficult economic challenges we face. However, Senator, you are correct, individuals near retirement or in retirement are among those hardest hit by the economic decline we have witnessed for more than a year. The President has pledged to identify ways to assist these individuals, including ways that our system of savings might be adjusted. Steps taken last year were a critical beginning. If confirmed, I look forward to working with Congress on this important topic.

Question 9

As President Obama and Congress work together to develop stimulus legislation, I could not help but notice that I share many of the priorities that the President expressed support for on the campaign trail. In particular, I have, with Senator Lincoln and Bunning, introduced the *Unemployment Benefit Tax Suspension Act of 2009* to exempt unemployment compensation from tax in 2008 and 2009. There is no reason why we should be taxing unemployment benefits, which so many Americans are relying on to put food on the table and a roof over their heads.

Would you agree with me that this proposal should be part of any stimulus package sent to the White House? Why or why not?

Far too many Americas have lost their jobs over the past year. As I said today in the hearing, it is imperative that we aggressively pursue a full range of measures to help restore our economic health, both in the financial sector and in the broader economy. In the meantime, there is no question that our system of unemployment compensation is a vital linchpin for many Americans who have lost their jobs and far too often their economic well being. If confirmed, I look forward to working with you on measures that will restore our economic health and on the things we can do in the meantime to assist those in who have lost their job. Your idea is one of several we should seriously consider.

Question 10

Our nation currently faces a lack of available credit to promote development and job creation. This is particularly true for low-income and rural communities. It is for this reason that Senator Rockefeller and I, joined by Senators Bingaman, Kerry, Lincoln, and Stabenow on the Committee last November sent Senate Leaders a letter requesting that the New Markets Tax Credit receive an additional allocation of $1.5 billion as part of a stimulus package.

As you may know, the New Markets Tax Credit has had a very successful history in promoting development in distressed urban and rural communities. In fact, the Treasury Department reports that the incentive has helped to develop or rehabilitate over 68 million square feet of real estate and create 210,000 construction jobs and 45,000 new full-time jobs.

With the stiff competition for Credits, the Community Development Financial Institutions Fund, which administers the incentive, indicates that it has at least $1.5 billion in qualified applications on hand and that it can allocate any additional Credit authority within 90 days of enactment. The New Markets Tax Credit Coalition research shows that based on the program's track record, this would generate 11,000 permanent jobs and 3,500 construction jobs.

Wouldn't you agree that the New Markets Tax Credit should be part of a stimulus package? Why or why not?

The downturn we have witnessed in our financial markets and in the broader economy over the past year has particularly impacted our most distressed communities and neighborhoods. While I have not had an opportunity to study the New Markets Tax Credit program in great detail, I am aware that the program enjoys a wide range of support. It is viewed by many as an important revitalization tool for our distressed cities and rural areas. If confirmed, I look forward to studying this issue more fully. Tools such as the NMTC should be examined as we consider the best ways to help our cities and rural communities.

Question 11

Mr. Geithner, while most economists agree that it is permissible to run a sizable budget deficit during an economic recession to help stabilize the economy, I share a concern you raised in your testimony about the long-term state of the nation's finances. Indeed, I am worried that once economic growth returns, we will still be confronted by a large structural budget deficit and a tremendous federal debt that is already at an unprecedented $10.7 trillion. In fact, in its most recent projections released January 7, the Congressional Budget Office projected that the nation will run a deficit in each of the next 10 years for a total shortfall of over $3 trillion. If

left unchecked, future deficits could crowd out private investment and threaten economic growth.

Given that extending tax cuts for middle-income families and small businesses, finding a solution to the Alterative Minimum Tax, and expanding the availability of health insurance, could cost trillions, how do you plan to address these competing priorities and bring the budget into balance over the longer term?

My understanding is that although Treasuries are currently in great demand and we have no immediate financing concerns, if our nation's debt levels are not addressed, there will come a point at which we will not be able to use debt except at exorbitant interest rates, which will threaten long-term growth. Given your long experience in financial markets and the sizable deficits we now face, how long do we have to address this issue?

As you can imagine, our top priority right now is getting the economy moving again and creating jobs with a robust economic recovery plan. That being said, President Obama is committed to developing a plan that will reverse our declining fiscal position by restoring a stable debt to GDP ratio. To achieve this we will have to use many tools, such as making tough decisions and reform or eliminate programs that don't work, adhering to strong PAYGO rules, and addressing our biggest long-run fiscal challenge – the rising cost of healthcare. If confirmed, I intend to work with the other members of the President's economic team as well as with this Committee to bring down the cost of healthcare and improve quality, which will help our families, businesses, and the federal budget.

As for the National debt, I should note that putting in place the fundamentals for a strong US economy is the single most important action that we can take to reduce the risk of fiscal dependency. We should also continue to be seen as a place where capital is welcome. The Obama Administration, and I, if confirmed, look forward to working with Congress to bring forward an economic recovery program and to stabilize, repair, and reform the US financial system.

Question 12

I recently had the opportunity to review the household income statistics put out by the Labor Department. One thing that struck me was that those at the very top have seen substantial household income growth over the 1988 to 2007 period. Meanwhile, those in the middle and at the bottom have seen their incomes grow less than half as quickly.

To put some statistics around those conclusions, I would note that households at the 95th percentile – those earning $177,000 or more in 2007 – saw inflation-adjusted income growth of 22.7 percent between 1988 and 2007. Income for the median household – earning $50,233 in 2007 – grew 9.6 percent over the same period.

Finally, income for a household in the 10th percentile – earning just $12,162 in 2007 rose 10 percent over the 1988 to 2007 period.

While I don't believe the United States should massively redistribute income, I am concerned that the distribution of income appears to be getting more uneven. Middle- and lower-income families are having increasing trouble making ends meet in terms of making housing payments, putting food on the table, filling up their gas tanks. How can we narrow the gap between lower- and middle class household incomes with higher-income households? Put another way, how can we help those in the middle and the bottom get ahead?

I share your concern that the distribution of income appears to be getting more uneven. As someone who has spent his entire professional career working in the public interest, and has observed the impact of public policies – for better and worse – on the living conditions and life opportunities of lower- and middle-class households, I care deeply about this problem. As a public official, I know we have a lot more work to do when middle and lower-income families are having increasing trouble making ends meet and putting food on the table.

I believe it is critical not only for us to repair our financial system but also to make the investments that will lay the foundation for a stronger economic future for all Americans. To ensure equality of opportunity for all Americans and begin to reverse the trend of growing inequality, we need to invest more in helping Americans to develop the skills for global competition and to deal with the challenges of trade and technological change. Our tax policies will play a part, too, as will our efforts to save or create 3.5 million jobs and cushioning the blow of a severe economic downturn.

If I am confirmed, I look forward to working with you to address this challenge.

Question 13

Mr. Geithner, one of the most frustrating taxes we have to address each year is the alternative minimum tax (AMT). Every year, we are forced to pass a so-called patch so that millions of Americans are not ensnared by this onerous levy. Indeed, if we do not pass another patch in 2009, 30 million will face this onerous levy up from approximately 4 million in 2008. Although all of us agree that the AMT should not be allowed to ensnare this nation's middle-class taxpayers, the problem is that it is extremely expensive to address. In fact, CBO and the Joint Committee on Taxation estimate that it would cost $763 billion to index the AMT for inflation over the next 10 years. It will cost hundreds of billions more to fix the AMT if we extend even just President Bush's tax cuts for the middle class.

How do you plan to address the AMT over the long term while recognizing that the nation already faces a baseline deficit of over $3.1 trillion? How do you plan to ensure that America's middle class will not get stuck having to compute their taxes twice – once under the regular system and once under the AMT – only to find out that they how hundreds of dollars more than they first thought they would have to pay?

The AMT is clearly broken and needs to be fixed. The AMT exists for an important reason –to prevent people with very high incomes from exploiting deductions and loopholes to completely avoid paying income taxes. Over the years, it has migrated far from its original intention and is now affecting millions of middle-class families. If confirmed, I look forward to working with Congress on the President's commitment to fixing the AMT in order to reduce complexity for ordinary taxpayers in a single fiscally responsible way.

Question 14

While China's currency has appreciated nearly 19 percent since Beijing removed it from its peg to the dollar in July 2005, manufacturers and workers in trade-sensitive industries—such as paper production in Maine—feel that the Yuan ("You-on") may still be undervalued by as much as 20 percent, making Chinese imports artificially cheaper vis-à-vis competing U.S. goods. These domestic producers argue that the undervaluation of the Yuan has contributed to the burgeoning U.S. trade deficit with China, which set another record in November 2008 of $40.1 billion.

Do you believe that China's currency remains artificially undervalued, and that this undervaluation has a trade-distortive effect harmful to U.S. producers?

Former Secretary Paulson has frequently raised the China Currency issue at Strategic Economic Dialogue meetings with Beijing, most recently last month, arguing for greater flexibility in the exchange rate. Yet the Treasury Department's inability to classify China's intervention in the valuation of its currency as "manipulation" has frustrated me and many of my colleagues who would like to see greater pressure put on China to allow its currency to appreciate more rapidly, according to market forces.

Do you believe the Bush Administration's policy of handling this issue through bilateral dialogue has worked satisfactorily, or would your recommend further actions be taken by the Obama Administration?

Finally, In July 2007 the Finance Committee—with my support—favorably reported the "Currency Exchange Rate Oversight Reform Act of 2007," which would direct the Secretary of the Treasury to identify countries with "fundamentally misaligned" currencies (i.e., currencies that do not correspond to market conditions, whether or not due to deliberate foreign government manipulation), and impose gradually increasing restrictions on financial cooperation with such countries over the course of a year, possibly culminating in the U.S. bringing a formal dispute resolution case against an offending country in the World Trade Organization.

Are these legislative changes that you would recommend the President sign into law? Would you like to see different or additional authorities granted to the Treasury Department to deal with currency manipulation?

President Obama - backed by the conclusions of a broad range of economists - believes that China is manipulating its currency. President Obama has pledged as President to use aggressively all the diplomatic avenues open to him to seek change in China's currency practices.

More broadly, we look forward to a productive economic dialogue with the Chinese government on a number of short- and long-tem issues. The Yuan is certainly an important piece of that discussion, but given the crisis the immediate focus needs to be on the broader issue of stabilizing domestic demand in China and the US. The latest figures show that China's growth in 2008 was 9%, a full 4 percentage points lower than in the previous year. Because China accounts for such a large fraction of the world economy, a further slowdown in China would lead to a substantial fall in world growth (and demand for US exports) and delay recovery from the crisis. Therefore, the immediate goal should be for us to convince China to adopt a more aggressive stimulus package as we do our part to try to pass a stimulus package here at home.

ANSWERS TO QUESTIONS FROM SENATOR STABENOW

1. **The Michigan economy is facing one of the most difficult and severe recessions in the country. However, as of December 31, only two Michigan-based institutions have received funding under the Capital Purchasing Program and none in Southeastern Michigan. In November, I wrote a letter to Secretary Paulson urging him to ensure that the Treasury programs focus the remaining funds from TARP on helping these smaller struggling institutions. The larger banks have cut back on their lending in Michigan and it's the community bankers who will be making the loans to small businesses and help provide the necessary liquidity to our markets. If confirmed, what will you to do ensure that smaller institutions, in particular those based in the hardest-hit states, receive funding under TARP?**

   Community banks are an important source of credit for small businesses. As you know, support for smaller banks through the Capital Purchase Program under the Emergency Economic Stabilization Act is ongoing. While the very first recipients of support under this program were the largest banks, I am committed to ensuring that the commitment to support smaller and community banks under this program is carried out faithfully and expeditiously. If confirmed, I will work to ensure that support from this program reaches the community banks that need it. The letter that NEC Chairman Lawrence Summers sent to Congressional Leaders on January 15th underlined the Obama administration's commitment to ensuring the soundness of community banks throughout the country.
2. **The housing market collapse is pulling down the entire economy, and to get our economy back on track, we must address housing. The Frank TARP proposal would require Treasury to develop a program, outside of the TARP, to stimulate demand for home purchases and clear inventory of properties, including through ensuring the availability of affordable mortgages rates for qualified home buyers. What do you think needs to be done to stabilize home prices and to get consumers to buy homes?**

   The Obama administration will commit substantial resources of $50-100 billion to a sweeping effort to address the foreclosure crisis. As the Obama administration carries out the EESA, our actions will reflect the Act's original purpose of preventing systemic consequences in the financial and housing markets. We will implement smart, aggressive policies to reduce the number of preventable foreclosures by helping to reduce mortgage payments for economically stressed but responsible homeowners, while also reforming our bankruptcy laws, and strengthening existing housing initiatives like Hope for Homeowners. Banks receiving support under the EESA will be required to implement mortgage foreclosure mitigation programs.

   Reducing foreclosures will play an important role in allowing home prices to stabilize by reducing the supply of homes on the market. The administration also plans to focus support on increasing the flow of credit through a variety of programs. The Federal Reserve has announced a $500 billion program of support, which is already having a significant beneficial impact in reducing the cost of new conforming mortgages. Lower costs of financing will make it easier for consumers to purchase homes and greater access to credit will increase the ability of consumers to secure financing and purchase homes.

3. **Our country is currently facing the worst financial crisis in decades. This is due in part to a lack of oversight and enforcement by our regulators. What do you think needs to happen in the regulatory overhaul of the financial system to ensure a crisis like the one we are currently experiencing can never happen again? What will be your priorities and recommendations for President-elect Obama to address this issue?**

   My first priority in thinking about our regulatory structure will be improving the capacity of our financial system to withstand shocks. There is no doubt in my mind that our financial system, as we have witnessed during this crisis, failed to meet its most basic obligations. The system was too unstable, too fragile, and too weak to withstand high levels of stress. As such, people who did everything right and played by the rules and were careful were hurt by the actions of those who took too much risk and too little responsibility. That, to me, is the sign of a system that is unfair and unjust and very much in need of reform.

   If I am confirmed, I will move quickly in consultation with Congress to build a stronger, more resilient system with greater protections – as a very high priority – for consumers and investors. Getting these basic objectives right is more critical than worrying about the exact structure of our regulatory agencies. I'd like to work with you and learn more about your views on the best options for redesigned regulatory structures. I know we can preserve the unique strengths of our financial markets in providing individuals and entrepreneurs access to capital and credit while also making our system more safe, more sound, and more just.

4. **Carbon trading is currently being considered at a scale that some believe would create the largest new derivatives market in the world. How do you think this market should be regulated and what role, if any, do you envision for Treasury in these markets?**

   The President believes that a market mechanism offers the best way of addressing the challenge of climate change. Market mechanisms have worked before as solutions to environmental problems, and they will give all American consumers and businesses the incentives to use their ingenuity to develop economically effective solutions to climate change. The extent to which the Treasury Department will play a role in administering such a program has not been determined yet. However, I look forward to working with other members of the Administration and with members of Congress to determine how to construct an efficient and effective program that best leverages federal resources.

5. **There are a number of renewable industries that are looking for reasons to remain here in the United States to produce their products instead of going overseas. Implementing certain tax policies would encourage those companies further down the supply chain. A manufacturing tax credit could act as a force multiplier and would stimulate job creation in our country. What are your thoughts on such a tax policy?**

   Our country is facing a set of economic conditions that rival any that we have seen before. The President has said that we need to be aggressive in our approach to restoring economic health. As a part of our strategy, the Administration has said that we should pursue tax policies in our economic recovery plan that work and provide an immediate jolt to sectors of the economy that will make the best use of the assistance while also establishing a framework for long-term growth.

   There is no question that among the tax policies we pursue an important sector of the economy we must consider our manufacturing base. If confirmed, I look forward to working with you on ways to ensure that our manufacturing sector is both vibrant and competitive.

6. **It is critical that companies in a loss position, many of them small and medium-sized and in the manufacturing sector, are able to participate in stimulating the economy. What are your thoughts on helping these companies who are struggling most?**

   I agree that we must not lose sight of struggling small and medium-sized businesses in our stimulus plans, especially those businesses in the manufacturing sector. Companies in a loss position may not be able to use otherwise available credits and incentives. If confirmed, I will explore with my staff the appropriateness of various proposals to help companies with losses survive these difficult times.

7. **In 2004, Congress enacted the tonnage tax to improve the competitiveness of the U.S. shipping industry. Subsequently, it became known that the statute is ambiguous about whether an S corporation is eligible for the tonnage tax. As a Senator, President-elect Barack Obama supported clarifying S corporation eligibility to elect the tonnage tax, recognizing that if they were ineligible for the tonnage tax, American vessels owned by S corporations would be at a competitive disadvantage against American vessels owned by C corporations and against foreign operators. Can you provide some guidance on S corporation eligibility to elect the tonnage tax?**

   If confirmed, I will review with my staff whether S corporations are eligible to elect the tonnage tax under current law and whether any guidance under current law, or proposed changes to current law, are appropriate.

8. **Article IV of the IMF Charter, obligates each member nation; " to avoid manipulating exchange rates or the international monetary system in order to**

prevent effective balance of payments adjustments or to gain an unfair competitive advantage over other members." The IMF has adopted surveillance provisions to guide member nations on how various IMF Articles will be interpreted. With regard to surveillance of Article IV, it defined currency manipulation as: "protracted large scale intervention in one direction in the exchange market." Over the last few years China's global current account surplus has risen to over 11 per cent of its GDP, but it has maintained an undervalued currency by massively intervening in currency markets. What do you think of China's currency policies? And, more generally, what is the best approach to ensuring countries are not engaged in manipulating currency markets around the world?

President Obama - backed by the conclusions of a broad range of economists - believes that China is manipulating its currency. President Obama has pledged as President to use aggressively all the diplomatic avenues open to him to seek change in China's currency practices. While in the U.S. Senate he cosponsored, with Senator Stabenow, tough legislation to overhaul the U.S. process for determining currency manipulation and authorizing new enforcement measures so countries like China cannot continue to get a free pass for undermining fair trade principles. The question is how and when to broach the subject in order to do more good than harm. The new economic team will forge an integrated strategy on how best to achieve currency realignment in the current economic environment.

More generally, the best approach to ensure that countries do not engage in manipulating their currencies is to demonstrate that the disadvantages of doing so outweigh the benefits. If confirmed, I look forward to a constructive dialogue with our trading partners around the world in which Treasury makes the fact-based case that market exchange rates are a central ingredient to healthy and sustained growth.

9. **During this unprecedented financial crisis, the government has provided liquidity to the nation's financial institutions through a broad range of emergency federal credit programs. The Federal Home Loan Bank System also has played a significant role in providing liquidity, providing just over $1 trillion in "advances" to its over 8,100 financial institution members during the 15-month period ending September 30, 2008. Once markets normalize, what role do you see for the Federal Home Loan Bank system in providing liquidity and credit support mechanisms to our markets?**

The Federal Home Loan Bank System has been an important source of liquidity for financial institutions during this crisis. The current crisis has proven that it is helpful for financial institutions to have multiple sources of liquidity to contend with extreme cyclicality. In recognition of the systemically important nature of these institutions, the US government has been provided with extraordinary, temporary authority under the Housing and Economic Recovery Act of 2008 to support the Federal Home Loan Bank system. It is difficult to predict, at this point, the characteristics of a normalized world, and thus the future demand for the support provided by the Federal Home Loan Bank system.

10. **As you know, our economic recovery depends on ensuring the availability of financing, especially for the housing sector. I understand that investors are currently unwilling to invest in securities backed by mortgages and that the secondary market for these mortgage-backed securities is essentially frozen. Some analysts believe a contributing factor is a U.S. GAAP accounting rule that is inconsistent with the international standard known as IAS 39. Under our U.S. Statement of Financial Accounting Standards (SFAS) No. 115, specifically known as the other-than-temporary impairment (OTTI) rule, investments must be accounted for using a theoretical current fair value which, in this market will result in losses that exceed expected economic losses. What are your thoughts on this rule and its role in the current economic downturn? If confirmed, what role would the Treasury play in working with the SEC and the FASB on studying this issue?**

One of the top priorities of our administration in response to the current financial crisis is to increase the flow of credit in our financial sector, particularly in the secondary market for mortgage-backed securities that you mention in your question.

The financial crisis has highlighted the urgent need to overhaul the oversight of our financial system. If confirmed, I look forward to working closely with Congress to develop a smart and effective regulatory system that will meet our current needs as well as the challenges and opportunities we will face in the years ahead. The current financial crisis has exposed a number of deficiencies in our federal regulatory system.

The role of accounting and reporting standards is to help provide investors and the capital markets with sound, unbiased financial information. Mark-to-market accounting and reporting helps protect investors, promote transparency and market integrity and act as a risk management tool.

I believe bank regulators could be part of the solution in helping regulated institutions ensure that they help all employees and officers fully comply with all applicable accounting rules for structured finance transactions. Inaccurate asset valuations have contributed to investor distrust about the information available to them in making investment decisions.

Questions for Treasury Secretary-Designee Timothy F. Geithner
From Senator Carl Levin
January 18, 2009

Market Oversight

1) In 1998, former SEC Chairman Arthur Levitt, Treasury Secretary Lawrence Summers, and Federal Reserve Chairman Alan Greenspan all opposed an attempt by the Commodity Futures Trading Commission (CFTC) to examine the over-the-counter (OTC) swaps market and then supported statutory restrictions on federal authority to regulate swaps in the Commodity Futures Modernization Act of 2000. Former Chairman Levitt recently stated that he now regrets the position he took during those years: "The market was too large, too explosive in growth to merely allow pure market forces to suffice as self-regulatory mechanisms. I have some regrets about it, clearly." In October 2008, Mr. Levitt wrote: "Our nation's financial markets are in the midst of their darkest hour in 76 years. We are in this situation because of an adherence to a deregulatory approach to the explosive growth and expansion of America's major financial institutions. Our regulatory system failed to adapt to important, dynamic and potentially lethal new financial instruments as the storm clouds gathered."

a) Do you agree with former Chairman Levitt's statement that our regulatory system has failed to adapt to the development of new financial instruments and that the positions taken in 1998-2000 to deregulate markets was, in retrospect, a mistake?

b) Should federal oversight be strengthened with respect to new financial products, including new derivative and complex structured financial products and, if so, how?

I believe that our regulatory system failed to adapt to the emergence of new risks. And I very much believe that federal oversight needs to be strengthened, including in the areas of derivative markets. If confirmed, I look forward to working closely with Congress to put in place comprehensive financial reform. We are going to need sweeping changes, in regulatory policy, the oversight structure, and in our tools for crisis management.

In this context, we will have to carefully evaluate the changes in laws and regulation of the last decade.

If confirmed, I will work closely with the Federal Reserve, the CFTC, the SEC and Congress to address the gaps in our current financial market and product regulation.

2) Former Federal Reserve Chairman Alan Greenspan testified last October that he, too, now believes that the conceptual framework underlying the deregulation of swaps in the CFMA was a mistake. Mr. Greenspan testified: "I made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such as that they were best capable of protecting their own shareholders and their equity in the firms. . . . So the problem here is something which looked to be a very solid edifice and, indeed, a critical pillar to market competition and free markets did break down."

a) Do you agree with Mr. Greenspan's recent statements that the financial collapse of 2008 demonstrated the errors in the assumptions underlying the deregulatory approach in the CFMA? Can we rely on market participants and unfettered free market forces to prevent systemic risks and unreasonable price fluctuations?

b) Do you support stronger regulation of U.S. financial markets to protect market participants and prevent systemic risks and, if so, how?

I agree that market discipline failed in important respects, and those failures were magnified by failures in supervision and oversight. As I mentioned in my previous answer, I believe that we must have a much stronger and comprehensive framework of safeguards in place to protect investors and consumers and to provide greater financial stability.

With respect to over the counter derivatives markets, I believe we need to have as our objective bringing greater transparency, accountability and safety to these markets. There may be a number of ways to achieve this, but steps to be taken in the short-term include bringing standardized products within centralized clearing mechanisms and setting an effective statutory and regulatory framework for regulating all derivatives dealers. If confirmed, I will undertake a careful comprehensive review of how best to strengthen the safeguards for these critically important markets.

3) What are your views on the adequacy of bank oversight by the Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTS) within the Treasury Department? If confirmed, would you support actions by the OCC and OTS, like actions taken by the Federal Deposit Insurance Corporation (FDIC), to increase bank fees to strengthen oversight?

The current financial crisis has exposed a number of serious deficiencies in our federal regulatory system. If confirmed by the Senate, I am committed to working with the Congress, members of the incoming Administration and other financial regulators to strengthen oversight of depository institutions and other financial entities.

All stakeholders share responsibility for helping to finance crucial oversight of these institutions that are vital to the successful functioning of our economy. Fees on the industry are one source of such financing. In the context of our efforts to reform the regulatory system, I would be willing to consider changes to how we ensure sufficient resources are available to finance a stronger and more sophisticated supervisory and enforcement system.

4) What are your views on consolidating the OTS and the OCC to lower costs and increase consistent oversight? Do you agree with the view that the OTS lowered standards to attract thrifts and increase its fee revenue?

As we examine the deficiencies in our existing regulatory structure, we need to consider all recommendations for improvement, including the possible consolidation of agencies and functions. I do not currently have adequate information to judge the reasons for, or outcomes of fee-setting policies implemented by OTS officials. Upon reviewing those policies, I look forward to consulting with Congress to take the steps necessary to strengthen the oversight of our financial institutions.

5) What are your views on whether and how federal oversight should be strengthened with respect to:

a) hedge funds?

b) companies that are not banks or broker-dealers, but buy and sell financial swaps and other financial products, like AIG Financial Products?

Effective federal oversight of systematically significant financial institutions, whose failure could destabilize our markets and severely disrupt credit flows, is critical to protecting the integrity of our economy. I support the goal of having a registration regime for hedge funds because we need greater information and better disclosure in the marketplace. I believe that we should also establish an effective regulatory framework for derivatives dealers.

6) In 2004, Congress enacted legislation imposing a one-year cooling-off period before federal bank examiners could take a job with a bank they oversaw. If confirmed, would you support a similar cooling-off period for all financial regulators?

Yes, I would support.

Capital Reserve Requirements

7) What are your views on the current U.S. capital reserve requirements for banks organized or operating in the United States?

a) Are existing U.S. capital reserve requirements insufficient or are they sufficient but were inadequately enforced to prevent the current financial crisis?

b) Should there be increased capital reserve requirements for banks that engage in:

— derivative transactions?

— credit default swaps?

— other types of swaps, including interest rate, currency, equity, and commodity swaps?

— all or some types of securitizations?

— transactions occurring offshore or involving offshore entities?

— over-the-counter transactions that are outside federal disclosure and regulation requirements?

c) What changes, if any, do you support in U.S. capital reserve requirements for banks to protect the U.S. financial system and prevent future financial crises?

Ensuring that U.S. banks maintain adequate capital reserves is a critical component of a well-functioning banking system. The financial crisis has revealed that many U.S. and foreign banks did not have adequate capital reserves to offset the losses that they sustained requiring dramatic policy action to address this problem. If confirmed, I will instruct Treasury in conjunction with other regulators to conduct a comprehensive review of existing capital requirements and related accounting regimes.

Complex Structured Finance Transactions

8) How important a role did collateral debt obligations (CDOs), auction-rate securities, structured investment vehicles (SIVs), and other structured finance transactions play in the current financial crisis? What were the regulatory deficiencies that allowed these transactions to undermine U.S. financial stability, and how would you correct them?

All of these structures--CDOs, SIVs, auction-rate securities—played a part in facilitating the contagion that led to our financial crisis. Product innovation outstripped the capacity of initial risk management and regulatory oversight to keep up. Exacerbating the situation was the degree of reliance on ratings agencies and the vulnerability of those ratings to potential conflicts of interest, a decline in underwriting standards, and a severe downturn in the housing sector. In retrospect, far too little attention was paid to the magnitude of exposure of U.S. financial institutions to mortgage-based securities.

Apart from the changes already underway to regulatory policy (e.g. capital and liquidity requirements) and longer term changes to regulatory structure, there need to be significant changes to how supervision is conducted in the major institutions. I believe these changes should include: increased focus on systemic vulnerabilities; efforts to design and carry out more effective reviews of risk management practices; mechanisms for making the conclusions of select reports public, along the lines of the Senior Supervisors' Group surveys that are currently released to the public; more frequent and more focused forward-looking assessments of capital and liquidity adequacy under a range of possible scenarios; meaningful institutionalization of the cooperative process now underway with the SEC, FDIC, OCC, OTS and primary foreign supervisors in the design of and follow-up on horizontal reviews across firms; greater efforts to ensure that supervisors have adequate information on global exposures and funding positions of large foreign financial institutions operating within the U.S.; more frequent reviews of valuation practices for select types of assets across institutions as a way of revealing significant outliers in those practices; and more focus on the quality of an institution's internal checks and balances, such as incentives in compensation schemes, allocation of capital, pricing of internal liquidity and independence of valuation functions.

9) In 2004, the Office of the Comptroller (OCC) and the Office of Thrift Supervision (OTS) in the Treasury Department, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Securities and Exchange Commission (SEC) issued a proposed Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities ("Interagency Statement on Sound Practices"). In 2006, the agencies issued a revised proposal, and issued a final statement in 2007.

a) Please describe your role, if any, in agency deliberations with respect to the proposed and final statements. If you participated, did you support the revisions to the 2004 proposed statement?

b) The Interagency Statement on Sound Practices became effective on January 11, 2007. According to the statement, the OCC, OTS, Federal Reserve, FDIC, and SEC were to use the Statement as guidance for reviewing the internal controls and risk management policies, procedures, and systems of financial institutions engaged in Complex Structured Finance Transactions (CSFTs) as part of their ongoing supervisory process. Were you aware of this guidance, and do you know if the guidance was regularly adhered to by each of the federal agencies that signed the statement since its effective date?

c) The Interagency Statement indicates that CDOs and credit default swaps (CDS) typically would not be considered to be CSFTs subject to the guidance. In light of the role played by CDO and CDS transactions in the current financial crisis, would you support revising this approach so that CDO and CDS transactions are covered by the Interagency Statement on Sound Practices?

While I did not participate in the interagency deliberations with respect to the proposed and final statements, members of the Federal Reserve Bank of New York staff worked with staff at the Federal Reserve Board of Governors to provide input into the background materials for those deliberations.

I was aware of this guidance. I cannot attest as to the extent to which the guidance was regularly adhered to by each of the five federal agencies that were signatories to the guidance. With respect to the activities of the Federal Reserve Bank of New York, our supervisors were actively engaged in evaluating the remedial efforts of two large banking organizations and the complex structured finance transactions they engaged in with Enron.

The interagency statement focuses on the heightened legal and reputational risks that institutions may face in connection with complex structured finance transactions. The guidance provides as examples of transactions that may warrant additional scrutiny such as those that:

- Lack economic substance or business purpose;
- Appear to be designed or used primarily for questionable accounting, regulatory, or tax objectives, particularly when the transactions are executed at year end or at the end of a reporting period for the customer;
- Raise concerns that the client will report or disclose the transaction in its public filings or financial statements in a manner that is materially misleading or inconsistent with the substance of the transaction or applicable regulatory or accounting requirements;
- Involve circular transfers of risk (either between the financial institution and the customer or between the customer and other related parties) that lack economic substance or business purpose;
- Involve oral or undocumented agreements that, when taken into account, would have a material impact on the regulatory, tax, or accounting treatment of the related transaction, or the client's disclosure obligations;
- Have material economic terms that are inconsistent with market norms (e.g., deep ``in the money'' options or historic rate rollovers); or

- Provide the financial institution with compensation that appears substantially disproportionate to the services provided or investment made by the financial institution or to the credit, market or operational risk assumed by the institution.

While I believe additional supervisory guidance is absolutely necessary to address the massive credit losses and lessons learned from this financial crisis, I do not believe that simply incorporating certain new financial instruments into pre-existing supervisory guidance, which was developed to address an altogether different set of issues, is necessarily the most effective approach. I look forward to working with you on this issue.

10) If confirmed, would you support reviewing the financial institutions that received at least $1 billion in TARP assistance to determine if they have used their best efforts to comply with the standards and guidance set forth in the Interagency Statement on Sound Practices?

I am committed to assessing efforts to comply with the standards and guidance in this Interagency Statement by TARP recipients and all other financial institutions.

Credit Default Swaps

11) How important a role did credit default swaps (CDSs) play in the current financial crisis? What were the regulatory deficiencies that allowed CDSs to undermine U.S. financial stability?

With respect to over the counter derivatives markets, I believe we need to have as our objective bringing greater transparency, accountability and safety to these markets. There are a number of ways to achieve this, and steps that can be taken include bringing standardized derivative products within centralized clearing mechanisms and setting a statutory and regulatory framework for regulating all derivatives dealers. If confirmed, I intend to work closely with Congress to help develop such a framework to address our needs at this time and the challenges and opportunities ahead of us.

12) The Commodity Futures Modernization Act of 2000 (CFMA) prohibits SEC and CFTC regulation of all types of swaps, including interest rate, currency, equity, commodity, and credit swaps.

a) What were your job titles and positions from 1998-2000?

b) Please describe your role, if any, in the efforts by the SEC, Treasury, and Federal Reserve to prevent the CFTC's potential assertion of regulatory authority over swaps and derivatives in 1998.

c) Please describe your role, if any, during the discussions regarding the CFMA, including provisions to limit SEC and CFTC authority to regulate swaps. Please also include any role you played during the negotiation to limit state authority to regulate these swaps.

d) Did you support or oppose these statutory provisions at the time they were enacted in 2000?

e) What is your current view of the statutory prohibitions on regulation of swaps? If confirmed, would you support the repeal of these prohibitions?

In 1998, I served as the Assistant Secretary for International Affairs. In 1999, I served as the Under Secretary for International Affairs.

The financial crisis has highlighted the need to significantly overhaul oversight of our financial system. Currently, many financial instruments trade in over-the-counter markets. Reforms to financial market regulation, including over-the-counter derivatives, must have as an objective bringing greater transparency, accountability and safety to these markets. Additionally, we must ensure that any loopholes that allow market participants to evade regulation are closed and that regulators have the authority and the resources they need to ensure the integrity of our markets. If confirmed, I will begin working with Congress and other financial regulators to accomplish these goals.

13) Should the federal government regulate CDSs? If so, should CDSs be regulated as securities or commodities?

I support establishing a statutory and regulatory framework for overseeing all derivatives dealers, and establishing centralized mechanisms for derivatives products. I look forward to working with Congress relating to the unique features of Credit Default Swaps given their relationship to the transparency and market integrity of the corporate bond and equity markets.

Furthermore, given the relationship of these derivatives to the commodities and securities markets, I believe that we need to foster effective cooperation amongst regulators while ensuring appropriate regulation.

14) What are your views on whether and how the federal government should regulate other types of swaps, such as interest rate, currency, equity, or commodity swaps?

As I have noted, I believe that we need more transparency to promote transparency, accountability and safety for these products.

There may be a number of ways to achieve this, but steps can be taken in the short term to bring all of these products within centralized clearing mechanisms and setting a statutory and regulatory framework for regulating all derivatives dealers.

Troubled Asset Relief Program

15) The Bush Administration, through the Treasury Department's Office of Financial Stability, has declined to impose requirements on companies receiving Troubled Asset Relief Program (TARP) funds to report on how they will use those funds. If confirmed, would you support imposing reporting requirements on TARP recipients to determine how they use TARP funds? Would you support requiring banks to lend a portion of those funds to third parties?

The President-elect believes that assistance under the Emergency Economic Stabilization Act of 2008 must promote the stability of the financial system and increase lending. If confirmed, I will ensure that we will measure, monitor and track the impact of the program on lending and access to credit. Going forward, as a condition of federal assistance under this program, healthy banks without major capital shortfalls will be required to increase lending above baseline levels.

If confirmed as Secretary of Treasury, I will require the recipients of investments under this program to provide detailed and timely information on their lending patterns broken down by category. Public companies would report this information quarterly in conjunction with the release of their 10Q reports.

16) If confirmed, would you support requiring a viability plan by a specified date from each financial institution that received at least $1 billion in TARP funds to outline how they plan to maintain or regain financial stability, identify and reduce any inventories of troubled assets, repay any TARP loans, and eliminate the need for any federal guarantees?

The President-elect believes that assistance under the Emergency Economic Stabilization Act of 2008 must promote the stability of the financial system and increase lending. If confirmed, I will implement safeguards in this program to improve the effectiveness of our financial stabilization efforts. As Treasury Secretary, I would ensure that the terms of investments made under this Act are appropriately designed to promote rapid repayment of government funds and to encourage private capital to replace public investments as soon as economic conditions permit. If confirmed, I will work with Congress to ensure that the conditions for assistance reflect our shared objective of ensuring that public assistance for the financial system will be temporary, not permanent.

17) If confirmed, what policies, procedures and controls would you implement to protect the billions of taxpayer dollars and guarantees extended to Citigroup and AIG?

The President-elect is committed to safeguarding taxpayer interests under the Emergency Economic Stabilization Act of 2008. If confirmed, I will ensure that assistance provided under this Act is undertaken with the maximum degree of accountability and transparency possible, and I will closely monitor the financial condition of firms that have received large amounts of assistance under this program. The terms of support extended under the Emergency Economic Stabilization Act of 2008 to Citigroup and AIG have been established in the agreements reached with those firms. Our objective will be to seek to replace investments made by the U.S. Government with private investment as quickly as possible.

18) If confirmed, what controls would you impose on TARP recipients to ensure compliance with requirements on executive pay, stock dividends, and the $500,000 cap on compensation tax deductions?

Excessive executive compensation that provides inappropriate incentives has played a role in exacerbating the financial crisis. This issue has been and should continue to be closely examined by the public, shareholders, boards of directors, Congress, and the incoming Administration, including Treasury and the SEC. If confirmed, I will charge my staff at Treasury, including the Internal Revenue Service, with ensuring that the regulations implementing the executive compensation provisions of the Economic Emergency Stabilization Act (EESA) are fully complied with.

One specific control we would plan to impose on TARP recipients is that executive compensation above a specified threshold amount be paid in restricted stock or similar form that cannot be liquidated or sold until government assistance has been repaid. In addition, we would limit TARP recipients' ability to pay dividends. One specific measure would be a requirement that TARP recipients wishing to pay dividends obtain approval from their primary federal regulator. In addition, in the case of TARP recipients receiving exceptional assistance, quarterly dividends would be strictly limited until the government has been repaid. These controls are described in National Economic Council Director-Designate Summers' January 15, 2009 letter to the Congressional leadership.

If confirmed, I will work and coordinate closely with Congress and members of the administration. To that end, my staff will examine the administrative guidance that Treasury has issued under the TARP and EESA, including Treasury's interim final rule and Notice 2008-94, Notice 2008-PSSFI, and Notice 2008-TAAP. We will also review the reports from the GAO and the Congressional Oversight Panel.

19) If confirmed, would you favor extension of the $500,000 cap on compensation tax deductions to all U.S. corporations and all of their employees to end taxpayer subsidies of excessive executive pay?

If confirmed, I would consider extending at least some of the TARP provisions and features of the $500,000 cap to U.S. companies generally as well as potentially imposing other rules beyond those potentially in effect. A number of the provisions that accompany the $500,000 cap are worthy of being considered for broader application. The specifics of an effective solution, going forward, require careful analysis, including a review of the newly enacted tax code limitations on offshore deferred compensation.

In reviewing policy options in this area, I will examine prior efforts to limit corporate tax deductions for executive compensation. Prior to the Economic Emergency Stabilization Act (EESA), there have been three major statutory attempts to rein in executive compensation: golden parachutes (Internal Revenue Code section 280G) in the 1984, the million dollar cap on tax deductible compensation (Code Section 162m) in 1993, and restrictions on non-qualified deferred compensation (Code Section 409A) in 2004. Each has faced challenges for different reasons, and some may even have exacerbated the problem they were designed to address.

Any modification will require careful thought, a thorough understanding of the regulatory framework and corporate practices relating to executive compensation, tax policy and employee benefits, and a clear understanding of the implications and likely impact of alternative designs. If confirmed, I intend to draw upon both the expertise at Treasury and the IRS and the advice of leading outside experts in these fields. We will also coordinate closely with the National Economic Council, the SEC, and Congress.

Tax Issues

20) The United States loses an estimated $100 billion each year from offshore tax abuses.

a. What priority would you place on tackling the problem of offshore tax abuses?

b. If confirmed, would you support the Levin-Coleman-Obama Stop Tax Haven Abuse Act to shut down offshore tax abuses?

I share the President-Elect's commitment to aggressively address the problem of offshore tax abuses and complement you and your staff on the excellent work that they have done to highlight the problem. If confirmed, this issue will be a high priority for the Treasury Department.

The President-Elect is committed to shutting down offshore tax schemes and, as you know, cited your legislation as evidence of steps that he would like to take to accomplish this goal. If confirmed, I will treat the offshore tax abuse issue as a high priority and will examine a wide range of policy options to address offshore tax abuses, including increasing IRS enforcement authority, requiring greater disclosure and taxpayer accountability, changing the presumption for transactions in tax-secrecy jurisdictions and other ideas included in your legislation.

21) The Internal Revenue Service (IRS) collects an estimated $4 for every $1 spent on enforcement. Would you support additional resources for tax enforcement efforts?

If confirmed, I will be a strong advocate for the Internal Revenue Service and its efforts to secure sufficient funding to carry out its mission successfully. Tax enforcement is a key priority for the IRS and I look forward to working with IRS Commissioner Doug Shulman to ensure that the compliance and enforcement mission of the IRS receives the necessary support and funding.

22) During your tenure as Treasury Under Secretary for International Affairs, did you examine international tax issues, and, if so, what were the most significant issues you examined?

In my capacity as Under Secretary for International Affairs, I did participate in efforts with other Treasury officials, including the Assistant Secretary for Tax Policy, in the G-7 and in the Organization for Economic Cooperation and Development to address the problem of tax havens. Some of the tax enforcement challenges we face now are new, others have plagued our tax system for decades. Under your leadership, the Permanent Subcommittee on Investigations has played a critical role in highlighting egregious tax evasion techniques and the troublesome role of certain tax preparers in exacerbating compliance problems.

23) How do you view the relationship and respective roles of the Treasury Secretary, the Assistant Secretary for Tax Policy, and the IRS Commissioner?

The Secretary of the Treasury is the principal economic advisor to the President and in that role is responsible for formulating and recommending domestic and international financial, economic, and tax policy. The Assistant Secretary for Tax Policy is the Secretary's principal advisor on all tax-related matters. The IRS Commissioner's duties include administering, managing, conducting, directing, and supervising the execution and application of the internal revenue laws or related statutes and tax conventions to which the United States is a party. I will work closely with the Assistant Secretary of Tax Policy and IRS Commissioner to create sound tax proposals and ensure that the current tax laws are administered effectively. Also, I will encourage the Assistant Secretary of Tax Policy and the IRS Commissioner to work together to develop tax policy options that take into account IRS administrative and compliance issues.

Financial Accounting Rules

24) What is your view of the relationship between Treasury and the Financial Accounting Standards Board (FASB)? What is your view on whether Congress should legislate accounting rules?

The SEC has statutory authority to set accounting standards for all public companies. It has recognized and relied on FASB for this task. The role of accounting and reporting standards is to help provide investors and the capital markets with sound, unbiased financial information on the activities, results, and financial condition of reporting enterprises. It is important to investor protection and the integrity of markets that we maintain the independence of this standard setting process.

The SEC recently issued a report supporting the existing mark-to-market valuation rules, but recommending some improvements. What is your view of the current mark-to-market valuation rules?

The role of accounting and reporting standards is to help provide investors and the capital markets with sound, unbiased financial information. Mark-to-market accounting and reporting helps protect investors, promote transparency and market integrity and act as a risk management tool.

25) Do you believe U.S. banks have fully applied mark-to-market valuations to the structured finance transactions on their books, including asset-backed securities, credit default swaps, and CDOs? Do you believe inaccurate valuations are currently impeding U.S. credit markets? If confirmed, what actions would you take to insure accurate book valuations for U.S. banks?

I believe bank regulators could be part of the solution in helping institutions ensure that they help all employees and officers fully comply with all applicable accounting rules. Inaccurate asset valuations have contributed to investor distrust about the information available to them in making investment decisions.

26) Current SEC Chair Christopher Cox has indicated that he thinks the SEC should allow U.S. publicly traded companies to use international financial reporting standards (IFRS) issued by the International Accounting Standards Board (IASB) instead of U.S. generally accepted accounting principles (GAAP) in their financial statements. Do you believe the Sarbanes-Oxley Act allows the SEC to delegate the development of accounting standards to the IASB? If confirmed, would you try to advance such a proposal?

Without reliable information, our markets cannot function effectively. The thrust of Sarbanes-Oxley was to improve the accuracy of information provided to investors by public companies. I do not believe that the Act allows the SEC to delegate to another entity the development and enforcement of accounting rules for U.S. companies. The International Accounting Standards Board works with the FASB and SEC to enhance global accounting rules that affect U.S. companies and other investors, as well as international investors. I support and will do my best to advance actions to improve the flow of consistently reliable information that provides a sound basis for investor confidence and help ensure that the U.S. remains a leader in global markets.

27) What is your view of the FASB accounting standard rule requiring stock option compensation to be treated as an expense on corporate financial statements? If confirmed, would you support efforts to change this standard? If so, what changes would you support?

The role of accounting and reporting standards is to help provide investors and the capital markets with sound, unbiased financial information. If I am confirmed as Treasury Secretary, I will review and support all rules, including the FASB accounting standard rule requiring stock option compensation, designed to protect taxpayers and investors.

28) Right now U.S. corporate tax deductions for stock option compensation are not in alignment with the mandatory accounting treatment of this compensation, and often result in corporate tax deductions that are many times larger than the compensation expense shown on the corporate books. If confirmed, would you agree to review this discrepancy between book and tax treatment of corporate stock option compensation?

The relationship between how corporations treat stock option compensation for tax and financial accounting purposes is a complex topic. If confirmed, I will examine the issue and explore policy options in this area.

Abusive Credit Card Practices

29) Senate and House hearings have documented abusive credit card practices that mire American families in debt. In December, the Federal Reserve issued a new rule identifying certain unfair or deceptive credit card practices to be barred beginning in 2010.

a. If confirmed, would you support or oppose legislation to codify the Federal Reserve rule?

b. If confirmed, would you support or oppose legislation to ban additional unfair credit card practices?

c. All major U.S. credit card issuers are national banks, and several are overseen by the OCC. If confirmed, what priority would you place on ensuring that these banks comply with the new credit card rules on a timely basis?

The Federal Reserve has recently finalized new regulations that apply to the credit card industry. If confirmed, and in consultation with the Treasury staff, I will review these rules to determine if additional statutory changes are needed to protect cardholders from abusive credit card practices.

President-elect Obama has proposed a number of initiatives both to improve transparency in order to empower consumers to better protect themselves and to ban certain credit card practices such as universal defaults and retroactive rate charges. I intend to work with Congress as well as other federal regulators to ensure effective consumer protection.

I do now, and would as Treasury Secretary, if confirmed, continue to place a high priority on enforcement of all banking rules.

Anti-Money Laundering Programs

30) Offshore jurisdictions too often facilitate money laundering, foreign corruption, tax evasion, and other misconduct.

a. If confirmed, would you support international efforts to combat offshore secrecy laws that facilitate wrongdoing?

b. An innovative U.S. enforcement effort is pending to limit Swiss secrecy laws by serving a John Doe summons on a Swiss bank, UBS AG, to obtain the names of approximately 19,000 U.S. clients with $18 billion in Swiss accounts that have not been disclosed to the

IRS. If confirmed, would you support the ongoing litigation to enforce the John Doe summons?

c. The Financial Action Task Force (FATF) is the leading international body combating terrorist financing and money laundering. If confirmed, would you support a reinvigorated effort by FATF to identify countries that are not actively cooperating with anti-money laundering (AML) efforts?

d. In 2006, FATF criticized the U.S. for forming nearly two million corporations and limited liability companies each year without identifying the beneficial owners behind them. FATF asked the U.S. to correct this deficiency in its AML laws by June 2008. The U.S. has missed that deadline in part because the states have been unable to agree on beneficial ownership disclosure rules that would meet FATF standards. If confirmed, would you support the Levin-Coleman-Obama legislation introduced in the last Congress to correct this deficiency in state incorporation practices?

Illicit finance is not only a concern for law enforcement, but it can also pose challenges to the integrity of the financial system and threats to U.S. national security interests. If confirmed, I will support an international cooperative effort to address abuses and wrongdoings that are facilitated by offshore secrecy laws.

If confirmed, I would request a briefing on this enforcement effort by the IRS Commissioner, the IRS Chief Counsel, the Treasury General Counsel and the Assistant Secretary of Tax Policy so that I understand the options and status of this effort.

FATF has indeed played a very important role in the effort to combat global money laundering in general and more recently the effort to combat terrorist financing specifically. I take these issues very seriously, understanding them to be at the nexus of U.S. national security, intelligence, diplomatic, economic and law enforcement interests. If confirmed I will look forward to working with the Administration's national security team to seek additional measure to target illicit finance, including through reinvigorated FATF measures. I will also look forward to working with Congress on these issues.

Recent Financial Crisis

31) Please describe your role, including whether you had personal discussions with the Federal Reserve Chairman and Treasury Secretary and any other actions you have taken, with regard to providing capital or financial guarantees to AIG since September 2008.

As the President of the Federal Reserve Bank of New York, I was involved with, and engaged in, extensive conversations with Chairman Bernanke and Secretary Paulson about all aspects of the actions we collectively undertook to stabilize AIG in September and November of 2008. I also engaged with John Reich, the Directors of the Office of Thrift Supervision, as well as with the New York state insurance commissioner, Eric Dinallo.

32) Please describe your role, including whether you had personal discussions with the Federal Reserve Chairman and Treasury Secretary and any other actions you have taken, with regard to providing capital or financial guarantees to Citigroup since September 2008.

As the President of the Federal Reserve Bank of New York, I was closely involved and engaged in extensive conversations with Chairman Bernanke and Secretary Paulson about, the actions taken with respect to Citibank and the other large financial institutions that received capital and guarantees in the October launch of the Treasury's Capital Purchase Program and the FDIC's Temporary Liquidity Guarantee Program. I was also closely involved in the discussions of how to structure the government's package to stabilize Citibank in late November 2008. However, I was not involved in the government's direct negotiations with the management of Citibank over the precise terms or structure of the deal that was struck over the course of the weekend of November 24-25.

33) Please describe your role, including whether you had personal discussions with the Federal Reserve Chairman and Treasury Secretary and any other actions you have taken, with regard to the acquisition of Bear Stearns by JPMorgan Chase.

As the President of the Federal Reserve Bank of NY, I was deeply involved in, and had many personal discussions with Chairman Bernanke and Secretary Paulson around the actions taken by the Federal Reserve and the Treasury to facilitate the acquisition of Bear Stearns by JPMorgan Chase. As Bear Stearns was not an entity that fell under the Federal Reserve's oversight, I also engaged in numerous conversations with Chairman Cox at the SEC during that period as well.

34) Please describe your role, including whether you had personal discussions with the Federal Reserve Chairman and Treasury Secretary and any other actions you have taken, with regard to the acquisition of Countrywide and Merrill Lynch by Bank of America?

While I was kept apprised of the developments around the acquisitions of both Countrywide and Merrill Lynch by Bank of America through conversations with Chairman Bernanke, Secretary Paulson and Richmond Fed President Jeffrey Lacker, I was not involved in the negotiations or decision-making with respect to either of these transactions as the Federal Reserve Bank of New York is not responsible for the oversight of Bank of America.

35) Please describe your role, including whether you had personal discussions with the Federal Reserve Chairman and Treasury Secretary and any other actions you have taken, with regard to the acquisition of Wachovia Corporation by Wells Fargo?

I was involved in the developments around the acquisition of Wachovia by Wells Fargo through conversations with Chairman Bernanke, Secretary Paulson, Chairman Bair and Richmond and San Francisco Fed President's Lacker and Yellen. I was not involved in the negotiations with respect to this transaction as the Federal Reserve Bank of New York does not oversee either Wells Fargo or Wachovia.

36) Please describe your role, including whether you had personal discussions with the Federal Reserve Chairman and Treasury Secretary and any other actions you have taken, with regard to providing capital or financial guarantees to Fannie Mae and Freddie Mac in 2008.

I was involved in, and kept apprised of, many of the discussions with Chairman Bernanke, Secretary Paulson, FHFA Director Lockhart, and others around the Treasury's efforts to assess the need and method to stabilize the situation with the GSEs at that time. As these institutions were not under the oversight of the Federal Reserve Bank of New York, I was not directly involved in the decision of the government to put the GSEs into conservatorship.

37) Please describe your role, including whether you had personal discussions with the Federal Reserve Chairman and Treasury Secretary and any other actions you have taken, with regard to Lehman Brothers in September 2008.

As the President of the Federal Reserve Bank of New York, I was engaged in extensive conversations with Chairman Bernanke, Secretary Paulson, Chairman Cox and others during the period leading up to the bankruptcy of Lehman Brothers in September 2008. Over the weekend prior to Lehman's declaration of bankruptcy, meetings were held with the heads of a number of large financial institutions at the Federal Reserve Bank of New York, and I participated in these meetings along with Secretary Paulson.

SUBMITTED BY SENATOR GRASSLEY

COMMITTEE STAFF MEMORANDUM

Timothy Geithner recently filed amended tax returns for years 2001, 2002, 2004, 2005 and 2006 reporting combined additional taxes and interest of $31,536. For years 2001 and 2002, the most substantial adjustments resulted from his failure to pay self-employment taxes (SE tax) on earned income while employed by the International Monetary Fund (IMF). Mr. Geithner previously had agreed to similar adjustments to SE tax for years 2003 and 2004 after his returns were examined by the Internal Revenue Service (IRS). The IRS waived penalties for those years. The remaining adjustments on the amended returns resulted from a variety of issues identified during a review of his returns by Finance Committee staff during the nomination process.

Mr. Geithner self-prepared his original tax returns for years 2000, 2001, 2002 and 2005. He used paid tax preparers to prepare his original tax returns for years 2003, 2004, 2006 and 2007. He used paid preparers to prepare a 2001 amended return that was filed in July, 2002, and his recently amended returns for years 2001, 2002, 2004, 2005 and 2006. All returns were filed using married filing jointly filing status.

Mr. Geithner regularly employs household help. It has been determined that the legal working status of one individual was lapsed for approximately 3½ months during 2005 while in the employ of Mr. Geithner.

Tax Adjustments

Background

On December 5, 2008, the Presidential Transition Team (PTT) met with Finance Committee staff and disclosed that Mr. Geithner had paid to the IRS $34,023 in additional taxes and $8,679 in interest because he had failed to pay self-employment taxes on his IMF income paid during 2001 through 2004. The IRS audited Mr. Geithner in 2006 for tax years 2003 and 2004, resulting in additional taxes of $12,719 and $2,128, respectively, plus interest of $1,885. The IRS waived penalties for these tax years. Mr. Geithner voluntarily amended his tax returns for years 2001 and 2002 after Barack Obama expressed his intent to nominate Mr. Geithner to be Secretary of the Treasury and paid additional taxes of $2,364 and $16,812, respectively, plus interest of $6,794.

Tax Year	Self-Employment Tax	Interest	Total Tax and Interest
2001	$2,364	$956	$3,320
2002	$16,812	$5,838	$22,650
2003	$12,719	$1,711	$14,430
2004	$2,128	$174	$2,302
Total	**$34,023**	**$8,679**	**$42,702**

As a result of this meeting, a letter was sent on December 9, 2008 to Mr. Geithner's attorney requesting Mr. Geithner's tax returns, notes and other documentation pertaining to tax years 2000 through 2007. Information in response to this letter was received on December 16, 2008. Committee staff have examined this material. Telephone interviews were conducted with three of Mr. Geithner's accountants and a Human Resources representative at the IMF. Mr. Geithner met personally with staff on December 19, 2008 to answer questions about the self-employment tax issue and other issues identified during the course of the document review.

Self-Employment Taxes

The most significant tax concern identified is Mr. Geithner's failure to pay social security taxes during his entire tenure at the IMF, which began in 2001 and concluded in 2003 (some compensation was not paid until calendar year 2004). He paid no FICA taxes or self-employment taxes with respect to the IMF income during that time.

Under section 3121(b)(15), international organizations like the IMF are exempted from the Federal Insurance Contributions Act (FICA, or social security taxes). Such organizations do not pay the employer share of FICA. There is no employee liability for the employee share of FICA and there is no payroll withholding for the employee's share. Under section 1402(c)(2)(C), service performed by an employee of such an organization is treated as service that is subject to the Self-Employment Contributions Act (SECA, or SE taxes) to the extent that the service is performed in the United States by a United States citizen. Thus, employees of an international organization who are citizens of the United States must pay SE taxes with respect to the compensation received from the organization. IMF workers receive tax allowances for federal, state and self-employment obligations in the form of gross-ups to their regular salary. The IMF, as is their policy as an international organization, did not withhold any taxes, including FICA taxes, and reported "NONE" on Form W-2 in Box 2 (Federal income tax withholding) and Box 4 (Social security tax withheld). No entries appeared in Box 3 (Social security wages), Box 5 (Medicare wages and tips) and Box 6 (Medicare tax withheld).

IMF employees are responsible for meeting their own tax obligations, including federal income taxes, state income taxes and self-employment taxes. The IMF provides employees with several documents throughout the year to help employees understand and meet their tax obligations. These documents include:

- *IMF Employee Tax Manual.* This manual is given to employees at the time they are hired and includes information describing how to pay self-employment taxes.
- *Quarterly Wage Statements.* These statements are provided to employees on a quarterly basis. They report on separate lines for each type of tax the amount of gross-ups for federal, state and self-employment taxes that have been included in wage income for that quarter.

- *Year-End Wage Statements.* These statements are delivered annually via an e-mail that describes the data as very important and includes information regarding the payment of self-employment taxes. The wage statement sent with the e-mail contains a detailed breakdown of wages and compensation paid to the employee for the entire year, including separately stated amounts for federal, state and self-employment taxes.
- *Annual Tax Allowance Request.* IMF employees are required to file annually a form requesting the federal, state and self-employment gross-ups to wages.

Mr. Geithner acknowledged receiving all of these documents. He wrote contemporaneous checks to the IRS and the State of Maryland for estimated tax payments in amounts that tied exactly to the federal and state tax allowances reported on the IMF quarterly wage statements. He did not write checks corresponding to the self-employment tax allowance that was separately stated directly underneath the federal and state allowance amounts. He filled out, signed and submitted an annual tax allowance request worksheet with the IMF that states, "I wish to apply for tax allowance of U.S. Federal and State income taxes and the difference between the "self-employed" and "employed" obligation of the U.S. Social Security tax which I will pay on my Fund income."

Mr. Geithner has experience with social security tax issues. For tax years 1993 through 1995, he late-filed, in February, 1996, social security taxes and Maryland FUTA taxes for household employees. For 1998, he incorrectly calculated Medicare taxes for household employees and received an IRS notice. He filed a corrected 2001 Form W-2 for his household employee. He received notices from the Social Security Administration and the IRS regarding the non-filing of 2003 and 2004 Forms W-2 (the matters were dropped after he submitted copies of the forms). He has filed Schedule H (employment taxes for household help) with several tax returns. He reported self-employment taxes on Schedule C net income for his personal consulting business and his wife's clinical work. In addition, he used tax software to prepare his own returns. These programs include specific boxes and prompts to enter social security taxes.

In November, 2006, the IRS announced a settlement offer to resolve tax matters of U.S. based employees of foreign embassies, foreign consular offices and international organizations.

Other Tax Adjustments

The amended returns contain various other tax adjustments identified during a review of Mr. Geithner's returns. Additional tax of $4,334 and interest of $1,232 applies to these adjustments. Items adjusted include a ten-percent early withdrawal penalty on a distribution from a retirement plan maintained by the federal government, recapture of a section 179 deduction for equipment used in a business that was discontinued, an additional charitable contribution deduction for non-cash items, a reduction in utilities expense to account for personal use, investment interest expense, and reductions to the dependent child care credit. Mr. Geithner included payments to overnight camps in his dependent care credit computations for years 2001, 2004 and 2005. The accountant who prepared his 2006 tax return apprised him that payments to overnight camps were not allowable expenses for purposes of the credit but he did not file amended returns at the time to correct the prior years.

Household Employees

Mr. Geithner has employed three persons to provide household help since 2004. He did not obtain the required Form I-9, Employment Eligibility Verification, from these persons at the time they were hired to verify their legal work status. The legal status of the three employees was reviewed and notes were entered into an address book with citizenship dates, passport numbers and employment authorization numbers, as applicable, for each employee. No copies were retained of the documents used to determine legal status.

One employee, hired in September, 2004, provided a United States Citizenship and Immigration Service Employment Authorization Document (EAD) issued on July 15, 2004 as proof of legal work status. The EAD number was recorded in the Geithner's address book together with the expiration date of the EAD, July 14, 2005. When the EAD expired, the employee did not renew her legal work status and the Geithners did not follow up with the employee to confirm whether she had done so. This person remained employed by the Geithner's until October, 2005. Thus, for the period July 15, 2005 through October, 2005, the person was not eligible for legal employment. Employment taxes were appropriately paid on the individual throughout her period of employment with the Geithners.

International Monetary Fund **Payroll Statement**

Timothy Franz Geithner /[redacted] **Annual Salary:** $[redacted] **Pensionable Gross:** $[redacted]
Pay Period: 08/29/2002 to 09/11/2002 **Pay Date:** 09/05/2002 **Outstanding Loans:** $0

Earnings	Hours	Amount Current Pd	Amount Y-T-D
Federal Tax Allowance		[redacted].08	[redacted]23
State Tax Allowance		[redacted]95	[redacted].86
SE Tax Allowance		[redacted]45	[redacted].35
Other Earnings		0.00	[redacted]54
Total Earnings		[redacted].48	[redacted].98

Deductions	Amount Current Pd	Amount Y-T-D
Total Deductions	0.00	[redacted].92

Other Payments	Hours	Amount Current Pd	Amount Y-T-D
Total Other Payments		0.00	[redacted]35

Pd 9/14/02

Total Amount Paid	[redacted]48
Total Deductions	0.00
Net Pay	$[redacted].48

Distribution Of Net Pay

Bank Name	Account Type / Number	Deposit
[redacted]	[redacted]	[redacted]48
Total Distributions		$[redacted]48

Timothy Franz Geithner
Immediate Office
Policy Development & Review Dept.

Message:
This quarterly tax allowance is based on a projected annual W-2 taxable amount for 2002 of $[redacted]66. Please note that this amount may vary each quarter.

Geithner, Timothy

From:	Pension & Tax Unit [redacted]
Sent:	Thursday, December 20, 2001 1:54 PM
To:	Timothy Franz Geithner
Subject:	Fourth Quarter Tax Allowance Payment For 2001.
Sensitivity:	Private

2001-12-19-SAL-710641.pdf itax012_710641.pdf itax030_710641.pdf

Mr. Geithner:

The attached electronic files contain important information concerning the payment of your fourth quarter tax allowance for 2001. Please PRINT these files and RETAIN them for your records. The contents of each file are described as follows:

PAY ADVICE - presents a detailed breakdown of your allowance. It also includes banking information on the funds to be deposited to your account on 12/20/2001.

ITAX012
PAGE 1 - reports your actual year-to-date earnings by category. (Your earnings MAY include "GLI Imputed Income". This is income you must recognize on the value of employer contributions to term life insurance coverage in excess of $50,000. The amount may appear high for 2001 because of the refund of premiums that occurred in October.)

PAGE 2 (and Page 3, if applicable) displays the calculation of your tax allowance.

SELF-EMPLOYMENT INCOME - ITAX030
Fund staff are not required to pay self-employment tax on the earnings attributable to services performed abroad (even though your total earnings ARE subject to Federal and state income taxes.) Accordingly, if you traveled outside the U.S. on official business or were appointed to a post abroad during 2001, you will receive a copy of this attachment. The attachment indicates the number of days you were on mission and prorates your earnings based on the ratio of your days working abroad to your total days in pay status. This proration is your income subject to self-employment tax and is used in the Fund's computation of your SE tax allowance. You should use this to prepare your 2001 Form 1040, Schedule SE. The statement should be printed and attached to your tax return.

To view the reports, double click on the attachment and select the 'Open It' radio button. You may enlarge the font on the E-Advice by clicking on the magnifying glass icon on the toolbar and then clicking anywhere on the report, or by selecting any of the options from the View menu. You may print the attachment by selecting the 'Print' option from the File menu.

Please direct any questions to the Pension and Tax Unit mailbox: TRE, Pension and Taxes.

Report ID: 'AX012B

INTERNATIONA)NETARY FUND
ACTUAL AND PR CTED EARNINGS

For Earnings Paid As Of 12/21/2001
And Projected Earnings On Or After 12/01/2001

Page No. 1.(
Run Date 12/ 2001
Run Time 04.32.16

Name: Geithner,Timothy Franz
Empl ID: [redacted]

State: MD
Locality: 031 Montgomery
Annual Rt: $[redacted]

Allowance Begin Date: 09/04/2001
Allowance End Date: 12/31/2001

Part Year? Yes
FEI? No
TEA Allow: $[redacted]

Total Days Overseas: 1

Earnings Code	Description	Actual Amount	Projected Amount	Total Amount
REG	Net Salary	$[redacted].65	$0.00	$[redacted].65
FTA	Federal Tax Allowance	$[redacted].05	$0.00	$[redacted].05
GII	GLI Imputed Income	$[redacted].75	$0.00	[redacted].75
REG	Regular Pay	$-0.01	$0.00	$-0.01
SEA	Self Employment Tax Allowance	$[redacted].21	$0.00	$[redacted].21
STA	State Tax Allowance	$[redacted].46	$0.00	$[redacted].46
TEA	Spouse and Child Allowances	$[redacted].93	$0.00	$[redacted].93
Total Earnings =		[redacted]	$0.00	[redacted]

Report ID: 'AX012B

INTERNATIONA' 'NETARY FUND
QUARTERLY TAX ALLOW. ; CALCULATION REPORT

Page No. 2.0
Run Date 12/ ;001
Run Time 04.3;.16

PART YEAR STEP 1 CALCULATION
4TH QUARTER 2001

Name: Geithner,Timothy Franz   Empl ID: [redacted]   Begin Date: 09/04/2001   End Date: 12/31/2001

	Federal-MFJ	MD-MFJ Montgomery	MD-MFJ
Net Fund Income	$[redacted].52		
Federal Tax	$[redacted].84		
State Tax	$[redacted].15		
SE Tax*	$[redacted].49		
Total Fund Income	$[redacted].00		
Spouse Income	$[redacted].00		
Total Gross Income	$[redacted].00	$[redacted].00	
Adjustments	$[redacted].49	$[redacted].48	
Total Adjusted Gross Income	$[redacted].51	$[redacted].51	
Deductions			
Exemptions	$[redacted]00	$[redacted].00	
Exemption Phaseout	($[redacted].00)		
Average Ded	$[redacted].00	$[redacted]00	
Staff State Tax	$[redacted].15		
Spouse State Tax	$[redacted].41		
Deduction Phaseout	($[redacted].00)	($[redacted]01)	
Phaseout Addback		$[redacted]69	
Net Deduction	$[redacted].45	$[redacted].68	
Taxable Income	$[redacted].07	$[redacted]83	
Tax Thereon	$[redacted]06	$[redacted]56	
Less Spouse Tax	$[redacted]22	[redacted]41	
Staff Portion	$[redacted]84	$[redacted]15	
Percent Not Worked	[redacted]	[redacted]	
Amt To Be Subtracted From Step 2	$[redacted].31	$[redacted].24	

* Total Days Overseas: [redacted]1
* Out Inc Subject SE : $[redacted].00
* Out Inc Subject Med: $0.00
* Inc Subject SE Tax : $[redacted].29

Report ID: 'AX012B

INTERNATIONA' 'NETARY FUND
QUARTERLY TAX ALLOW. . CALCULATION REPORT

PART YEAR STEP 2 CALCULATION
4TH QUARTER 2001

Page No. 3.0
Run Date 12/ :001
Run Time 04.3..16

Name: Geithner, Timothy Franz Empl ID: [redacted] Begin Date: 09/04/2001 End Date: 12/31/2001

	Federal-MFJ	MD-MFJ Montgomery	MD-MFJ
Net Fund Income	$[redacted].28		
Federal Tax	$[redacted].36		
State Tax	$[redacted].70		
SE Tax*	$[redacted].21		
Total Fund Income	$[redacted].55		
Spouse Income	$[redacted].00		
Total Gross Income	$[redacted]55	$[redacted]55	
Adjustments	$[redacted].21	[redacted].21	
Total Adjusted Gross Income	[redacted].34	[redacted].34	
Deductions			
Exemptions	$[redacted].00	[redacted]00	
Exemption Phaseout	($[redacted].00)		
Average Ded	$[redacted].00	$[redacted]00	
Staff State Tax	$[redacted].70		
Spouse State Tax	$[redacted].41		
Deduction Phaseout	($[redacted].60)	($[redacted]60)	
Phaseout Addback		$[redacted]39	
Net Deduction	$[redacted]41	$[redacted].79	
Taxable Income	$[redacted]93	$[redacted]56	
Tax Thereon	$[redacted].58	[redacted].11	
Less Spouse Tax	$[redacted]22	$[redacted].41	
Staff Portion	$[redacted]36	$[redacted].70	
Less Amount from Step 1	$[redacted].31	$[redacted].24	
Fed Tax Allow	$[redacted].05		
Plus SE Tax	[redacted].21		
Total Annual Tax Allow	$[redacted].26	$[redacted]46	
Less Tax Allow Paid YTD	$[redacted].00	$[redacted].00	
Quarterly Payment	$[redacted].26	$[redacted]46	$[redacted]00

* Total Days Overseas: 1
* Out Inc Subject SE : $[redacted].00
* Out Inc Subject Med: $0.00
* Inc Subject SE Tax : $[redacted].29

*** Part Year W2 Income Basis ***

Actual Net Fund Inc	$[redacted]32
Fed Tax Allow	$[redacted].05
State Tax Allow	$[redacted].46
SE Tax Allow	$[redacted].21
W2 Income Basis	$[redacted].04

pl 12/27/01

Attachment 1

INTERNATIONAL MONETARY FUND

TAX ALLOWANCE APPLICATION
FOR U.S. FEDERAL AND STATE INCOME TAXES AND SOCIAL SECURITY TAX FOR 2002
APPLICATION MUST BE RECEIVED BEFORE NOVEMBER 15, 2002
BY TREASURER'S DEPARTMENT

PLEASE READ ATTACHED INSTRUCTIONS BEFORE FILLING OUT THIS FORM

1. Name: Geithner,Timothy Franz — 3. Emplid: [redacted]
2. Dept: PDRAI — 4. [redacted]

5. 2002 Filing Status
   - _ Single
   - ✓ Married Filing Joint
   - _ Married Filing Separate
   - _ Unmarried Head of Household
   - _ Widow(er) with dependent child
     (Date spouse died ________)

6. 2002 Exemptions — Over 65 — Blind
   - ✓ Yourself
   - ✓ Spouse
   - ✓ Dependent Children — 2
   - _ Other Dependents
   - _ No. of Dependent Child Credits

7. 2002 Spouse Income (FROM WORKSHEET) [redacted]
   (A)-Earned Income
   (B)-Capital Gains Income
   (C)-Other Income

8. To be completed by new staff employed by the Fund in calendar year 2002.
   Your adjusted gross income prior to joining the Fund.
   Amount subject to Social Security and Medicare: ________
   Amount subject to Medicare only: (Prior CSRS federal employees) ________

9-A. Current Address:
   Street: [redacted]
   City: [redacted] County: [redacted]
   State: [redacted] Zip Code: [redacted]

9-B. New Address:
   Street: ________
   City: ________ County: ________ (Maryland residents)
   State: __ Zip Code ________ Date Address Changed: ________

10. In accordance with General Administrative Order No. 5, Revision 7, Section 7.03, I wish to apply for tax allowance of U.S. Federal and State income taxes and the difference between the "self-employed" and "employed" obligation of the U.S. Social Security tax which I will pay on my Fund income. I authorize the Fund or any of its staff members designated by it for the purpose, to ascertain from the appropriate tax authorities whether tax returns were received. I hereby certify that all the information contained herein is true to the best of my knowledge and belief and that I will pay the taxes for which I have received tax allowance payments from the Fund. I certify that if any of the data provided on this application changes, I will immediately report such changes to the Fund.

Date: 10/17/02 Signature: ________

Telephone Extension: 37760 Room Number: 5-600

INTERNATIONAL
MONETARY FUND

Tax Allowance System

December 1993

Introduction

Purpose of the Booklet

This booklet explains the International Monetary Fund's tax allowance system and advises staff members who are subject to U.S. income tax how and when they should file estimated tax payments and income tax returns.

The booklet describes the Fund's existing tax allowance system. The Fund's tax allowance system may change as a result of policy review or changes in the law, which is amended frequently.

The tax allowance policy is formally described in GAO No. 5., Rev. 7. This GAO is currently being revised to incorporate changes to the tax allowance system that were approved in 1992. If there is a difference between GAO No. 5 and this booklet, GAO. No. 5 takes precedence.

Goal of the Tax Allowance System

The goal of the Fund's tax allowance is to provide staff members with an allowance that is reasonably related to the income taxes they pay on their Fund salaries and allowances. The tax allowance is not a tax reimbursement. It is computed using general assumptions and not on the facts of the particular staff member. It normally will not be exactly equal to the actual income tax due.

Table of Contents

I. *Explanation of the Tax Allowance System*

Why the Fund Pays a Tax Allowance

Fund member countries have agreed not to impose income tax on the compensation of Fund staff who are nationals of other countries, but they may impose income tax on the Fund compensation of their own nationals.

Although most countries do not tax Fund salaries, some do. The United States taxes the Fund salaries of its citizens, wherever they work. France taxes the Fund salaries of its citizens who work in France. A few other countries tax Fund salaries under limited circumstances.

In order to make the after-tax incomes of 's staff members comparable, the Fund pays a tax allowance to staff members who are subject to national, state, or local income tax.

Who is Eligible to Receive a Tax Allowance

As stated above, staff members who are required to pay national, state, or local income tax based on their Fund salaries are entitled to receive tax allowances.

U.S. citizens who are staff members are required to pay U.S. tax are entitled to receive tax allowances. U.S. citizens who are contractuals do not receive tax allowances even though they are required to pay U.S. taxes; their salaries are adjusted to account for this fact. Green card holders (resident aliens) and G-IV visa holders (non-resident aliens) do not pay U.S. income tax on their Fund salary and, therefore, are not entitled to tax allowances. French citizens working for the Fund in Paris receive tax allowances because they are required to pay French income tax.

How the Tax Allowance is Calculated

Because the vast majority of staff to whom the Fund pays a tax allowance are U.S. citizens, this booklet focuses on the tax allowance paid to U.S. citizens.

If you are U.S. citizen and are eligible to receive a tax allowance, the Fund calculates your tax allowance in a manner similar to the manner in which you calculate your tax liability. It uses your actual filing status, personal exemptions, and state of residency, and partially takes into account your spouse's income, if any. However, it excludes your non-Fund income, since your tax allowance relates only to your Fund income. Instead of using your actual itemized deductions, the Fund deducts the higher of the standard deduction or an "average deduction". Your average deduction is the average amount of itemized deductions that, according to IRS statistics, a person has, who has the same gross income as you.

Example 1 shows how this calculation is done. Example 1 and the other examples in this booklet are based on the U.S. tax law in effect on December 1, 1993.

Example 1

TAX ALLOWANCE CALCULATION FOR A SINGLE STAFF MEMBER

Staff Profile:

Net Salary:	$50,000
Marital Status:	Single
Dependents:	None
State of Residency:	DC

Income	
Net salary	$50,000
Federal tax allowance	11,024
State tax allowance	4,760
Income for average deductions	$65,784
Social security tax allowance	4,513
Gross Fund income (W-2 income)	$70,297
Less Adjustments/Deductions	
Social security tax allowance	4,513
Average deductions	9,043
State tax allowance	4,760
Personal exemption	2,350
Income on which tax allowance is computed	$49,631
Tax Allowance	
Federal	$11,024
State	4,760
Social security	4,513
Total tax allowance	$20,297

Explanation of the Tax Allowance System

The Income on Which Your Tax Allowance is Based

As you can see from Example 1, the Fund pays a tax allowance on the gross Fund income ($70,297 in this example), rather than on the net salary ($50,000). Your gross Fund income is your net salary plus your tax equivalency allowance, your tax allowance, and most other allowances and reimbursements that you receive. See "Key Terms" on page 29 for a list of all items included in gross Fund income. Your gross Fund income is the taxable income that the Fund reports to the IRS each year on a W-2 form.

Computing Your Social Security Tax Allowance

U.S. employees of the Fund are considered self-employed for purposes of social security taxes only.

The Fund pays the difference between your U.S. self-employment tax, which is the social security tax that self-employed U.S. citizens pay, and the employee's share of social security taxes. You pay the employee's share of U.S. social security taxes, as you would be required to do if you worked for any U.S. employer. In 1993 the social security tax rate is equal to one-half of the self-employed tax rate, so the Fund pays one-half of your self-employment taxes.

Most employers pay

A gross salary . . .

Gross Salary Minus **Taxes** Equals **Net Salary**

. . . but income taxes are deducted, which leaves a net salary.

The Fund pays

A net salary . . .

Net Salary Plus **Tax Allowance** Equals **Gross Salary**

. . . and a tax allowance is added to help cover the income taxes you owe.

Explanation of the Tax Allowance System

Illustrative Iterative Calculation of a Tax Allowance for A Single Staff Member With a Net Salary of $50,000

	1st Iteration	2nd Iteration	3rd Iteration	4th Iteration	5th Iteration	6th Iteration	And So On
Net Pay	50,000	50,000	50,000	50,000	50,000	50,000	
State Tax Allowance		3,526	4,389	4,650	4,728	4,751	4,757
Federal Tax Allowance		7,732	10,035	10,730	10,936	10,998	11,016
Social Security Tax Allowance		3,532	4,439	4,493	4,507	4,511	4,512
Gross Pay	50,000	64,790	68,863	69,873	70,171	70,260	
Minus:							
Personal Exemptions	2,350	2,350	2,350	2,350	2,350	2,350	
Average Deductions	6,250	8,420	8,843	8,983	9,025	9,038	
State Taxes	3,526	4,389	4,650	4,728	4,751	4,757	
One Half Social Security Taxes		3,532	4,439	4,493	4,507	4,511	
Federal Taxable Income	37,874	46,099	48,581	49,319	49,538	49,604	
Federal Taxes	7,732	10,035	10,730	10,936	10,998	11,016	
Social Security Taxes	7,064	8,878	8,986	9,014	9,022	9,024	
One Half Social Security Taxes	3,532	4,439	4,493	4,507	4,511	4,512	

Basic Calculation Procedures

The complexity of calculating tax allowances arises because deductions assumed in the calculations are determined by gross pay, but gross pay is not known until the tax allowance is calculated and added to net pay.

This problem is solved by doing a series of calculations. As a first step, the taxes payable on net pay are calculated assuming the amount of the deductions applicable to the level of net pay, as if it were gross pay.

The state, federal, and one-half of the social security taxes calculated in the first iteration ($3,526, $7,732, and $3,532) are then added in the second iteration to net pay to arrive at an estimate of gross pay ($64,790), and the taxes are recalculated. In the new calculations, the higher amount of the deductions applicable to the new level of gross pay are assumed.

This process continues through as many additional iterations as are necessary until the difference in estimated taxes between two successive iterations falls below $1.00. At that point, the amounts of the Federal, state, and social security tax allowances and the amount of average deductions correctly reflect gross pay (net pay plus tax allowances).

Explanation of the Tax Allowance System

Deducting Social Security/ Self-Employment Tax

For purposes of computing both income and self-employment taxes, the IRS allows self-employed taxpayers to deduct from gross income one half of the self-employment taxes that they pay. The Fund uses these deductions in calculating your tax allowance.

Deriving Average Deductions

The average deductions in Example 1 are based on income of $65,784. As stated above, average deductions are the average amount of itemized deductions (excluding state and local income taxes) that, according to IRS statistics, a person with a given level of gross income would have. Certain itemized deductions (e.g., medical and dental expenses and miscellaneous itemized deductions) are subtracted from the IRS average deduction statistics because Fund staff are generally unable to claim these amounts. (See Appendix G for selected average deductions.) The income on which average deductions are based is gross Fund income less social security tax allowances, imputed income from spouse points and group life insurance, safeguard tax allowances in the final year of Fund employment, and certain allowances received by staff working outside the United States. The IRS-derived amount of state and local taxes are excluded from average deductions. Instead, the state and local taxes computed by the tax allowance program are subtracted from income.

How Your Marital Status Affects Your Tax Allowance

As shown on the next few pages, your marital status on the last day of the year affects the computation of your tax allowance.

Single

If you are single, your tax allowance computation will be similar to the computation shown in Example 1.

There is one difference between the computation in Example 1 and the computation of many single staff members—the average deductions of single staff members with net income less than $60,000 are less than the average deductions of married staff members with the same income. Smaller average deductions are used for single staff members because, according to IRS statistics, the itemized deductions of single taxpayers are frequently less than the itemized deductions of married taxpayers since they often do not own a home and, consequently, cannot deduct mortgage interest and real estate taxes.

Married Filing Jointly
Spouse Income Less Than Yours

If you are married and your spouse's income is less than or equal to yours, the Fund computes your joint tax liability using the married filing jointly status. It then subtracts the tax liability of your spouse, computed assuming a married filing separately status. The difference is your tax allowance.

See Example 2 for an illustration of the calculations for a married staff member whose spouse's income was less than the staff member's Fund income.

In Example 2, the gross joint income on which the federal tax allowance is calculated is the sum of the staff member's gross Fund income ($57,704) and the spouse's income ($20,000). Average deductions are based on the gross joint income ($77,704) less the staff member's social security tax allowance ($4,077). Personal exemptions are deducted for the staff member, spouse, and child ($2,350 X 3). The spouse's federal tax liability ($1,706) is subtracted from the joint federal tax liability ($10,195) to yield the staff member's federal tax allowance ($8,489). For Virginia and DC residents, the staff member's state tax allowance is computed without regard for the spouse's income, as is done in the calculation of the staff member's actual state tax liability. Because Maryland requires taxpayers who file joint federal returns to file joint state returns, the state tax allowance of Maryland residents take spouse income into account.

Spouse Income More Than Yours

If your spouse's income is more than yours, the Fund may or may not take your spouse's income into account when computing your tax allowance. Your tax allowance is first computed as described for spouses whose income is less than the staff member's. It is then computed using the married filing separately status. Average deductions in this second calculation are based on your income only and personal exemptions of dependents are prorated between you and your spouse according to net income. The results of these two calculations are compared. You receive the greater of the two.

Example 3 is an example of the calculation that would be done for a staff member whose spouse's income was more than the staff member's Fund income.

Married Filing Separately

The married filing separately status is used in your tax allowance computation if you are separated from your spouse and you and your spouse file separate tax returns for the year in question.

Explanation of the Tax Allowance System

Example 2
MARRIED FILING JOINTLY

Staff Profile:	
Net Salary:	$40,000
Tax Equivalency Allowance:	$ 2,600
Marital Status:	Married
Dependents:	One Child
Spouse Income:	$20,000
State of Residency:	Virginia

Income	
Net salary	$40,000
Tax equivalency allowance	2,600
Federal tax allowance	8,489
State tax allowance	2,538
Social security tax allowance	4,077
Gross Fund income (W-2 income)	$57,704
Spouse income	20,000
Gross joint income	$77,704
Less Adjustments/Deductions	
Social security tax allowance	4,077
Average deductions based on income of $73,627*	9,927
Staff member's state tax allowance	2,538
Spouse's state taxes	567
Personal exemptions	7,050
Income on which tax allowance is computed	$53,545
Tax allowance	
Federal tax liability on joint income	$10,195
Less spouse's federal tax liability	1,706
Federal tax allowance	$8,489
State tax allowance	2,538
Social security tax allowance	4,077
Total tax allowance	$15,104
*Gross joint income	$77,704
Less social security tax allowance	4,077
Equals income on which average deductions are based	$73,627

Example 3
MARRIED FILING SEPARATELY
Spouse Income Greater Than Staff's

Staff Profile:	Net Income:	$30,000
	Tax Equivalency Allowance:	$ 1,890
	Marital Status:	Married
	Dependents:	Two Children
	Spouse Income:	$60,000
	State of Residency:	Virginia

	Married Filing Jointly Calculation	Married Filing Separately Calculation
Income		
Net salary	$30,000	$30,000
Tax equivalency allowance	1,890	1,890
Federal tax allowance	5,331	4,990
State tax allowance	1,707	1,687
Social security tax allowance	2,959	2,932
Gross Fund income (W-2 income)	$41,887	$41,449
Spouse income	60,000	N/A
Gross income for tax allowance calculation	$101,887	$41,499
Less Adjustments/Deductions		
Social security tax allowance	2,959	2,932
Average deductions*	13,460	6,232
Staff Member's state tax allowance	1,707	1,687
Spouse's state taxes	2,624	N/A
Personal exemptions	9,400	4,261**
Income on which tax allowance is computed	$71,737	$26,387
Tax Allowance		
Federal	$15,289	$4,990
Less: Spouse's Federal tax liability	9,958	N/A
Federal tax allowance	$5,331	$4,990
State	1,707	1,687
Social security	2,959	2,932
Total tax allowance	$9,997	$9,609
*Average deductions based on:		
Gross Fund income	$41,887	$41,499
Plus Spouse income	60,000	N/A
Less social security tax allowance	2,959	2,932
Equals income on which average deductions are based	$98,928	$38,563

**Prorated share

Explanation of the Tax Allowance System

Head of Household

If you use the head of household filing status when you file your income tax return, the Fund uses this status when computing your tax allowance.

You are eligible to use the head of household filing status if you meet two tests:

1. You are unmarried or considered unmarried on the last day of the year. You are considered unmarried if you are legally separated from your spouse and your spouse did not live in your home during the last six months of the year.

2. You pay more than half the cost of keeping up a home that was the main home during more than half the year for you and a dependent.

Example 4 shows the tax allowance calculation of a staff member filing as head of household.

Other Conditions that Affect Your Tax Allowance Calculation

Several other conditions may affect the calculation of your tax allowance. These conditions and the tax allowance calculations used when the conditions prevail are discussed in the appendices. They include:

Part year employment with the Fund	Appendix A
Two states of residence during the year	Appendix B
Both spouses work for the Fund	Appendix C
Your spouse works for another international organization	Appendix D
Staff working abroad	Appendix E
Safeguard Calculations	Appendix F

Changes in U.S. tax law also affect the calculation of your tax allowance. Several recent changes enacted in the Revenue Reconciliation Bill of 1993 will affect your tax allowance. They are discussed in Appendix H.

Example 4
HEAD OF HOUSEHOLD

Staff Profile:

Net Salary:	$50,000
Tax Equivalency Allowance:	$ 2,500
Marital Status:	Divorced
Dependents:	One Child
State of Residency:	DC

Income	
Net salary	$50,000
Tax equivalency allowance	2,500
Federal tax allowance	9,672
State tax allowance	4,578
Income for average deductions	$66,750
Social security tax allowance	4,526
Gross Fund income (W-2 income)	$71,276
Less Adjustments/Deductions	
Social security tax allowance	4,526
Average deductions	9,185
State taxes	4,578
Personal exemptions	4,700
Income on which tax allowance is computed	$48,287
Tax Allowance	
Federal	$9,672
State	4,578
Social security	4,526
Total tax allowance	$18,776

II. Will Your Tax Allowance Cover Your Taxes?

Will Your Tax Allowance Cover Your Taxes?

As stated in the introduction to this booklet, your tax allowance is not a tax reimbursement. It is computed using general assumptions. Because your tax characteristics may be different from those assumed, your tax allowance may be greater or less than the tax liability on your Fund income. Your tax allowance is not meant to cover the taxes on your non-Fund income, such as investment income, nor does it cover the taxes on your spouse's income. In addition, your tax allowance does not cover the employee's share of social security taxes.

The primary reasons why your tax allowance may not match the tax liability on your Fund income are explained in more detail below:

1. You Must Pay the Employee's Share of Social Security Taxes

Employees of international organizations are considered self-employed for purposes of social security taxes. As such, they must pay both the employer's and the employee's share of social security taxes. The Fund gives you a tax allowance for the employer's share of social security taxes only. You are responsible for the employee's portion of this tax. If you worked outside the Fund, you would also pay the employee's share of social security taxes.

The employee's share of social security taxes (in 1993) is 7.65% of the first $57,600 of earned income plus 1.45% of the amount greater than $57,600 but less than $135,001. Beginning in 1994, there will be no ceiling on the amount taxed at 1.45%.

2. Your Itemized Deductions are Lower Than Your Average Deductions

If your actual itemized deductions are lower than your computed average deductions because, for example, you do not own a home, your actual taxable income will be more than the taxable income used in your tax allowance computation. Your tax allowance will, thus, be less than your tax liability.

This deficiency may be at least partially offset by the safeguard adjustment. See Appendix F for an explanation of the safeguard adjustment. Example 5 in Appendix F shows a situation in which a staff member's average deductions are higher than the staff member's actual itemized deductions.

3. The Tax Rate Applied to Your Fund Compensation

Under the U.S. graduated income tax system, the first income you earn is taxed at the 15 percent rate, the next income is taxed at the 28 percent rate, and so forth, up to the 39.6 percent rate. In computing your tax allowance, the Fund assumes that the first income earned is your Fund income and the last income earned is your outside income. Your tax allowance is, thus, computed using the lower rates, and your tax allowance is less than it would be if the Fund assumed that your outside income were earned first.

III. Applying For and Receiving Your Tax Allowance

Applying for Your Tax Allowance

Each October, you will receive a tax allowance application. The application will ask you to provide your filing status, the number of dependents that you have, your new address if you moved during the year, your spouse's age, and your spouse's estimated earned and unearned income, social security benefits, and capital gains. In order to be eligible to receive a fourth quarter tax allowance, you must complete and return this application to the Treasurer's Department in early November.

It should be noted that the request for your spouse's income for tax allowance purposes is separate and distinct from the request for your spouse's income for tax equivalency allowance purposes, because the definition of spouse income used in the computations of these two allowances is different. For tax allowance purposes, the Fund uses your spouse's taxable income. For tax equivalency allowance purposes the Fund uses your spouse's earned income. You must, therefore, respond to both requests for information.

Receiving Your Tax Allowance

Your tax allowance is paid to you in four installments. Your first three installments are based on current tax law, your projected fund income for the year, and the filing status, number of dependents, state of residency, and spouse income that you claimed on your *prior* year's tax allowance application. Your fourth quarter tax allowance computation is based on current tax law, your projected Fund income for the year, and the filing status, number of dependents, state of residency, and spouse income that you claimed on *this* year's tax allowance application. Your fourth quarter tax allowance is the difference between the fourth quarter computation and the tax allowances that you received in the first three quarters of the year. You will receive your quarterly tax allowance approximately a week before each of the first three estimated tax payments is due. The fourth installment will be paid in late December.

Applying for a Recalculation of Your Tax Allowance

You should apply for a recalculation of your tax allowance if one or more of the following situations apply to you:

1. Your spouse's income, as estimated on your tax allowance application, differs from your spouse's actual income by more than $200. The estimation of your spouse's income is printed on the tax allowance computation worksheet that you receive with your fourth quarter tax allowance.
2. The filing status on your actual tax return is different from the one you listed on your tax allowance application.
3. The number of dependents on your actual tax return is different from the number of dependents listed on your tax allowance application.
4. You would benefit from the safeguard adjustment. See Appendix F for an explanation of the safeguard adjustment.
5. You want to receive part of your safeguard adjustment early. If you received a safeguard adjustment last year, you may apply for an interim safeguard adjustment this year. The interim adjustment is a partial prepayment of this year's safeguard adjustment.

Application forms for these recomputations are distributed by staff bulletin in January. You have until February 28th to apply for an interim safeguard adjustment. You may apply for the other recalculations until August 15th.

IV. Paying Your Taxes

Making Estimated Tax Payments

The federal and state governments require you to pay your taxes in quarterly installments. To make your estimated tax payments, send an estimated tax voucher and your check to the taxing authority. Dates and form numbers for estimated tax vouchers and for final tax returns are listed on page 15. Write your social security number, the form number and the period to which the tax applies on your check.

Estimated self-employment taxes are sent to the federal government along with estimated federal income taxes, using the same voucher and check. Note that each quarter you should pay both your own share of self-employment taxes and the share of these taxes reimbursed by the Fund.

You will be penalized if you do not make your tax payments on time and in the correct amounts. To avoid penalties in 1993, each of your estimated payments must equal at least one fourth of your prior year's total tax liability, including your self-employment tax liability, or one fourth of 90% of your current year's liability. If your 1992 adjusted gross income was greater than $75,000 ($37,500 for married filing separately) and your 1993 adjusted gross income is at least $40,000 ($20,000 for married filing separately) more than your 1992 adjusted gross income, your estimated payments must equal 90% of your 1993 tax liability.

Beginning in 1994, you can avoid penalties if each of your quarterly estimated payments equals one fourth of:

If, last year, your taxable income was $150,000 or less ($75,000 for married filing separately):

1. 100% of last year's liability; or
2. 90% of this year's liability

If, last year, your taxable income was more than $150,000 ($75,000 for married filing separately):

1. 110% of last year's liability; or
2. 90% of this year's liability

The additional regular federal income tax that you owe due to the increased 1993 rates may be paid in three equal installments due:

Installment 1—April 15, 1994
Installment 2—April 17, 1995
Installment 3—April 15, 1996

See Appendix H for the new 1993 tax rates.

Tax Payment	Due Date	
Installment 1	April 15	(Virginia due May 1)
Installment 2	June 15	
Installment 3	September 15	
Installment 4	January 15	
Final Return	April 15	(Virginia due May 1)

	Form Number		
Taxing Authority	Est. Tax Voucher	Final Return	Extension
Federal	1040 ES	1040	4868
DC	D-40 ES	D-40	FR-127
Virginia	760ES	760	760-E
Maryland	502 D	502	502 E

Paying Your Taxes

Filing Your Final Return

Your final tax returns and the balance of the taxes owed are due on April 15 (May 1 for Virginia).

You may get an extension of time to file your return. However, the extension is for filing only; the balance of your tax liability must be sent in with the extension request or you will be charged interest.

Each January you will receive a Form W-2 from the Fund. The W-2 will show the amount of income which you must report to the government. You will receive a W-2, which is used to report the income of employees, rather than a Form 1099, which is the form used to report the income of self-employed people, because the IRS considers you to be an employee for all purposes except social security taxes. For purpose of social security taxes, you are considered self-employed.

The Fund issues very few Form 1099s because, as stated above, these forms can be issued only to individuals who are not considered employees by the IRS. The IRS considers a person an employee if his or her employer has the right to control and direct the person's work and the means by which the person does the work. Evidence of an employer-employee relationship is full-time employment, working at the employer's place of business, using the employer's computers, tools, and supplies, following the employer's instructions, and being paid a salary or an hourly wage rather than by the task.

Report your W-2 income on the wage line of the appropriate tax form. Also report it on line 2 of Federal Schedule SE, in order to calculate the amount of your self-employment tax. At the bottom of Schedule SE, note that you are an employee of an international organization.

Though Schedule SE calls for income from Schedule C, which is the form usually used to report earnings from self-employment, you should not file Schedule C. You are not allowed to reduce your W-2 income by business expenses such as those listed on Schedule C. Contractual employees receiving a W-2 should, similarly, not file a Schedule C, since they are also not allowed to reduce their W-2 income by business expenses.

Tax forms are available in the first floor hallway of the headquarters building, opposite the Credit Union automatic teller machine, and at most public libraries and post offices. Once you have filed estimated taxes and your final return, the government will send these forms to you annually.

VI. Key Terms

Adjusted Gross Income—gross income less one-half of self-employment taxes, IRA and KEOGH deductions, alimony paid, one-fourth of self-employed health insurance, the penalty on early withdrawal of savings, and deductible moving expenses (beginning in 1994).

Average Deductions—the average amount that, according to IRS statistics, a person with a specific level of income would take as itemized deductions on his or her tax return (excluding the deduction taken for state and local income taxes).

Dependent—You may claim an individual who satisfies five tests as your dependent. The person must

1) Be related to you or a member of your household.
2) Be a citizen or resident of the U.S., or a resident of Canada or Mexico.
3) Not file a joint return.
4) Have gross income less than $2,350 (indexed for inflation). This test does not apply if the person is your child and is under 19, or is a full time student under 24.
5) You must provide more than half of his or her support.

Earned Income—wages, salary, other employee compensation, and income from self-employment.

Effective Tax Rate—average tax rate imposed on your income.

Estimated Tax—advance payments of tax which are made quarterly.

Filing Status—a condition that, in part, determines your tax rates. Filing statuses include single, married filing jointly, married filing separately, and head of household. Your filing status is governed by your marital status on the last day of the year.

Form 1040—IRS form used by U.S. citizens and residents to file individual income tax returns.

Form 1040-ES—IRS form used to file quarterly estimated tax payments.

Form 1099—IRS form on which payors report the income paid to self-employed individuals.

Form W-2—IRS form on which employers report the gross income of employees (both staff members and contractual employees).

Gross Income—all worldwide income unless specifically excluded from taxation by the Internal Revenue Code.

Gross Fund Income—the amount of taxable benefits that you receive from the Fund. Gross Fund income includes net salary, tax equivalency allowance, overtime payments, spouse travel on points, installation and resettlement allowances, settling-in and separation grants, termination benefits, subsistence allowance, housing allowance, rent, utilities, cost of living allowance, automobile allowance, rest and recovery allowance, home leave, per diem and incidentals, storage, non-deductible moving expense reimbursements, and the imputed value of group life insurance and interest from the SRBP.

Itemized Deductions—amounts by which you can reduce your adjusted gross income. Common itemized deductions are mortgage interest, real estate taxes, state and local income taxes, and charitable contributions.

Marginal Tax Rate—the tax rate imposed on the last dollar you earn.

Net Salary—the pay that you receive from the Fund, net of allowances.

Key Terms

Self-Employment Taxes—the social security taxes paid by self-employed people. As a Fund employee you are considered self-employed for purpose of social security taxes.

Social Security Taxes—the required payment into the U.S. Social Security System. As an employee of an international organization you pay self-employment taxes instead of social security taxes.

Standard Deduction—a dollar amount that reduces your adjusted gross income. It is used instead of itemized deductions if your itemized deductions are lower than the standard deduction.

Tax Equivalency Allowance—the allowance you receive from the Fund for each family member who qualifies as your dependent under the Fund's rules.

Taxable Income—earned income plus interest income, dividends, capital gains, pensions, rental income, income from partnerships and trusts, alimony, unemployment compensation, and most other revenue, less adjustments to income, itemized deducations, personal exemptions, the foreign earned income exclusion, and the housing exclusion.

Tax Allowance—The amount you receive from the Fund to help you pay your federal, state, and local income taxes and your self-employment taxes.

United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510-6200

September 23, 2008

Via Electronic Transmission

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Henry M. Paulson, Jr.
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Mr. Timothy F. Geithner
President and Chief Executive Officer
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Gentlemen:

On July 10, 2008, I wrote to you seeking further details regarding the Federal Reserve's actions in support of the purchase of Bear Stearns Companies Inc. (BSC) by JPMorgan Chase & Co. (JPM). I have received no response. My questions need to be answered in a more timely way, especially in light of (1) the continuing financial crisis where more transparency is being promised, (2) the current legislative proposals to authorize additional federal commitments that dwarf the BSC deal, and (3) the Finance Committee's oversight responsibilities with respect to the use of bonded debt of the United States.

In question number 6 of that letter I sought periodic updates on the current value of the assets managed by the Federal Reserve under the deal. Moreover, this question was posed again last week and there was no reply. Accordingly, what is the current value of those assets and when will I receive answers to the rest of my questions posed two-and-half months ago?

Please respond by the close of business on September 25, 2008. The answers and requested materials should be delivered to the Committee office and addressed to Jason Foster of the Senate Finance Committee. Please provide electronic copies of all responses, as well as, a log of any responsive documents being withheld, including a detailed description of the document and the reason for withholding it.

I appreciate your continued cooperation on this matter.

Sincerely,

Chuck Grassley

Charles E. Grassley
Ranking Member

Byron York
NR White House Correspondent
January 14, 2009, 5:15 p.m.

Geithner Accepted IMF Reimbursement for Taxes He Didn't Pay

The problem with the treasury secretary-designate's tax records.

By Byron York

Although it has been dismissed by some observers as a "hiccup" in an otherwise smooth confirmation process, treasury secretary-designate Timothy Geithner's failure to pay self-employment taxes during the years he worked at the International Monetary Fund is causing some Republicans on Capitol Hill to ask serious questions about his actions. First among those questions is why he accepted payment from the IMF as restitution for taxes that he had not, in fact, paid.

Documents released by the Senate Finance Committee strongly suggest that Geithner knew, or should have known, what he was doing when he did not pay self-employment taxes in 2001, 2002, 2003, and 2004. After his failure to pay was discovered, first by the IRS and later during the vetting process, Geithner paid the federal government a total of $42,702 in taxes and interest.

The IMF did not withhold state and federal income taxes or self-employment taxes — Social Security and Medicare — from its employees' paychecks. But the IMF took great care to explain to those employees, in detail and frequently, what their tax responsibilities were. First, each employee was given the IMF Employee Tax Manual. Then, employees were given quarterly wage statements for the specific purpose of calculating taxes. Then, they were given year-end wage statements. And then, each IMF employee was required to file what was known as an Annual Tax Allowance Request. Geithner received all those documents.

The tax allowance has turned out to be a key part of the Geithner situation. This is how it worked. IMF employees were expected to pay their taxes out of their own money. But the IMF then gave them an extra allowance, known as a "gross-up," to cover those tax payments. This was done in the Annual Tax Allowance Request, in which the employee filled out some basic information — marital status, dependent children, etc. — and the IMF then estimated the amount of taxes the employee would owe and gave the employee a corresponding allowance.

At the end of the tax allowance form were the words, "I hereby certify that all the information contained herein is true to the best of my knowledge and belief and that I will pay the taxes for which I have received tax allowance payments from the Fund." Geithner signed the form. He accepted the allowance payment. He didn't pay the tax. For several years in a row.

According to an analysis released by the Senate Finance Committee, Geithner "wrote contemporaneous checks to the IRS and the State of Maryland for estimated [income] tax payments" that jibed exactly with his IMF statements. But he didn't write checks for the self-employment tax allowance. Then, according to the committee analysis, "he filled out, signed and submitted an annual tax allowance request worksheet with the IMF that states, 'I wish to apply for tax allowance of U.S. Federal and State income taxes and the difference between the "self-employed" and "employed" obligation of the U.S. Social Security tax which I will pay on my Fund income."

In a conversation today with sources on Capitol Hill who are familiar with the situation, I asked, "Was Geithner made whole for tax payments that he didn't make?"

"Yes," one source answered. "He was getting the money. He was being paid a tax allowance to pay him for tax payments that he should have made but had not."

Geithner paid his 2003 and 2004 obligations after an IRS audit. He paid his 2001 and 2002 obligations after he was nominated to be treasury secretary. The Obama transition team argues that Geithner simply slipped up, saying Tuesday that Gieithner "mistakenly had not paid self-employment taxes" for the years in question. In a closed-door meeting with Senate Finance Committee members on Tuesday, Geithner explained his failure to pay the self-employment taxes as an oversight. In the days before his confirmation hearing, senators are going to want to know more about how that happened.

— Byron York is National Review's White House correspondent.

The New York Times

January 15, 2009

EDITORIAL

More Questions for Mr. Geithner

President-elect Barack Obama's team reacted predictably to the disclosure that Timothy Geithner, the nominee for Treasury secretary, failed to pay a chunk of his federal taxes over several recent years. The script gets played out, with slight variations, whenever a presidential nominee gets in that kind of trouble.

On Tuesday, when Mr. Geithner's failures were first reported by The Wall Street Journal, the Obama transition office issued a statement calling his underpayment of taxes "honest mistakes." On Wednesday, Mr. Obama himself said it was "innocent." Those themes have been echoed by several of the senators who will conduct Mr. Geithner's confirmation hearing, which is now scheduled for next Wednesday.

As much as Mr. Obama and his team may wish it, however, the disclosures cannot be dismissed so easily, or papered over. The just-the-facts report of Mr. Geithner's tax transgressions, compiled and released by the Senate Finance Committee, paints a picture of noncompliance that is considerably more disturbing than his supporters are acknowledging.

Mr. Geithner must be questioned forcefully about these matters at the hearing next week, and his explanations must be credible. Even in the best of economic times, it would be hard to accept a Treasury secretary — who, after all, is in charge of the Internal Revenue Service — with a cavalier attitude toward paying his taxes. Today, in a time of economic peril, the nation cannot afford a Treasury secretary with a tainted ability to command respect and instill confidence.

According to the report, when Mr. Geithner's tax returns for 2003 and 2004 were audited by the I.R.S. in 2006, the auditors found that he had failed to pay self-employment tax in those years. To make good, he paid the back taxes, plus interest — $16,732.

Obama officials say Mr. Geithner, who worked for the International Monetary Fund, had made a common error among international employees in Washington. But as The Journal reported on Wednesday, failing to pay the self-employment tax is not necessarily common among sophisticated I.M.F employees. Rather, one of the reasons such noncompliance is widespread is that it includes household embassy workers and other lower- level contractors. And regardless, the Finance Committee found that Mr. Geithner had signed paperwork at the I.M.F. that acknowledged his self-employment tax obligation.

The story does not stop there. Mr. Geithner also failed to pay the self-employment tax in 2001 and 2002. Those returns, which the report says Mr. Geithner prepared himself, were not audited and so the I.R.S. did not order him to pay up — which raises the question of why he did not voluntarily amend those returns and pay the taxes and interest at the time of the 2006 audit. Instead, he waited until after vetting by the Obama team late last year revealed the shortfall — $19,176 in taxes and $6,794 in interest.

A similar lapse occurred on another tax issue. On returns for 2001, 2004 and 2005, Mr. Geithner wrongly claimed expenses for sleep-away camps in calculating his dependent care tax credit. The accountant who prepared his 2006 return informed him that payments to overnight camps were not allowable expenses, but again, he did not file amended returns for the previous years at that time. The report does not break out the taxes and interest on that item alone, but along with other adjustments, Mr. Geithner owed an additional tax of $4,334 and interest of $1,232.

Many people find taxes baffling, but before his job at the I.M.F, Mr. Geithner was a senior official in the Treasury Department under President Clinton, and for the past five years he has been the president of the Federal Reserve Bank of New York. With that professional profile, tax transgressions are tough to excuse.

A Geithner Tax Amnesty

THE WALL STREET JOURNAL

Source: The Wall Street Journal
Date: 01/15/2009

Washington is abuzz over Treasury Secretary-designate Timothy Geithner's $34,000 self-employment tax "mistake." The brouhaha has prompted a second delay for Mr. Geithner's confirmation hearing, which was originally scheduled for Friday but will now be put off until after the inauguration.

When he does appear, Senators will want to know how a reputed financial wizard could have overlooked his Self-Employment Tax liability for four years. All the more so because he had signed a document from his employer at the time, the International Monetary Fund, certifying "that I will pay the taxes for which I have received tax allowance payments." Democrats are saying this is no big deal, but if that's true then perhaps they should consider applying their tax absolution a little more broadly.

Some of our readers may recall something called "the tax gap," which is the estimated difference between taxes due under the law and the taxes that the Internal Revenue Service actually collects. In 2007, the IRS estimated that the gap stood at $290 billion a year. And since Democrats took control of Congress, Senators like Max Baucus and Kent Conrad have made a fetish out of closing the gap. Mr. Baucus has browbeaten the IRS over the gap, demanding plans to close it and putting out newsletters decrying it.

In response, the IRS issues regular "fact sheets" to inform taxpayers about such questions as whether your small business is actually a "hobby," and how you can "help yourself by filing past due returns." The IRS also audits taxpayers to check that their deductions are legitimate and that they've included all their 1099 income and so on. The IRS estimates that more than 90% of the gap is the result of honest mistakes or misunderstandings, but it also includes people who didn't report their snow-shoveling income, their eBay sales or even their babysitting money.

But now Mr. Geithner has come along seeking the job of overseeing the IRS, among other duties. And lo, Mr. Geithner is a living embodiment of The Gap.

He's no different from those people – you know who you are – who overestimated their charitable contributions or "forgot" about that $500 cash payment they received when it came time to do their taxes. Even after the IRS audited him in 2006, Mr. Geithner paid back taxes only for the two years – 2003 and 2004 – for which he had been audited. He did not bother to amend his 2001 and 2002 returns until late last year, when the tax issue came up during the Obama vetting process.

But Mr. Baucus, who once called the tax gap "an affront to all the rest of us who pay our taxes," is not affronted. "This is an honest mistake and it's clear there was no intention not to pay," said the Finance Committee Chairman.

For our part, we are delighted that Mr. Baucus and Democrats are suddenly in such a forgiving tax mood. In addition to being a teaching moment for liberals, perhaps Mr. Geithner's tax snafu can do all of America some good. We'd suggest that Mr. Geithner and Mr. Baucus together set a new standard for the IRS in dealing with people who, like Mr. Geithner, make a boo-boo on their tax returns.

Let's have an amnesty – with penalties waived, as they were for Mr. Geithner – for all those Americans who somehow "forgot" to pay their taxes but are now willing to fess up or are audited. If forgiveness is to be the order of the day for the man who may soon be responsible for the IRS, American taxpayers deserve a similar reprieve.

Byron York
NR White House Correspondent

January 16, 2009, 1:00 a.m.

More Questions About Geithner

Were his tax problems a "common mistake"? And what about those accountants?

By Byron York

In their defense of Treasury Secretary-designate Timothy Geithner, members of the Obama transition team have said that his failure to pay Social Security and Medicare taxes during a 2001–03 stint at the International Monetary Fund was a "common mistake," and, in addition, that Geithner received the approval of two accountants for his erroneous tax returns. Now, new details are emerging that cast doubt on both of those arguments.

"He made a common mistake," incoming White House press secretary Robert Gibbs said of Geithner this week. Obama officials also cited an Internal Revenue Service publication that said "as many as half" of the employees of international organizations make mistakes on their tax returns.

But that figure appears to be a significant exaggeration of the specific situation at the International Monetary Fund, where Geithner worked. "There's not a high incidence of non-payment of taxes," Bill Murray, an IMF spokesman, told me Thursday. "We have a very low incidence of that here."

Murray took care to say that he was not commenting in any way on Geithner or the current controversy. But he pointed out that the IMF has an ethics office, which issues a yearly report on various transgressions among the organization's 2,600 employees (about 25 percent of whom are Americans). The ethics office's 2007 report contained a chart of those transgressions; tax problems were listed under the heading "Unpaid Debts." In that column, there was exactly one example in 2007. "It's not unprecedented that people have had problems paying their taxes, or not paying their taxes, but it's not a widespread issue," Murray told me.

Other sources who have looked into the matter suggest that the IRS's "as many as half" estimate includes many employees of embassies, particularly lower-level employees—like those working in food service and security—who might not have great experience in financial matters. That group doesn't include Geithner, who was a high-ranking official in the Treasury Department before joining IMF. In addition, the IRS estimate included many different categories of mistakes in its estimate, including employees who "either fail to report their wages, claim deductions they are not entitled to, incorrectly establish SEP/IRA retirement plans, fail to pay self-employment tax or fail to file tax returns at all."

Finally, staffers for the Senate Finance Committee interviewed an official at the IMF as part of their Geithner research and were told that problems such as Geithner's occurred perhaps once a year. Given all that, it's probably more accurate to say that Geithner-like mistakes by high-ranking

IMF officials are not only *not* common, but seem to be quite rare.

As for the matter of Geithner's accountants, a memo issued by the Obama transition earlier this week said that Geithner prepared his 2001 returns—the first in which he failed to pay self-employment tax—himself. "However, an accountant reviewed his 2001 returns as part of an amended return filed [in] 2002," the transition memo said, "and also failed to catch the mistake on the self-employment taxes."

It turns out that is not the complete story. According to knowledgeable sources, Geithner, when he prepared his original 2001 return, reported that he would make a pension contribution. He later decided not to make that contribution and therefore needed to file an amended return. He approached an accountant for the specific purpose of changing the pension contribution entry and filing the amended return. It appears that Geithner gave the accountant the tax return, but no underlying documentation.

Senate staffers have talked to the accountant and have concluded that the accountant approached the task narrowly—he fixed the pension line and filed the amended return. It could be that Geithner thought the accountant gave the return more careful scrutiny overall, but it seems doubtful that the accountant gave Geithner's return a clean bill of health, as the transition office implied.

The transition office also says another accountant prepared Geithner's 2003 and 2004 returns—2003 was the last one in which Geithner actually worked for the IMF. The transition memo says that the second accountant "prepared Mr. Geithner's 2003 and 2004 returns and advised him in writing that he was exempt [from] self-employment taxes on his IMF income."

If that is the case, it is still true that Geithner filed his 2001 and 2002 returns—and collected reimbursement from the IMF for doing so—without paying self-employment taxes. And whatever the second accountant said, it appears that Geithner himself has not claimed to investigators that he believed he was exempt from paying the self-employment tax. If he had been assured by experts that he was exempt, then he might have been expected to make that argument, but he didn't. Instead, it appears Geithner has told investigators that he wasn't aware that he hadn't made the payments, that it somehow slipped by him.

Geithner's confirmation hearing is now set for Wednesday. Look for these issues to be the subject of extensive questioning.

— Byron York is National Review's White House correspondent.

Byron York
NR White House Correspondent

January 19, 2009, 8:09 a.m.

Geithner Can't Explain His Failure to Pay Taxes

The treasury secretary–designate's answers leave some senators baffled.

By Byron York

What was he thinking? That is without doubt the question asked most often by nearly everyone looking into Treasury Secretary–designate Timothy Geithner's failure to pay Social Security and Medicare taxes in 2001, 2002, and 2003. It's certainly the question that will be asked at Geithner's confirmation hearing on Wednesday. But it is also the question perhaps least likely to be answered to anyone's satisfaction, because according to sources close to the confirmation process, Geithner doesn't have an answer to that most basic question about his behavior.

"His explanation was kind of, 'I don't know—it was stupid, obviously it was a mistake, and I don't know why I did it,'" recalls a senator who was present during Geithner's surprise appearance before a members-only meeting of the Senate Finance Committee last week. "What do you say to that?"

The meeting was the first time that members other than chairman Max Baucus and ranking Republican Charles Grassley heard of Geithner's tax problem. Baucus and Grassley had known about the issue since early December, but last Tuesday's meeting was part of a carefully planned roll-out for the other members of the committee. First, committee investigators explained the problem to the senators. Then, Geithner himself came in and responded to their questions. And while that was happening, Obama transition officials began to distribute a set of talking points defending the nominee. "They put out their release before our meeting with Geithner even ended," says the senator. "We did not know about any of it until we walked into the meeting."

What senators learned at the gathering was not only that Geithner had failed to pay self-employment taxes during his time at the International Monetary Fund. They learned that the IMF had repeatedly informed Geithner, as it had all its employees, of his obligation to pay that tax. They learned that Geithner signed documents saying he would pay the tax. And they learned that Geithner accepted IMF reimbursement for Social Security and Medicare taxes that he had not, in fact, paid. Geithner paid part of his obligation after a 2006 Internal Revenue Service audit, and the rest of it after he was nominated to become treasury secretary. In all, he paid $42,702 in back taxes and interest. In addition to his payment of the unpaid self-employment taxes, Geithner also had to pay $5,566 to cover other shortfalls in his tax payments, for a total of $48,268 in back taxes and interest.

Since their meeting with Geithner was the first time that most senators had heard of the problem, their questions were not terribly detailed; several of the queries were along the lines of "What were you thinking?" And Geithner's answers were not terribly satisfying. "He can't offer a specific reason," says another source familiar with what went on at the meeting. "He doesn't really have an answer. He just didn't know."

So why did Geithner not pay the taxes in question? There is no obvious answer. It could have been pure oversight—a "common mistake," as the Obama transition team has called it. But there are questions about how common the mistake actually was; an IMF official, while not commenting on Geithner's case in particular, has said that instances of non-payment of taxes by IMF staffers are relatively rare. If Geithner's problem was not common, then some senators will want to know whether there was anything about Geithner's particular circumstances in 2001, 2002, and 2003 that might have contributed to his actions. Was he distracted? Was he short of money? Was there anything else going on that might have affected his decision-making concerning his taxes?

In the end, senators will be looking for any reason to explain why a man of Geithner's financial sophistication—he came to the IMF after a stint as a high-ranking official in the Treasury Department and left the IMF to become head of the Federal Reserve Bank of New York—could have made such mistakes on his taxes. If he were confirmed as treasury secretary, Geithner would, among other things, oversee the IRS, something that makes his tax problem all the more relevant to his confirmation. "This is the guy who heads up the IRS," says the senator who is baffled by Geithner's situation. "All the taxpayers look to him, and when he says, 'Gee, I don't know why'—does that become a defense?"

— Byron York is National Review's White House correspondent.

Written Introduction of Timothy Geithner by Sen. Charles Schumer
January 21, 2009

Thank you Mr. Chairman. It is my privilege to be here today to introduce Timothy F. Geithner as President Obama's nominee to be Treasury Secretary. In these times, as our financial system is sailing into uncharted and turbulent water, there is no navigator more suited for this job by way of intelligence, experience, inclination and temperament than Tim Geithner. Tim has made some mistakes, which he has freely admitted and corrected, but these errors pale before the myriad mistakes made by the operators of financial institutions and government regulators overseeing them. We need the very best, not the 2nd best, person in Treasury to correct these mistakes.

Tim's career in government began 20 years ago as a staffer at Treasury. His abilities quickly launched him up the career ladder, and by the mid-1990s, he was a senior crisis manager with then Secretary Rubin and then-Deputy Secretary Summers and helped guide the U.S., and indeed, the global, financial system through a series of international financial crises, including the Asian financial crisis in 1997 and 1998.

For the past six years, Tim has served as the President of the Federal Reserve Bank of New York. From that position, he's tried to raise awareness of the risks posed to the economy by the current crisis and to call Congress' attention to the inadequate powers and authorities of the Treasury Department and Federal Reserve to deal with this economic maelstrom.

Far before many other regulators, Tim had recognized the extent of the danger that our economy faced, and was trying to raise awareness. In the aftermath of the Bear Stearns failure, Tim noted that the current crisis was so severe that it was "...not something that the market can solve on its own." And in July he called on Congress to establish a legal framework for dealing with the failures of non-bank financial institutions. **Had we heeded his advice then, the Treasury Department and Federal Reserve might not have faced the failure of Lehman Brothers with an empty regulatory toolbox.**

Tim has also been a leader on financial regulatory reform. In September 2006, he led other regulators in calling for enhanced regulation of hedge funds. In April of 2008, Tim called for a major overhaul of the system, not just in structure, but also in the way that regulators do their jobs, and the policies that we implement to ensure stability. He noted that "our objective should be a system that preserves the unique strengths of our financial markets in providing individuals and entrepreneurs access to capital and credit, but with a greater capacity to withstand stress."

Tim's background also makes him the perfect person to handle some of the less-high profile but no less critical international affairs aspects of the job of Treasury Secretary. At a time when the United States must look to rebuild its reputation abroad, work with countries across the globe to manage a financial crisis magnified by globalization, develop a new regulatory regime for a financial system that ignores national boundaries, and respond to an increasingly powerful and aggressive China, Tim's personal experiences growing up abroad, and professional experiences in the international affairs division at Treasury, ensure that he brings a formidable set of qualifications and abilities to the job.

However, as he takes on this monumental position, there are a few things that he must keep in mind.

First, he must lead the Treasury Department in a full reexamination of the TARP program, and the other governmental responses to the crisis, to ensure that they are achieving their goals of ensuring stability, promoting lending, and protecting taxpayers. I, and many of my colleagues on the committee and in the Congress ,feel that Secretary Paulson made the initial program too generous to the banks and that before the 2nd $350 billion is spent, that a new set of terms and conditions must be established. **Secretary Paulson gave the banks too much dessert before he made them eat any of their vegetables. Secretary Geithner must be the responsible parent and restore some balance to this situation.**

Second, and we know he'll do this, since he's already started, Tim must lead a national, and in fact, an international conversation about the structure and function of financial regulation. Without major reforms to the way that we and others oversee financial institutions, the history of the last 18 months is doomed to repeat itself.

Finally, and perhaps his most difficult task of all, Tim must help guide the U.S. economy back onto stable long-term footing. The satirical newspaper, The Onion, recently ran a headline that struck a nerve with me, because I think it's all too true. **It read "Recession-Plagued Nation Demands New Bubble To Invest In".** The fact of the matter is that for too long, this country has relied on easy credit to support its growth. We need to redevelop stable-long-term industries that can survive the ups and downs of the business cycle. We need to reinvigorate American manufacturing, stimulate American savings and end our national addiction to debt. It will not be easy, but I'm confident that if we commit ourselves to this task, American will emerge as the strongest nation on the planet for the next 50 or 100 years.

In closing Mr. Chairman, Tim faces a daunting set of challenges and tasks, but he is a uniquely qualified candidate for this position, and I'm proud to say that I will support his nomination. I would like to close by thanking him for his willingness to continue serving his country in these troubled times. God knows that he's paid his dues and then some, over the past 18 months, not to mention the past 20 years, and while, he could easily go to the private sector and work less hours, for more money than he will make as a simple government employee, he has chosen to accept the challenge that President Obama presented to all of us, and to continue to devote himself to serving his country, and striving to make the world a better and safer place. For that I commend him. Thank you Mr. Chairman.

COMMUNICATIONS

Hearing on Confirmation of Mr. Timothy F. Geithner

to be

Secretary of the U.S. Department of Treasury

January 21, 2009

Submitted by
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FINANCE-US: Treasury Nominee Failed to Halt Bond Scam
By Lucy Komisar

NEW YORK, Jan 19 (IPS) - U.S. senators at Timothy Geithner's confirmation hearing for Treasury Secretary Wednesday may want to ask him about a failure to act that is costing the U.S. a lot more than the amount he evaded on taxes.

The Federal Reserve Bank of New York, which he has led since 2003, conducts the operations on Wall Street of the Federal Reserve Bank in Washington, the country's central bank. The New York Fed under Geithner's presidency has failed to stop massive naked short selling of U.S. Treasury bonds that threatens the stability of the market and sale of the bonds.

Ironically, the scam, enabled by a lack of regulation at the behest of Wall Street brokerage houses, makes it more expensive for the U.S. to bail out those same financial institutions.

It happens this way: an individual or fund is allowed to sell bonds without owning them. This is called short selling. The seller, whose broker has generally "borrowed" bonds from another broker, is supposed to subsequently buy them on the market, and return them to the lender. The seller does this because he believes that the bond is going down, and he will buy them at a cheaper price than he sold them for.

Naked short selling occurs when a seller does not borrow the bonds for delivery at settlement, and therefore never has to buy them. This is called a failure to deliver, or FTD.

Meanwhile, the buyer thinks he or she has the bonds but has just an IOU. The result is a distortion of the market. Sellers sell bonds they never own or borrow, so there are more securities sold than issued by the government. These phantom bonds don't represent money paid to the U.S. Treasury or genuine securities for buyers.

The major broker-dealers who handle bond trades like the system. They profit from fails by using clients' money for other purposes.

The economist who has done the key work on this issue is Dr. Susanne Trimbath, who heads STP Advisory Services in Omaha, Nebraska. She previously worked for the Depository Trust Co, a subsidiary of Depository Trust and Clearing Corp, the U.S. clearing house for stocks and bonds.

Dr. Trimbath said, "In fall of 2008, about two trillion dollars in Treasury bonds were sold but undelivered for six weeks, more than 20 percent of the daily trading volume, up from 8.6 percent in the first five months of 2008." It was a spike from 1.2 percent in the first five months of 2007.

"There was excess demand for the Treasuries," she said. "Rather than allow this to push the price up, the Federal Reserve Bank of New York and the DTCC allowed failures to deliver to depress the price." This affects the value of bonds held by individuals, funds and major investors such as China.

The latest figures on failures to deliver are 600-800 billion dollars. Dr. Trimbath said, "The numbers look better now because the Fed threw two trillion at the market, which was used to cover these fails."

She said that Geithner failed to heed the warnings of economists at the New York Fed who in 2002 and again in 2005 analysed failures to deliver of Treasuries and recommended fines for the brokers responsible. A New York Fed white paper in April 2006 called for stricter enforcement of delivery and penalties for violations. The Bond Market Association opposed reforms, and again Geithner failed to act.

Even the current financial crisis has provoked only a faint reaction from the New York Fed. On Jan. 5, it acknowledged that, "Since November, short-term interest rates have declined to unprecedented levels." It proposes a regulation to allow the buyer and seller to agree that if the buyer doesn't receive the securities by five days after sale, the buyer could submit a claim against the seller for payment. But this can be done now and could have been done in 2002.

This is how the bond system works. The U.S. Congress authorises the federal government to issue bonds to cover the national debt. Individuals and institutions, even countries, can buy the bonds directly or through brokers. If a purchaser buys through a broker, the bonds remain in the broker's name or the name of a central depository such as DTCC. The Treasury pays the bond's interest to the broker, who credits the client's account.

Since regulators don't require the bonds to be delivered to the buyer, the broker gives clients an electronic IOU for the bond and for the interest payments as well. But if the bonds aren't delivered by the seller, the electronic IOUs represent phantoms. Dr. Trimbath points out that, "The significant result of the IOU system is that brokers are able to sell many more bonds than the Congress has authorised. The transactions are called 'settlement failures' or 'failed to deliver' events, since the broker reported bond purchases beyond what the sellers delivered." She said, "There is no limit on the number of IOUs the broker can hand out...and there are usually more IOUs in circulation than there are bonds."

This artificially inflates the supply and forces bond prices down. Investors who want to buy Treasuries - to lend money to the U.S. - may instead be lending money to their brokers. Brokers get not only the commission charges for the trade, but the use of the client's cash for the bond that was never delivered and therefore never paid for. Dr. Trimbath calculates this "loss of use of funds to investors at seven billion dollars per year, conservatively."

If the broker goes out of business, clients don't have the Treasuries, only the broker's electronic IOUs. Dr. Trimbath, said, "Who is going to get the chair when the music stops? It's not the individual investor. I've seen positions just deleted from people's statements without investors even knowing as the security they supposedly owned turns out to not exist."

This insecurity could discourage buyers of Treasuries, heralded as ultra-safe investments. "And for the bond buyers, brokerage houses, and banks, it's yet another crash-and-burn to come," said Dr. Trimbath.

Her solution: "If regulators and the central clearing corporation would only enforce delivery of Treasury bonds for trade settlement - payment - at something approaching the promised, stated, contracted and agreed upon T+1 (one day after the trade), there would be an immediate surge in the price of U.S. Treasury securities."

"As the prices of bonds rise, the yield falls. This falling yield then translates into a lower interest rate that the U.S. government has to pay in order to borrow the money it needs to fund the budget deficit and to refinance the existing national debt."

Brokers would have to buy real bonds to deliver to buyers. She said, "That's when the music stops."

Geithner might explain to senators why he has not stopped the billion-dollar phantom Treasury bonds scam.

Lucy Komisar is an investigative journalist who writes about the financial system. Her articles appear on thekomisarscoop.com/.

http://www.ipsnews.net/news.asp?idnews=45472/

Articles published by Inter Press Service (www.ipsnews.net), an international news agency, December 19, 2008.

FINANCE-US: AIG's Past Could Return To Haunt
By Lucy Komisar

NEW YORK, Dec 19 (IPS) - The U.S. will invest 40 billion dollars in American International Group (AIG), and will provide credit lines that could bring federal funding up to 144 billion dollars. It's the largest subsidy that a U.S. corporation has ever received.

In exchange, the U.S. gets nearly 80 percent of AIG stock.

This puts the U.S. in a unique position to investigate the internal operations of a giant corporation with a reputation for using the offshore system for tax evasion.

What accountants could learn would help U.S. President-elect Barack Obama -- who has denounced offshore tax evasion -- stop scams run by AIG and draft laws to prevent other insurance companies from doing the same.

U.S. authorities could begin their investigations with a look into a very curious practice that was revealed 15 years ago in a case that was never exposed by the mainstream press and which insurance insiders say is endemic.

In 1993, Terry Mills, who worked for a large insurance agency in Wilmington, Delaware, was tasked to get to the bottom of a messy insurance problem. The NVF Corporation, a Delaware holding company which owned a vulcanised fibre factory, was being reorganised after a federal court order stripped control of the company from its owner Victor Posner, a notorious crook.

Posner was a U.S. "corporate raider," famed for engineering hostile takeovers of companies, looting them and firing workers.

He had been charged by the U.S. Securities and Exchange Commission (SEC) in 1988 for participating in a fraudulent takeover scheme concocted with Wall Street crooks Michael Milken and Ivan Boesky. The SEC banned him from serving as officer or director of any publicly-held company.

It wasn't the first time he'd broken the law. In 1977, the SEC had filed a complaint against Posner and his companies for overstating earnings and treating assets of public corporations as private property, charging the companies for houses, servants, vacations and even groceries.

In 1987, he had been fined 7 million dollars for evading more than 1.2 million dollars in taxes. A year later, he was a defendant in an SEC complaint about a "stock parking" scheme to gain control of a corporation, that cheated investors of about 4 million dollars.

So Posner was notorious. Even so, Mills was astonished when he examined the insurance books. He discovered that NVF had been paying National Union Fire of Pittsburgh, a subsidiary of the insurance giant AIG, substantially over market for workmen's compensation insurance.

Mills told the director of the Delaware Insurance Department's bureau of examination that when he went to buy a policy for NVG from another insurance firm, he found the price was only half what the company had paid the year before.

Mills told IPS, "The fronting company was AIG. And the broker on the deal was Alexander and Alexander... one of the biggest brokers in the world." He said, "The senior management really didn't have a handle on what the costs were." Posner, who died in 2002, had ordered the deal, and the managers went along.

This is how the scam worked. Insurance companies normally insure themselves by laying off part of their risk to reinsurance companies, so if a claim comes in above a certain amount, the reinsurance company will pay it.

AIG had reinsured the NVF policy through Chesapeake Insurance, a reinsurance company Posner owned in Bermuda -- an offshore tax and secrecy haven whose books were safe from the eyes of U.S. regulators and tax authorities.

AIG would keep a portion of the inflated NVF premium and send the rest to Chesapeake. AIG would have a higher commission. Posner would write off the entire amount as a business expense and enjoy the extra cash in Bermuda, tax free.

A former insurance regulator told IPS, "Say the normal premium was 1 million dollars.(If I ran the company.) AIG could charge me 2 million dollars and then send a premium of 900,000 dollars over to a reinsurance company that it has set up for me in Bermuda. I never have to pay any claims, so I get to keep the 900,000 dollars tax-free offshore."

The company and bank records are private, so there is no way for outsiders to know how much tax money was actually diverted.

*This is the first of a two-part series on how AIG helped clients cheat on taxes. New York journalist Lucy Komisar reported on the AIG story as part of her continuing investigation of the offshore bank and corporate secrecy system. Her past articles appear on thekomisarscoop.com/. (END/2008)

http://www.ipsnews.net/news.asp?idnews=45175

FINANCE-US: AIG's Offshore Strategies Hide a Scam
By Lucy Komisar

NEW YORK, Dec 19 (IPS) - The company getting the biggest U.S. bailout operated a scam to help clients cheat on U.S. taxes, regulators say. It is AIG, American International Group, the world's largest insurance conglomerate.

AIG was run by Maurice "Hank" Greenberg. He was ousted as CEO in 2005 by the board of directors after the New York Attorney General charged him with fraudulent business practices, securities fraud, and other violations.

These charges did not mention a captive insurance scam that Greenberg, famous as a hands-on manager, would have been involved in approving. AIG took inflated fees from customers, set up reinsurance companies for them in Bermuda, and bought reinsurance from them, effectively giving their clients tax-free cash in that offshore island.

Would Greenberg have known that his company was writing such a tax-evading policy for the likes of Victor Posner, a notorious crook who was banned from public companies by the Securities and Exchange Commission (SEC) in 1988? Very likely.

The scam was discovered by Terry Mills who worked for a large insurance company in Delaware and was tasked to investigate the insurance of Posner's NVF Corporation in 1993. Mills found that the premiums were double the going rate. He said, "We were able to find them coverage in the standard market."

However, the Delaware Insurance Department did not make the scam public or take any action against AIG, which was so powerful that it intimidated government regulators. (The Delaware regulator who talked to IPS said AIG sent a private investigator to harass him.)

Provided the details of what AIG did, company spokesman Andrew Silver replied, "We don't have any comment on that."

That is because the captive insurance scam was systemic. "This was not an isolated case ... AIG did that a lot," a former insurance regulator said, speaking under condition of anonymity. "AIG helped companies set up offshore captive reinsurance companies. AIG would then overcharge on insurance and pay reinsurance premiums to the captives, giving the captive owners tax-free offshore income."

AIG declares on its website, "We pioneered the formation of captives almost 60 years ago," and it offers management facilities to run the captives in offshore Barbados, Bermuda, Cayman Islands, Gibraltar, Guernsey, Isle of Man, and Luxembourg -- where corporate and accounting records are secret and taxes minimal or nonexistent.

It was all in the family. Jeffrey Greenberg, the AIG CEO Greenberg's son, ran the Marsh Captive Management Group to help corporate customers set up reinsurance companies in offshore Barbados. Jeffrey was fired after his company was discovered rigging bids.

Doug McLeod, editor of the trade publication Business Insurance, said there were captives that hardly ever paid any claims. McLeod explained that he saw from the reinsurance records of one of the AIG companies that it had a captive. It reported a pretty large amount of premiums sent to that captive, but very little in claims payments coming back.

He said, "That is unusual. Why would a captive of a large company collect that amount of premium and not pay any claims? They could have gone through a loss-free year, but it doesn't seem likely."

David Schiff, editor of Schiff's Insurance Observer, told IPS: "There are more captive insurance companies in Bermuda than any place else. The whole purpose is that it's not regulated by the U.S."

He said, "How do they tell us Microsoft is paying too much for workers comp (compensation)? There's no way for a regulator to know that." He said, "Fraud is hard to find unless you get tipped off."

An insurance broker and risk management consultant who did not want to be identified, said. "It's common; that's the way it's done." He noted, "The oil companies all have offshore captives."

McLeod pointed out that several oil companies were joint shareholders of the Oil Insurance Ltd, an oil company group captive. There are more than 1,800 captive insurance companies based in Bermuda with over 60 percent owned by American interests.

McLeod said, "A majority of fortune 500 companies have captives." He pulled out a copy of the Tillinghas Captive Directory and ticked off U.S. companies with Bermuda captives: Levi Strauss: Majestic Insurance International, Caterpillar Tractor: Caterpillar Insurance Co. Ltd., FMC Corp (tractors): Financial Reassurance Co and Transcon Insurance, Carnival Corp.: Trident Insurance, all managed by Marsh.

Other big firms with captives were Schlumberger (oil field services): Harrington Sound Insurance and Castle Harbour Insurance, managed by JLT, and United Van Lines: Vanliner Reinsurance managed by Codan Management.

The insurance broker who did not want his identity disclosed, said, "Reinsurance has always been a traditional way of moving money. You can do a "rent-a-captive" where you don't even have to set up your own captive, you just run the funds through a bookkeeping system: it's even cheaper. The question is whether the IRS (U.S. Internal Revenue Service) lets you get away with it."

In 2002, the IRS and the Treasury required transactions with captives to trigger disclosure, list-maintenance, and registration requirements "based on information that many of these arrangements were being used to shift income improperly to PORCs (Producer-Owned Reinsurance Companies) for purposes of avoiding income tax." However, in September 2004, the George W. Bush administration abolished that rule. The IRS commissioner said that, "Based on disclosures by taxpayers and examination of tax returns, we have determined problems associated with these transactions are not as prevalent as initially believed."

Of course, fraudulent use of offshore captives is hardly likely to be disclosed by taxpayers or noted on tax returns. Spokesmen at Treasury and the IRS declined to discuss the issue.

It would be unthinkable for the U.S. to allow a business it has on life support to evade taxes or help others to evade them.

The multi-billion dollar bailout of AIG by the U.S. could trigger extensive examinations by accountants to make detailed analyses of the company's offshore strategies. What they learn could stop illicit practices by AIG and lead to laws to prevent other insurance companies from doing the same.

*This is the second of a two-part series on how AIG helped clients cheat on taxes. New York journalist Lucy Komisar reported on the AIG story as part of her continuing investigation of the offshore bank and corporate secrecy system. Her past articles appear on thekomisarscoop.com/.

http://www.ipsnews.net/news.asp?idnews=45176

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January 22, 2009

Senate Committee on Finance
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Statement for the Record by: Susanne Trimbath, Ph.D., 1318 Galvin Road South, Bellevue, NE 68005

Re: 1-21-09 Hearing to Consider the Nomination of Timothy F. Geithner, to be Secretary of the Treasury, New York
Re: 1-22-09 Open Executive Session to consider the nomination of Timothy F. Geithner to be Secretary of the Treasury

The following article details the problems caused by allowing **$2.5 trillion worth of Treasury bonds** to go **undelivered for 6 weeks**. Mr. Geithner has been head of FRB-NY since 2003. Economists at FRB-NY analyzed settlement fails in Treasuries and recommended fines in 2002 and again in 2005. Nothing was done. I believe this raises questions about his abilities.

Only Senator Grassley was willing to ask direct questions about Mr. Geithner's participation in the "monstrous act of government intervention and ownership over our financial markets." Transparency and oversight do not exist for the bailouts conducted under Mr. Geithner's leadership at the Federal Reserve Bank of New York. I applaud his questions on the Maiden Lane limited liabilities companies. Mr. Geithner is using unregulated companies to make loans and buy assets with public money completely outside the view of the public. In fact, this activity is completely in contravention of the Federal Reserve Act which prohibits the Fed from making unsecured loans and from buying and holding assets not of the US government. His responses to Senator Grassley's written questions were shamefully obtuse.

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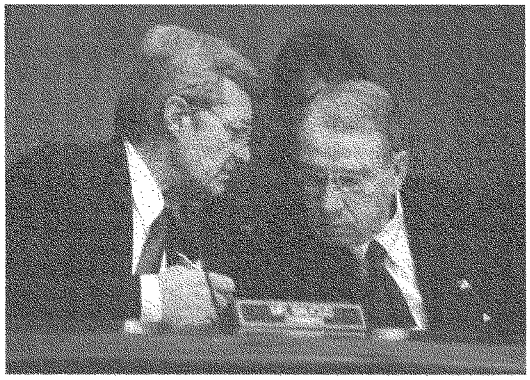
SHOULD WE BAILOUT GEITHNER TOO?

by Susanne Trimbath 01/22/2009 NewGeography.com



This morning the Senate Finance Committee approved the nomination for treasury secretary of Timothy F. Geithner, head of the Federal Reserve Bank of New York. Geithner is a Wall Street darling, but taxpayers may have a different take. Senator Jim Bunning (R-KY) reminded us at the Senate confirmation Hearing January 20 that Geithner was part of every bailout and every failed policy put forth by the current Treasury secretary. After you read this, you should begin to see why I'm so opposed to Geithner's appointment – I don't want the fox any closer to the hen house than he already is.

For starters, look at what the Fed has admittedly been up to – this is from a recent speech by the President of the San Francisco Fed, Janet Yelin. The Federal Reserve Act authorizes the Fed to lend to "individuals, partnerships, or corporations" in extraordinary times. For the first time since the Great Depression, the Fed is invoking this authority to make direct loans to subprime borrowers – that is, those who can't get credit from a bank.

Basically, the New York Fed, under Geithner's direction, created a couple of special companies so they could print money to get around restrictions on what the Fed can do directly. Now, be perfectly clear on this first point – this is not Treasury or TARP or Congress that's spending this money. It's the Federal Reserve. They don't have to ask Congress for money, they just print it. The Fed is providing "credit to a broad range of private borrowers." And by-and-large, they don't have to tell you who they give the money to, either. Here's how Yelin put it:

"It is worth noting that, as the nation's central bank, the Fed can issue as much currency and bank reserves as required to finance these asset purchases and restore functioning to these markets. Indeed, the Federal Reserve's balance sheet has already ballooned from about $900 billion at the beginning of 2008 to more than $2.2 trillion currently—and is rising."

Notice how easy it is to double our money – they just keep the printing presses running. In fact, the recent expansion is extraordinary. Since 2003 the Fed's balance sheet averaged only

$838 billion. So this doubling has all taken place in the past year. In the last recession, around 2002, the Fed's balance sheet increased by only 13%. If the current recession started in 2007, and if the Fed's balance sheet is any gauge, then we're in for much worse.

Average Federal Reserve balance sheet

Year	Reserves	% change
2000	$625,822,500,000	
2001	$653,774,500,000	4.5%
2002	$740,502,000,000	13.3%
2003	$762,853,509,434	3.0%
2004	$803,004,846,154	5.3%
2005	$843,397,519,231	5.0%
2006	$877,922,692,308	4.1%
2007	$907,023,653,846	3.3%
2008	$1,228,848,679,245	35.5%
2009	$2,175,364,000,000	77.0%

2000-2002 are for last 2 weeks only; 2009 is for first 2 weeks only. Data available from http://www.federalreserve.gov/releases/h41/hist/

Where are they spending all this cash? You probably didn't hear that the Fed started buying commercial paper through these "private-sector vehicle[s]" created to sidestep an act of Congress. (Commercial paper is the short term debt of corporations.) Another thing you aren't hearing about is that back in November 2008, the Fed bought $600 billion of mortgage-backed securities from AIG. This action, if taken without subterfuge, would not be legal. The Federal Reserve Act limits the Fed to buying securities that were issued or guaranteed by the U.S. Treasury or U.S. agencies. In order for the Executive Branch to get around a limit placed by the Legislative Branch, the Fed got help from the Treasury.

Yelin laid it out unabashedly: "Cooperation with the Treasury is necessary because the program entails some risk of loss and, under the Federal Reserve Act, all Fed lending must be appropriately secured. The Treasury has committed $20 billion of TARP funds to protect the

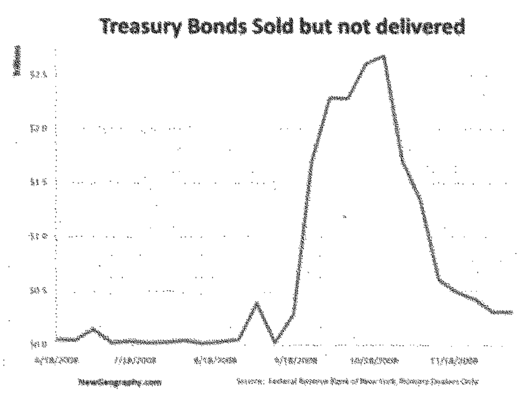
Fed against losses on the Fed's lending commitment of up to $200 billion." Don't kid yourself: this is a credit default swap on a national level.

On June 26, 2008, the Fed used this scheme to buy the assets of Bear Stearns. That money went to JP Morgan. On November 25, 2008, Geithner's New York Fed bought out the underlying assets for which American International Group had written credit default swaps, saving AIG from having to pay off the swaps when the assets failed. On December 12, 2008, they bought more residential mortgage-backed securities from AIG. Those two bailout packages currently stand at about $73 billion. The big ones are those where the recipients are not being named. On October 27, 2008, they bought commercial paper from "eligible issuers." On November 24, 2008, they bought "certificates of deposit, bank notes, and commercial paper from eligible issuers."

In an odd twist of democracy, you can read all about Geithner's personal income tax problem but you won't find anywhere information on who is benefiting from this particular bailout money which Geithner is in charge of passing out. The commercial paper bailout from the Fed (this doesn't include anything that Treasury is doing or that Congress has authorized) stands at $333 billion.

They aren't done, either. According to Yelin, there are plans in place to substantially expand this spree of lending, buying, and guaranteeing to include more kinds of assets issued by more kinds of institutions, like commercial loans and non-agency mortgage-backed securities.

Senator Chuck Grassley (R-IA) referred to this as Geithner's participation in "a monstrous act of government intervention and ownership over our financial markets." While TARP has a Special Inspector General and various congressional oversight duties, similar transparency and oversight does not exist for the bailouts conducted by Geithner in New York. Geithner may be, as Grassley asked him, "the general, drawing on your financial sector expertise, who will marshal the financial troops and assets of the Treasury Department." But he can't "lead our nation to prosperity."



He couldn't, in six years, stop the primary dealers in US Treasuries from selling more bonds than Treasury issued. The only way this could go on to the extent that it did, with an average of $2.1 trillion of Treasuries sold but undelivered for seven weeks from September 24 to November 5, is because Geithner did not have the support of the "financial troops" to stop it. In fact, I will suggest to you that this level of abuse, in what amounts to massive naked short selling of US Treasury securities, could only be done with complicity.

Finally, it is a simple matter to compare Geithner's activities at the Fed to those of Ken Lay at Enron. Remember all those "partnerships" with cool names derived from Star Wars movies? Geithner's New York Fed created Delaware Limited Liability Companies with the name "Maiden Lane" which is the Fed's street address in New York. They are using unregulated companies to make loans and to buy and sell assets completely outside the view of the public. The Senate Finance Committee approved Geithner's nomination on January 22, 2009 in an Open Executive Session. Geithner has proven he can hide the ball; let's not let this scheme move to Treasury.

Susanne Trimbath, Ph.D. is CEO and Chief Economist of STP Advisory Services. Her training in finance and economics began with editing briefing documents for the Economic Research Department of the Federal Reserve Bank of San Francisco. She worked in operations at depository trust and clearing corporations in San Francisco and New York, including Depository Trust Company, a subsidiary of DTCC; formerly, she was a Senior Research Economist studying capital markets at the Milken Institute. Her PhD in economics is from New York University. In addition to teaching economics and finance at New York University and University of Southern California (Marshall School of Business), Trimbath is co-author of Beyond Junk Bonds: Expanding High Yield Markets.